



# Regulating the Internal Market

Edited by  
**Niamh Nic Shuibhne**

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# Introduction

## Niamh Nic Shuibhne

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It really has been some time now since 1992, but its potency as a deadline that came (and went) remains strong. The internal market waits still to be ‘achieved’ or ‘completed’, but it seems locked in a prolonged state of ‘nearly there’. The Commission persists in its motivation of the Member States towards this end, praising the compliant and chiding the errant as appropriate, and its own legislative programme is proceeding buoyantly; at the time of writing, its proposal on the liberalisation of services is dominating the market agenda.<sup>1</sup> When or if the internal market might be ‘completed’ is anyone’s guess. But fixating on this goal rather misses the point as, whether ‘completely’ or not, a dense internal market *has* been achieved; it is up, running and functioning.

The purpose and future of the European Union continue to provoke the question ‘why?’, especially within the current scrambling for a Constitutional plan B. In a globally sensitised market debate, even the rationale for what might have been called the ‘safest’ EU purpose, the internal market, demands renewed reflection and justification. The functioning of the internal market, however, is much more about ‘how?’ – how does it work and, central to this, how and by whom is it managed? This collection of papers explores these questions about administration and supervision – in its broadest sense, ‘regulation’ – of the internal market, from a legal perspective. It seeks to combine cross-freedom, thematic analysis<sup>2</sup> with this emphasis on regulation and management, a strong focus in other disciplines within EU studies (and also interdisciplinary studies)<sup>3</sup> but less traditionally explored with a predominantly legal flavour. It strives also to avoid artificially isolating the market and

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<sup>1</sup> COM (2004) 2 final/3; amended by COM (2006) 160 final.

<sup>2</sup> A method of analysis advanced by, in particular, C. Barnard and J. Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Oxford: Hart Publishing, 2002).

<sup>3</sup> See, for example, G. Majone (ed.), *Regulating Europe* (Oxford: Routledge, 1996); K. Armstrong and S. Bulmer, *The Governance of the Single European Market* (Manchester: Manchester University Press, 1997); and C. Joerges and R. Dehousse (eds), *Good Governance in Europe’s Integrated Market* (Oxford: Oxford University Press, 2002).

constitutional aspects of government and governance; market regulation choices have political, institutional and constitutional implications, and indeed *vice versa*. Armstrong and Bulmer pinpoint how the concept of regulation veers into ‘governance without government’ and thereby throws up a whole range of questions which, primarily, reside in the zone of constitutional principle.<sup>4</sup> Moreover, the Treaty and doctrine that gave us the market were famously ‘constitutionalised’ at a very early stage in the evolution of the Community; perhaps the inevitable consequence of that process is that the market must operate within more constitutionally sensitive parameters than might usually be attributed to a trading area or agreement. This means that questions of market regulation, of regulatory techniques, and of the increasingly blurred boundaries between law and regulation are as much about democracy, power-sharing, competence, transparency and legitimacy as they are about efficiency, competition and results. So while 1992 may not have materialised as a deadline *per se*, perhaps it is better to think of the date as, nonetheless, a regulatory moment or watershed; as Armstrong observed, ‘the post-1992 activities of the EU’s political institutions have become less concerned with rule-making through legislation and more preoccupied with the management and application of the structures, strategies, and instruments associated with the [single European market]’.<sup>5</sup>

When evaluating the coherence or otherwise of the regulatory project at the very core of European integration, we do find, on the surface at least, a free market at a very advanced stage of implementation and functioning, and thus managed by a relatively formulaic application of internal market law. This is exemplified by a growing tendency to hand the market ‘back’ to the Member States and, increasingly, to authorities and bodies (both public and private) therein. The achievement of the internal market is no longer, on this view, conceptually based on reining in the Member States; we are quite simply beyond all that. Rather, we are in the midst of a period of regulatory creativity and experimentation, which conjures an almost casual air of (Commission) confidence in the place of the market in European integration, a nonchalance which borders, at times, on a swagger of condescending purposefulness – of course the internal market project is a good one, and good for you (depending of course on who ‘you’ actually are and where you come from).

Peeling back that veneer, however, we see too an internal market framework that strains to cope with a series of challenges, both internal and external to the EU itself. The downside of the shifting and varied approach to regulation is

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<sup>4</sup> Armstrong and Bulmer, *ibid.*, p. 256.

<sup>5</sup> K.A. Armstrong, ‘Governance and the single European market’, in P. Craig and G. de Búrca (eds), *The Evolution of EU Law* (Oxford: Oxford University Press, 1999), pp. 745–89 at 745; see similarly, Armstrong and Bulmer, *op. cit.*, n. 3 above, p. 8.

equally real, with tensions between increased and reduced centralisation, between enhanced codification and deliberate deregulation. There is the whole question of re-regulation, which reveals a shift (from national to supranational) regulatory capacity rather than, as neatly put by Armstrong and Bulmer, a ‘neo-liberal paradise’.<sup>6</sup> There is also quite a varied vocabulary of regulation – for example, ‘to regulate’ seems to cover such different understandings as cajoling and suggesting; guiding, shaping, or steering; manipulating; fixing, mandating and stipulating – with varied levels of prescription and persuasion being implied along this spectrum of obligation. Through all of this, we see elements of a supposedly unified market ideal working in very different ways; debates then emerge as to which model or method of regulation is ‘right’ and thus can or should be imposed on (all) other spheres of application. Relations between general and sector-specific rules, principles and concepts become problematic, and we see also a somewhat uneasy mix of soft law methods being deployed to secure ultimately, in truth, hard (legal) results. All of this means that the fundamental questions about appropriateness, coherency and legitimacy already suggested above – at the junction of government and governance – are never that far behind; and it is here that the legal expression of standards, principles and benchmarks will bite.

In both identifying and questioning these conflicting market and/or regulatory trends, the approach of the contributors is broadly twofold – some chapters reflect thematically on questions of regulation which cut across the spectrum of the market and its freedoms, while others adopt more sector (rather than freedom) specific lenses including, for example, regulation of the media and of the internet, through which contemporary regulatory dynamics can be re-considered. A series of power struggles becomes strongly apparent – between the Community legislature and the Community courts; between the Community courts and their national counterparts; between the Community institutions and the Member States; between all of these and both public and private bodies, and even individuals; and, increasingly, between the Community and external regulators, most notably the World Trade Organization (WTO). And if anything, tensions between these different levels and sites of regulation seem to be intensifying.

Laurence Gormley frames the collection with a historical backdrop to internal market evolution, beginning with the etymology of the term itself and then critically charting various phases of activity, consolidation, impasse and progression. The ebb and flow of committed interest in the internal market remains strongly frustrating today. The piece introduces trends and tensions with which subsequent chapters continue to grapple: the complexity of

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<sup>6</sup> Armstrong and Bulmer, *op. cit.*, n. 3 above, p. 9.



institutional priorities and relations; the patchwork of measures used to manage the market and the varying degrees of adherence they demand. Gormley concludes by setting down an arch challenge, calling on both national and Union actors strongly to rethink the priority – and delivery – of the internal market. He also urges caution against unguarded seduction by what he calls the ‘charms of regulatory pluralism’. From the outset, then, we are steered towards thinking that we are by no means ‘nearly there’.

Stephen Weatherill and Bruno de Witte both address the place of non-market values in the internal market scheme, exploring this question in respect of legislation and harmonisation rather than the more typically addressed premise of derogation via case law. The ‘constitutional character of some aspects of the law governing the internal market’, as outlined briefly above, is a strong theme of Weatherill’s analysis, as he uncovers the source of authority or competence to harmonise, and the implications of this for ‘residual national competence’. He asks hard questions about when a proposed harmonisation measure is, or is actually not, about building the market. The interaction between the scope of the Treaty freedoms and the (related, remaining) scope for harmonisation is discussed in general (in particular, looking at the conflict generated by post-Single European Act (SEA) express, but limited, competences in the domain of non-market values) but also concrete terms, using the value of consumer protection as a case study. Weatherill also tracks an emerging reaction against the ethos of ‘minimum’ harmonisation, formerly a method (until fairly recently) latched onto as a politically savvy way of achieving more ambitious ends than might otherwise have been possible. Throughout his contribution, the fluid (impossible?) reconciliation of market integration and local diversity looms large.

While first presenting the narrow view of competence to regulate the market that can be taken from the judgment in *Tobacco Advertising*<sup>7</sup> (with an end-result that Gormley describes as ‘scarcely surprising when the Community tries to justify harmonisation on the basis of unconvincing arguments’), Bruno de Witte goes on to uncover the deceptive subtlety of the Court’s claim. It is not that the market cannot be regulated at all, but that no one locus of regulatory power can claim *exclusive* regulatory competence. De

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<sup>7</sup> Case C-376/98 *Germany v Parliament and Council* [2000] ECR I-8419, esp. para. 83. The fiction of ‘non-regulation’ raises also, of course, the less direct, *de facto* regulatory power that thereby transfers to the problem-solving function of the Court, evoking also Sharpf’s ‘regulatory gap’ (see, for example, F. Scharpf, ‘Negative and positive integration in the political economy of European welfare states’ in G. Marks (ed.), *Governance in the European Union* (Sage, 1996), 18–42, and discussion by G. More, ‘The principle of equal treatment: From market unifier to fundamental right?’, in P. Craig and G. de Búrca (eds), *The Evolution of EU Law* (Oxford: Oxford University Press, 1999), pp. 517–53, esp. at 529 et seq.

Witte's discussion on the incorporation of non-market values addresses, as he puts it, 'the balance between market integration and policy integration'; the objectives underlying Community harmonisation legislation are examined again, but here from more of a substantive than constitutional law premise, thus complementing Weatherill's chapter. De Witte traces the mix of market/non-market objectives both before and after the SEA, revealing the constitutional discomfort discussed by Weatherill but going on to explore the underlying questions from a substantive perspective also – the market side of market harmonisation; he thereby demystifies some constitutional questions, acknowledging the constitutional framework of some internal market law, but presenting equally a less lofty reality of policy choices. In tackling difficult questions on levels of capacity strewn across (and outwith) express Treaty provisions, De Witte looks at what the market can mean, and contain. The situation is, somewhat ironically, easier when the non-market value is not itself the subject of an express competence in the Treaty; here, he uses the principle of derogation from Treaty freedoms not to contradict with but actually to explain and justify the capacity to accommodate non-market values in harmonisation legislation. In this way, market and non-market values can be seen as different facets of the same thing, and not, therefore, inherently in competition with one another. It all becomes much more about balance, not winning. Where express, and typically quite limited, competence *does* exist, however, things are more complex. Here, to authorise harmonisation, we enter the territory of a measure's 'principal aim', with strong potential for competence to harmonise so long as the 'aim' is primarily market-driven. Again, however, De Witte argues that the incorporation of non-market values can stem from a more sophisticated, broad-ranging understanding of that market; the will to harmonise is thus distinguished from a crude competence-hungry momentum. Having worked out some conceptual coherence, De Witte proceeds empirically to assess actual institutional practice; the story that unfolds here is far less susceptible to neatness, and calls for more nuanced consideration of the regulatory preferences and priorities of both institutional, and non-institutional, players.

Erika Szyszczak, Rachael Craufurd Smith, Michel Van Huffel and John Usher highlight and examine a series of regulatory questions using sector-specific lenses i.e. competition policy, the media, the internet and monetary movements, respectively (Chapters 4–7). Szyszczak examines both economic governance and economic constitutionalism in her discussion of the changing regulatory relationship between competition policy and the market freedoms, an unsettled interrelation that she depicts as the 'normative basis of the economic constitution', yet the management of which in real terms remains 'unfinished business from the internal market modernisation project of the 1980s'. She acknowledges the almost stealthy injection of momentum derived

from new forms of governance when traditional methods of law-making failed to advance the integration project. Interestingly, Szyszczak argues that it is not so much that market governance is a ‘new’ methodology, rather that its use and functions are more openly acknowledged and accepted, and being extended more comprehensively now, alongside ‘hard law’. Using tools like the open method of co-ordination to achieve substantive progress is emerging especially where national competence in a given area is closely guarded. Though focusing on competition policy, she depicts the character of the market regulatory zone more generally, unearthing a simultaneous drive for centralisation and de-centralisation, for de-regulation and re-regulation, the latter, she observes, being deployed mostly for areas that she calls ‘Community integration priorities’. Szyszczak traces the increasingly influential role of private economic actors in shaping competition policy, but discusses also the levels of expectations and duties that are thereby generated, thus shifting some of the responsibilities and burdens of public power into the private domain, an uneasy development from many perspectives (and itself the subject of a separate chapter). In the specific context of competition policy, she argues that the evolving role of these private market participants necessitates a far-reaching conceptual rethink. Picking up the bigger-picture theme discussed by both Weatherill and De Witte on non-market values, Szyszczak concludes her chapter with a parallel reflection on incorporation of what we might call ‘non-competition’ values.

Some of the concerns raised by Szyszczak on competition policy seem equally problematic for the media sector, discussed by Rachael Craufurd Smith. By looking at regulation of the media as a sectoral point for regulatory experimentation, Craufurd Smith teases out some of this underlying uneasiness, which relates somewhat also to Weatherill’s discussion of the less comfortable consequences of the minimum harmonisation drive. Craufurd Smith sketches regulation of the media as another example of the move away from ‘command and control regulation’, towards an increasingly prevalent blend of hard and soft law; of harmonisation and autonomy; and of co-regulation and self-regulation. In a deeply engaging narrative, using the Television Without Frontiers Directive<sup>8</sup> as a channel, she cuts through the ambiguity often surrounding discussion of different regulatory techniques, instead building a detailed and incisive profile of the different mechanisms and, crucially, providing concrete examples of the various techniques in (media) action. Mirroring Szyszczak’s reflections on the transfer of public power to private actors, Craufurd Smith reveals a similar shift in responsibility

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<sup>8</sup> Directive 89/552, OJ 1989 L298/23, amended by Directive 97/36, OJ 1997 L202/60.

for the setting of standards across various sectors of the media and the increasing role played here not just by industry and by voluntary regulatory bodies but also, at the lowest level of ‘regulation’, by the consumer; she provides a fascinating, and timely, discussion of how this exercise of privatisation is bolstered by considerations of fundamental rights and freedom of expression on the one hand, yet simultaneously making enforcement of human rights all the more difficult on the other. Throughout her contribution, Craufurd Smith raises and deals with the elements of both the constitutional and the substantive that characterise the evolution of regulatory policies. But she also raises fundamental questions as to the legitimacy of ‘new’ methods. A very varied approach to regulation and its many techniques may look bold and brave, but it generates also some very basic problems – not least, the disturbance of the institutional balance so painstakingly incorporated into the various stages of traditional law-making functions, including the after-care of judicial review.

In the specific field of e-commerce, Michel Van Huffel explores the reconciliation of an existing regulatory system, and indeed *acquis*, with sectors requiring something altogether more elaborate and sophisticated if a successful and contemporary (e-)marketplace is to be established, managed and maintained. If the regulation of services presents multiple challenges in general, not least in terms of its sheer scope, then the additional difficulties that provision of financial services via the Internet can generate present an even more complex set of challenges. Van Huffel’s analysis is channelled primarily through the E-commerce Directive,<sup>9</sup> and its interactions with EC law – as well as regulatory policies and techniques – on, for example, the free movement of services, financial regulations and protection of the consumer; he looks also at the transposition of fundamental internal market principles like mutual recognition to this burgeoning domain. Van Huffel provides a detailed – and opportune – discussion on the meaning(s) and implications of the country of origin principle in the context of services regulation. A string of related yet inconsistent legislative provisions across a flurry of related sectors unfolds; and, anticipating subsequent chapters on regulatory tensions that come from *outside* the Community, Van Huffel tries also to decipher hierarchies between EC and private international law in the context of e-commerce and more generally. Despite the perplexing inconsistencies that are uncovered throughout his contribution, Van Huffel concludes not with a pessimistic fatalism but instead, develops a number of clear and practical reforms from his detailed exposition and critique of the field. Overall, he rightly asserts that the Community *acquis* so long in the fashioning cannot just randomly be cast aside.

John Usher tells a somewhat similar story of incoherence in the context of

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<sup>9</sup> Directive 2000/31, OJ 2000 L178/1.

monetary movements, dealing again with sectors acutely testing a market framework which should in theory be able quite happily (conceptually) to deal with them, but which in reality (practically) cannot, causing interactions among the freedoms which seem to tie the rules and principles governing them into relational knots. Usher first traces the crafting of EC law on capital movements through a two-fold process of legislative harmonisation and judicial interpretation, but not always a successfully coherent one; we see a unique regulatory phenomenon here, a sort of 'reverse regulation' where the applicable rules evolved from secondary legislation into directly effective Treaty provisions, rather than the far more typical 'other way round'. Usher then introduces a web of interacting freedoms, discussing the rules applicable when cross-border payments are actually for goods or services, thus themselves the subject of (not always mutually compatible) Treaty provisions and secondary legislation, and all of these coated with a dense gloss of judicial interpretation. Further layers of complexity are added when Usher goes on, first, to compare the rules on payments within the Community and those relating to payments from/to third countries and, secondly, to bring the implications of non-discrimination for the very different Member State systems of taxation (both corporate and personal) into the equation. Thus, he presents sectoral, institutional and geographical factors, asking somehow to be gelled together into a coherent regulatory package; like Van Huffel, Usher similarly chooses to take up this challenge, concluding by suggesting ways of both incorporating and extending the *acquis*.

The debate on the common or civil law roots of the Court of Justice is transferred from its more usual administrative law home to a theory of market regulation by Gareth Davies. He frames his chapter with an introductory discussion on the function and place of courts in the community, and Community. In their operation of the Article 234 EC reference procedure, Davies sites the relationship between the Community and national courts firmly in the language and behaviour of competition, finding in particular that the Court of Justice is too directional, too concrete and, ultimately, disrespectful of the capacity of national courts to partake more materially in the management of the market. While Article 234 lines are drawn at interpretation of the law and application of that law to the facts, Davies contends that, while the concept of interpretation is itself a vague one open to abstract definition, the Court strays frequently into concrete determinations of both law *and* fact, the latter more properly the domain of the national courts. He demonstrates this empirically, assessing key judgments in the areas of free movement, competition, taxation and the common customs tariff. Davies portrays a hopeless circle of reference, whereby the Luxembourg Court delivers concrete judgments on particular facts containing little by way of more abstract, principled guidance, which thus spawn more references from national courts on similar but not identical

concrete questions. Always mindful of the importance of uniformity in Community law, but careful also not to see that principle as an immovable, sacred block to any creativity and development, Davies proposes a system based on appeals rather than references, giving to *all* courts, then, a meaningful role in the application and interpretation of Community law, and thereby enhancing analogous market values like efficiency and participation, noting shrewdly that there is ‘little market for control any more’. His overall judgment on the market for law finds the present balance tilted far too heavily in a bias of centralisation, thus transposing his arguments to regulatory as well as institutional competition and finding, ultimately, ‘an adjudicative system poorly adapted to a large and dynamic market’.

The role of private actors, in both an internal and external capacity, is explored by Robert Lane and Panos Koutrakos. If the market comprises not just the Member States but also consumers (defined in as broad a sense as possible) as well as traders and industries, then its regulation must accomplish a fragile balance between protection and empowerment. Lane’s reference to the free market ideology of Adam Smith’s ‘invisible hand’ evokes also Mayne’s less hallowed but fitting notion that ‘[i]f economics was once little more than natural history, it is now coming more to resemble applied biology’.<sup>10</sup> Lane acknowledges the ‘oxymoron of regulating the free market’ and then seeks to establish the role of the private actor within that paradigm. While the extent of the rights granted to individuals has always characterised the most striking aspects of Community law, he argues that legal development happens more now in respect of the *duties* they ‘owe’, and here, specifically in the market context; we saw this to some extent in the chapter by Rachael Craufurd Smith, but Lane extends the premise, exploring not just the regulation of the market *by* private actors, but also the regulation *of* those individuals in their exercises of market participation. On the first strand, regulation *by*, Lane examines in some detail a question alluded to by many of the other contributors: the capacity (or otherwise) of the individual to influence the direction of market regulation via his/her access to judicial protection. First distinguishing the private realm of competition law (though later cautioning that the two spheres work when competition, but not regulation of the market more generally, is privatised), Lane then goes on to look at the degrees to which the market freedoms have been found to rein in the private market conduct of individuals. Yet again, the picture that emerges is riddled with incoherence, where horizontal effect has been achieved for most aspects of the free movement of workers, flirted with in respect of the free movement of goods,

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<sup>10</sup> R. Mayne, *The Community of Europe: Past, Present and Future* (New York: WW Norton, 1963), p. 65.

mismanaged in the field of services, and remains uncharted for the free movement of capital. Lane accepts a distinction in favour of the free movement of persons to some extent, his support for horizontality here underpinned by the status of EU citizenship; but he cautions against a rigid freedom model, advocating instead a functional division – truly recognising the person(al). In all cases, however, Lane points to a critical difficulty inherent in the extension of horizontal effect – the corollary extension of the derogation tool to private actors also; despite the openness of the Court to this, Lane dismisses it as ‘nonsense’ in reality, since private actors have ‘neither the power nor the duty to protect public policy’. Ultimately, the individual in the market is motivated by self-interest; but not much more than that, Lane suggests, can be expected, or imposed.

The role (or burden) of the individual in effecting management of the market through legal means and methods stands in fairly ironic contrast to the subjection of the national courts themselves, as challenged by Davies. Koutrakos picks up this call for decentralisation in quite a different context, arguing against the emasculation of national courts in respect of external (commercial) relations, looking to the implications of WTO membership and the Common Commercial Policy (CCP). In the context of the former, he presents the management role historically taken on by the Court of Justice in its interpretations of international agreements, virtuously protecting the scheme of protection for the rights of individuals found within the Community framework but not other international arrangements. He thus presents the Court undertaking a threefold juggling act, ‘at the intersection of Community law, international law and national law’, and reminds us that beyond internal parameters, the Court does not attribute its masterpiece principle, direct effect, lightly. Koutrakos reminds us also, however, that it is the character of the WTO legal framework, and not misplaced jealousy, that guides the Court’s reluctance; that framework may well be an evolving one, but it is one, for now at least, in respect of which a constitutional dimension ‘has been exaggerated’. Despite its complementary function vis-à-vis the internal market, the position of the individual does not fare more strongly in respect of the CCP, a position sealed by the Court in *Opinion 1/94*.<sup>11</sup> But Koutrakos cautions against an overblown status for the individual more generally in this sphere of EU external relations – the link to the internal market only goes so far, relating to matters of policy and content; the more relevant comparator is legal context, and the differences in that vein are both numerous and incontestable. It is not that there is no consideration of the individual, but that the levels of market management are, at the external level, altogether different. As noted at the

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<sup>11</sup> [1994] ECR I-5267.

outset, the place of the national courts in this web of protection, is especially significant, in terms of delivering ‘downwards’ from there to the individual.

Following through on the external dimension of the market, but moving away from the specific question of the protection of the individual, Nick Bernard tackles precisely the smooth functioning of these levels of market management depicted by Koutrakos. Bernard sees less of an internal–external market divide in his sectoral assessment of air transport regulation. His central thesis is that, in reality, the internal market simply *is* affected by external trade, and yet this has still not been taken properly into account in the vacuum-like evolution of market regulation. Bernard begins by setting out both the (liberalised) intra-EC and the international air transport regulatory frameworks, and the inevitable conflicts between them; he goes on, however, to dissect the nature of these conflicts – are they normative or structural? This dictates whether a more streamlined approach can be put in place, but also *how* this might be done; is it a question of redirecting institutional relations, to iron out differences seen to result from a conflict of competing provisions, or are there more sensitive and intractable issues of capacity and competence that need to be resolved? The Court clearly shied away from the latter debate in the series of judgments collectively drawn together as the *Open Skies* cases,<sup>12</sup> leaving the Commission to work out a series of alternative ways forward, still awaiting mandate from a sluggish Council. Bernard’s parting message is that the interaction of internal and external market governance thrown up through the lens of the aviation sector is not something that can be ignored in the formulation and reformulation of governance structures.

Lorand Bartels looks at this point, in effect, from the opposite premise, closing the collection of papers with a somewhat cautionary tale by reminding us that regulatory questions pierce the market from outwith as well as within the EU. The very real potential for clashes with WTO law displace a sort of regional righteousness too often presumed by EU ‘insiders’. The reality of the contrary was picked up on by Van Huffel, when addressing hierarchies between EU and private international law in the context of e-commerce, but it developed in detail in the course of Bartels’ surgical analysis of competing norms, which he undertakes from a WTO law rather than EC law perspective. The discomfort generated is all the more stark given that Bartels challenges EC adherence to mutual recognition, a principle at the heart of market governance; but the concept – and reality – of preferential treatment that mutual recognition puts

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<sup>12</sup> Cases C-467/98 *Commission v Denmark* [2002] ECR I-9519; C-468/98 *Commission v Sweden* [2002] ECR I-9575; C-469/98 *Commission v Finland* [2002] ECR I-9627; C-471/98 *Commission v Belgium* [2002] ECR I-9681; C-472/98 *Commission v Luxembourg* [2002] ECR I-9741; C-475/98 *Commission v Austria* [2002] ECR I-9797; and C-476/98 *Commission v Germany* [2002] ECR I-9855.



in place vis-à-vis goods from inside the internal market (as well as goods of EEA and Turkish origin), while cutting through discrimination among the Member States, clearly discriminates against the non-preferred. Bartels' subtle presentation of the norms and provisions applicable at both EC and international levels allows the provisions of the relevant WTO agreements to speak for themselves, a modest yet astute methodology which serves to underpin the strength of his claims all the more. He also explores in-built WTO mechanisms of justification and derogation, trying to find ways in which the EC might proceed with the fundamentals of its internal market programme, looking at both constitutionally-flavoured and regulatory options. He finds only marginal scope for manoeuvre here and encourages instead a fundamental overhaul of the EC's approach to mutual recognition, what he calls 'a policy of conditional but non-discriminatory recognition of the technical regulations of all WTO Members', thereby affirming the views of the other contributors who see the days of the rigid internal/external market schism as well and truly numbered, but finding external as well as EC impetus for moving to a more comprehensive and complex, and less parochial, construct of the market and its regulation.

Finally, it is interesting also to think about some issues which did not really feature in the chapters collected here. The challenge of EU enlargement, and its obvious and considerable enlargement of the internal market (physical and regulatory) space, features only intermittently. Is this because it is simply too early to assess the impact of enlargement on the market framework? Or does it mean that geographical area is not really important or, at least, not as important as what we might call 'substantive area', i.e. the breadth of issues covered within the market is more testing than the breadth of the territory of application?

It is also worth noting that the principle of subsidiarity, as either a real or potential regulatory restraint, does not often feature in these legal assessments of regulation. Subsidiarity invokes a sliding scale of responsibility, thus seeming tailor-made to position the numerous claims of different market actors, yet its potency or otherwise in the context of market regulation did not materialise here. Weatherill refers to the Court's own slippery dealings with subsidiarity in *Tobacco Advertising*; and as Davies points out, supervision of subsidiarity drew much attention in the preparation of the Constitution, yet it remains an 'indeterminate idea' – is this bark-but-not-bite approach reflective of the limited reach and/or practical value of the principle itself, or of the difficulties encountered at a law-policy crossroads?

Looking at the market freedoms themselves, the free movement of persons is perhaps that which ends up being least addressed. Notwithstanding the prescriptive vision of Article 14 EC, has the free movement of persons graduated or been promoted 'upwards' from market governance? Does citizenship

of the Union now site these questions more comfortably within constitutional rather than market language?

Finally, references to the Constitution of the EU feature very sparsely – wisely, for the present time; but rather disappointingly, from the perspective that the gaps and problems identified in this collection are unlikely to be solved by this momentous exercise in Treaty reform. The constitutional place of the internal market (and competition policy) within the EU is restored;<sup>13</sup> but what that means, in terms of its management and of regulatory policy, and coherence between government and governance, seems no clearer really. This serves further to underscore the feeling of ‘missed opportunity’ that already haunts the troubled Constitution; but it challenges also the perception that the internal market was and remains that aspect of European integration both the existence and regulation of which we complacently take for granted.

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<sup>13</sup> See Articles I-3 and I-4 of the Constitutional Treaty, OJ 2004 C310/1.

# 1. The internal market: history and evolution

**Laurence W. Gormley**

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## INTRODUCTION

The term ‘internal market’ has a long and honourable history; at various times deserving its own Directorate-General within the Commission, at other times linked with industrial affairs. The concept of an internal market was well understood by the Court,<sup>1</sup> particularly in relation to taxation, and by the Community legislature;<sup>2</sup> but it was not until preparations commenced leading to the presentation of the famous White Paper *Completing the Internal Market*<sup>3</sup> that the term came into wider and popular use.<sup>4</sup> The legal concentration hitherto had been on the term ‘common market’, the establishment of which was one of the two means by which the aims of the then EEC Treaty were to be achieved.<sup>5</sup> That the phrase ‘internal market’ is less extensive in its ambit than the phrase ‘common market’ is no surprise,<sup>6</sup> although the distinction does not always seem to have been understood by the Court in more recent times.<sup>7</sup>

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<sup>1</sup> Case 54/84 *Paul v Hauptzollamt Emmerich* [1985] ECR I-915, esp. at paras 14–15.

<sup>2</sup> Thus the heading internal market was an already long-established heading in the *Bulletin of the European Communities* and already featured in the Conclusions of various European Council meetings.

<sup>3</sup> COM (85) 310 final.

<sup>4</sup> The phrase ‘internal market’ specifically emphasised the distinction from aspects related to external commercial policy.

<sup>5</sup> The other being originally the progressive approximation of the economic policies of the Member States: see Article 2 EEC.

<sup>6</sup> See P.J.G. Kapteyn and P. VerLoren van Themaat, *Introduction to the Law of the European Communities*, L.W. Gormley (ed.), 3rd edn (London: Kluwer Law International, 1998), 122–4; see also, as to the common market, *ibid.*, 2nd edn, p. 78. See further, L.W. Gormley, ‘Competition and free movement: Is the internal market the same as a common market?’ (2002) vol. 13:6 *European Business Law Review* 517–22.

<sup>7</sup> See, for example, Case C-376/98 *Germany v Parliament and Council* [2000] ECR I-8419; for comment, see Gormley (2002), *ibid.*

## HISTORY OF THE INTERNAL MARKET

In 1986, Schmitt von Sydow<sup>8</sup> identified three significant periods in the history of the internal market: the initial surge of the 1960s; the decline of the 1970s, and the new momentum of the 1980s.<sup>9</sup> To those should now be added what may conveniently be termed the period of consolidation and the period of re-evaluation.

Progress in the 1960s was spectacular: the customs union was fully established both internally and externally, and the last remaining customs duties between the then six Member States were abolished in 1968.<sup>10</sup> Significant progress was also made in reducing formalities and other controls at intra-Community borders with the adoption of the Community transit procedure.<sup>11</sup> The adoption of the general programme in 1969 to remove technical obstacles to trade,<sup>12</sup> and the adoption of provisions relating to the free movement

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<sup>8</sup> H. Schmitt von Sydow, 'The basic strategies of the Commission's White Paper', in R. Bieber et al. (eds), 1992: *One European Market?* (Baden-Baden: Nomos, 1988), pp. 79–106 at 80.

<sup>9</sup> The account of these three periods is based (with additional material) on that of Schmitt von Sydow, *ibid.* See also the various articles in (1989/1) *Legal Issues of European Integration* 1–168. See further, P. Craig, 'The evolution of the single market' in C. Barnard and J. Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Oxford: Hart Publishing, 2002), pp. 1–40, and D. Chalmers, 'The single market: From prima donna to journeyman', in J. Shaw and G. Moore (eds), *New Legal Dynamics of European Union* (Oxford: Oxford University Press, 1995), pp. 55–72.

<sup>10</sup> With the coming into force of the common customs tariff on 1 July 1968 through Regulation 950/68 (OJ English Special Edition 1968 (I), p. 275), subsequently replaced by Regulation 2658/87 (OJ 1987 L256/1), the Annex to which has been integrally replaced annually and amended when necessary (most recently by Regulation 1989/2004 (OJ 2004 L344/1). On 25 October 2004, the Commission announced its decision to cease to publish the annual integral replacement in the OJ: the online version of the TARIC can be consulted at [http://europa.eu.int/comm/taxation\\_customs/dds/en/tarhome.htm](http://europa.eu.int/comm/taxation_customs/dds/en/tarhome.htm).

<sup>11</sup> By Regulation 542/69 (OJ English Special Edition 1969 (I), p. 125), subsequently replaced by Regulation 222/77 (OJ 1977 L38/1) and then by Regulation 2726/90 (OJ 1990 L262/1), which has now been replaced by the Community Customs Code, Regulation 2913/92 (OJ 1992 L302/1), as amended on myriad occasions: see L.W. Gormley, 'Free movement of goods and customs union' in D. Vaughan and A. Robertson (eds), *Law of the European Union* (Richmond Law & Tax, loose-leaf since 2003), vol. 2, section 7 (forthcoming, 2007), which replaces D. Vaughan (ed.), *Law of the European Communities* (London: Butterworths, loose-leaf 1990–2001), vol. 3, section 12 (which itself constituted a continuation of the reprint under the same title in 1986 of *Halsbury's Laws of England*, 4th edn, vols 51 and 52 (London: Butterworths, 1986)). See also T. Lyons, *EC Customs Law* (Oxford: Oxford University Press, 2002) and B.J.M. Terra, *Community Customs Law* (The Hague: Kluwer Law International, 1995).

<sup>12</sup> OJ English Special Edition 1962 (2nd Series) IX, p. 25, renewed in 1973 (OJ 1973 C38/1).

of workers,<sup>13</sup> the general programmes for the abolition of restrictions on the freedom of establishment<sup>14</sup> and the freedom to provide services<sup>15</sup> form perhaps the most visible elements of this initial surge. In competition law, the adoption of Regulation 17<sup>16</sup> saw the establishment of the systematic enforcement of Community competition law, putting into place a structure which lasted until 1 May 2004.<sup>17</sup> In the agricultural field, common organisations of the various agricultural markets were progressively introduced.<sup>18</sup> Decision-making in the Council became made more flexible in many areas in accordance with the timetable laid down in the Treaty;<sup>19</sup> the passage of time extending the use of qualified majority voting. There was also progress in relation to capital movements,<sup>20</sup> and the adoption of the directives on value added tax<sup>21</sup> enabled the removal of one of the major obstacles to the free movement of goods, which also distorted the conditions of competition on the common market, in the form of cumulative turnover tax. All this progress on the legislative front went hand-in-hand with progress in economic welfare and integration.

By the 1970s, a certain Euro-sclerosis had started to set in: after the first enlargement on 1 January 1973, and two waves of economic recession, the Community's legislative programme was not always up to resisting the

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<sup>13</sup> See R.O. Plender, 'Free movement of persons', in Vaughan (ed.), *op. cit.*, n. 11 above, vol. 3, part 15, para. 48. See now, Directive 2004/38 (corrected version OJ 2004 L229/35) which has to be implemented by and repeals much existing legislation from 30 April 2006.

<sup>14</sup> OJ English Special Edition 1962 (2nd Series) IX, p. 7.

<sup>15</sup> *Ibid.*, p. 3.

<sup>16</sup> OJ English Special Edition (1959–62) (I), p. 87.

<sup>17</sup> With the replacement of Regulation 17/62, *ibid.*, by Regulation 1/2003, OJ 2003 L1/1).

<sup>18</sup> Initially set out in Regulations 19–24/62 (JO 1962 30/933 et seq.) dealing respectively with cereals, pigmeat, eggs, poultry, fruit and vegetables, and wine. See J.A. Usher, *EC Agricultural Law*, 2nd edn (Oxford: Oxford University Press, 2002); M. Cardwell, *The European Model of Agriculture* (Oxford: Oxford University Press, 2004); and J.A. McMahon, *Law of the Common Agricultural Policy* (Harlow: Pearson, 2000). These measures have been replaced at various times (particularly in 1967 and 1975); additional measures dealing with other agricultural products were adopted later. See currently, for example, Regulation 1784/2003 (OJ 2004 L270/78) on cereals.

<sup>19</sup> With the passage of the various stages, culminating in the end of the transitional period at midnight on 31 December 1969.

<sup>20</sup> First Directive implementing Article 67 EEC (OJ English Special Edition (1959–62) (I), p. 49), replaced by Directive 88/361 (OJ 1988 L178/5), and Directive 63/21 (OJ English Special Edition 1963–64 (I), p. 5), which ceased to have effect at the same time as the First Directive was replaced. See also Directive 63/464 (OJ English Special Edition 1963–64 (I), p. 45).

<sup>21</sup> Directives 67/227 and 67/228 (OJ English Special Edition 1967 (I), esp. pp. 14 and 16).

temptations of the siren calls of protectionism; in many areas, unanimity was still required for decision-making in the Council, which in this economic climate became a recipe for disaster. Although the adoption of the Sixth VAT Directive in 1977<sup>22</sup> can be seen as a major highlight in the integration progress, it was hedged around with so many exceptions, and derogations, that it almost resembled a colander. The Commission proposed many measures to fill these lacunae, yet little progress was made. Similarly, in the field of excise duties, there was scant success, save in relation to cigarettes.<sup>23</sup> In some areas, it even became clear that ground already gained was being lost by the invocation of safeguard clauses to frustrate the operation of some of the directives from the 1960s. The unwillingness of the Council to face up to its responsibilities led to an almost complete abdication of decision-making.<sup>24</sup> In the transport field, this caused the European Parliament to commence proceedings to have the Council's failure to act established by the Court; the Court had little difficulty in accepting the Parliament's case.<sup>25</sup> The progress in removing technical barriers to trade also slowed down considerably. With this lack of progress came a substantial increase in infringement procedures against Member States for breaches of Community law. This growth can, in part, be attributed to the increasing volume of Community law but, to a substantial degree, it also reflects the difficulties which market participants in particular were experiencing as a result of the gap between expectation and delivery in relation to the internal market. Particularly after the celebrated communication on the consequences of the *Cassis de Dijon* judgment,<sup>26</sup> the increasing flow of complaints and own-initiative dossiers transformed itself into a veritable flood of litigation. In the business sector in particular, the frustrations resulting from the difficulties in cross-border commerce started to become problems which could not be ignored.

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<sup>22</sup> Directive 77/288 (OJ 1977 L145/1), as amended on myriad occasions, see, generally, L.W. Gormley, *EU Tax Law* (London: Richmond Law and Tax, 2005) and in Vaughan and Robertson op. cit., n. 11 above, vol. 6, section 30; B.J.M. Terra and P.J. Wattel, *European Tax Law*, 4th edn (The Hague: Kluwer Law International, 2005); P. Farmer and R. Lyall, *EC Tax Law* (Oxford: Oxford University Press, 1994); and D. Williams, *EC Tax Law* (London: Longman, 1998).

<sup>23</sup> Directive 72/464 (OJ English Special Edition 1972 (31 December) L303/3), replaced by Directive 95/59 (OJ 1995 L291/40), as amended.

<sup>24</sup> As to the consequences of failure by the Council to meet already agreed obligations, see P. Pescatore, 'La carence du législateur communautaire et le devoir du juge', in G. Lüke et al. (eds), *Rechtsvergleichung, Europarecht und Staatenintegration* (Gedächtnisschrift für Constantinesco, Cologne, 1983), pp. 559–80.

<sup>25</sup> Case 13/83 *European Parliament v Council* [1985] ECR 1513.

<sup>26</sup> Case 120/78 *Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649; OJ 1980 C256/2, as to which, see L.W. Gormley, 'Cassis de Dijon and the Communication from the Commission' (1981) vol. 6:6 *European Law Review* 454–9 (also discussing other reactions to that Communication).

The response to these alarm calls in the Commission and the European Parliament was as significant as it was immediate. The political role played by the Kangaroo Group (see further below) in this process should not be underestimated. In June 1981, the Commission presented a communication on the state of the internal market to the European Council:<sup>27</sup> both the communication and the conclusions of the European Council recognised the perilous state of the internal market.<sup>28</sup> A second communication followed just over a year later, including operational and institutional arguments for procedural innovations.<sup>29</sup> At Copenhagen, in December 1982, the European Council gave instructions to the Council to act on some 30 proposals in priority areas that the Commission had identified; a specific deadline for such action was also laid down.<sup>30</sup> Moreover, the Council began to meet in a new formation dealing with matters relating to the internal market. This permitted a huge number of policy fields to be brought together, replacing the piecemeal approach of the Council spreading responsibility for internal market dossiers over various different formations, which sometimes worked in an unsynchronised manner, with a new, clearer and unified approach that would represent a forum for the achievement of political packages designed to maintain a dynamic balance of advantages and disadvantages of national interests. This point was emphasised in a report, in February 1983, on the assessment of the functioning of the internal market,<sup>31</sup> which looked not only at its economic impact, but also at its sociological and institutional background. The essential thrust of this report was that the Member States and the Council were distinctly underperforming, not merely because of pure protectionist interests (although they undeniably played a role in individual dossiers), but also because solutions were simply not examined in the Community context: the repercussions for Community cohesion and solidarity of national isolated initiatives often went unnoticed. The inertia of national bureaucracies and the huge range of issues relevant to the internal market made it also very difficult to arrive at appropriate political compromises and agreements, whether at Community or national level.

The Copenhagen mandate and the inauguration of the internal market Council breathed new life into the legislative work of the Council, particularly in the area of harmonisation of laws, most importantly resulting in a directive on measures to combat the proliferation of barriers to trade through a plethora of technical standards and regulations.<sup>32</sup>

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<sup>27</sup> COM (81) 313 final.

<sup>28</sup> Bull. EC 6-1981, point 1.1.6.

<sup>29</sup> COM (82) 735 final.

<sup>30</sup> Bull. EC 12-1982, point 1.2.3 (end of March 1983).

<sup>31</sup> COM (83) 80.

<sup>32</sup> Directive 83/189 (OJ 1983 L109/8); see S. Lecrenier, *'Les articles 30*

On the basis of the Moreau and Von Wogau report,<sup>33</sup> the European Parliament adopted a resolution on the internal market,<sup>34</sup> followed in June of that year by a consolidation programme presented by the Commission,<sup>35</sup> which sought the abolition of the most visible checks at intra-Community borders within 18 months. This programme was, however, superseded by the White Paper itself.

The White Paper was the product of an almost entirely brand-new Commission. The Delors–Cockfield alliance was to prove the strongest force for integration since Hallstein. Out of five topics presented to the new Commission at the beginning of 1985 as possible candidates for major initiatives, the internal market proved the most attractive: pressure for action in this area was intense; the existence of political will had been made manifest (there was no substantive opposition, the delays were more procedural than substantive) and, finally, the completion of the internal market had no additional budgetary implications. The publication of the Albert and Ball report<sup>36</sup> demonstrated the costs of market fragmentation, which, when the consequences of maintaining internal frontiers were also taken into account, went on to show the damage done by concentration on budgetary squabbles instead of addressing the fundamental substantive problems of the Community. It was noted in the House of Lords that just the cost of the discriminatory element of tax on Scotch Whisky in certain Member States between 1978 and 1981 was four times as high as the whole of the UK's net annual contribution to the Community budget during that period.<sup>37</sup>

Against such a background, the European Council and the European Parliament could do little but follow approvingly the announcement of the Commission's intention to secure a completion of a fully integrated internal market by 1992, a goal which would be facilitated by a programme involving

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*et suivants et les procédures de contrôle prévues par la Directive 83/189/CEE* (1985) 283 RMC 6–23, and '*Vers l'achèvement du marché intérieur: L'évolution des procédures de contrôle prévues par la Directive 83/189/CEE depuis quatre ans*' (1988) 315 RMC 121–39; and S. Weatherill, 'Compulsory notification of technical regulations: The contribution of Directive 83/189 to the management of the internal market' (1996) 16 *Yearbook of European Law* 129–204. Directive 83/189 has now been replaced, as is noted below.

<sup>33</sup> EP Doc. 1-32/84 (26 March 1984).

<sup>34</sup> OJ 1984 C127/9 (9 April 1984).

<sup>35</sup> COM (84) 305.

<sup>36</sup> M. Albert and A. Ball, *Towards European Economic Recovery in the 1980s* (rev. edn, Luxembourg: ECOP, 1983; New York: Prager, 1984).

<sup>37</sup> House of Lords Select Committee on the EC, Session 1981–82, 17th Report, *Internal Market* (London: HMSO, 1982), p. 90. See also Case 168/78 *Commission v France* [1980] ECR 347; Case 169/78 *Commission v Italy* [1980] ECR 385; and Case 171/78 *Commission v Denmark* [1980] ECR 447.



a realistic and binding timetable. Thus, in March 1985, the Brussels European Council noted as its first priority 'action to achieve a single large market by 1992, thereby creating a more favourable environment for stimulating enterprise, competition, and trade'.<sup>38</sup> The Commission was called upon to produce its programme and timetable before the next European Council meeting. Seven weeks of frenzied activity, and 17 drafts later, Lord Cockfield presented the White Paper on 15 June 1985.

Pausing there, a number of features stand out in the White Paper, which makes it perhaps the document most fitted to stand comparison with the Spaak Report,<sup>39</sup> as one of the most influential policy documents in the development of the Communities. Unlike the Spaak Report, however, the White Paper proceeded on the basis that the argument for the target date had already been won: it simply presented the logical consequences of the commitment to 1992 and set out the programme. Necessity, rather than feasibility, explains the fields of action selected for inclusion. The White Paper approached those problems for which solutions could be envisaged, as well as various areas where no realistic immediate solution presented itself, such as external commercial policy, and areas in which no clear Community competence could be established at that time, such as the right of asylum and the fight against terrorism. The White Paper, therefore, looked at the underlying reasons giving rise to physical or technical barriers and sought to examine how justified interests and concerns could be taken care of without disturbing free movement inside the Community. In a sense, though, certain parallels can be drawn with the approach of the Spaak Report, which looked at the problems to be solved and proposed concrete solutions. Although the White Paper did not specifically call for institutional reforms, those followed relatively hard on its heels in the Single European Act.<sup>40</sup> Indeed, the expansion of qualified majority voting and the conferral of express competence in the new areas of horizontal or flanking policies played a major role in the increased level and success of Community legislative activity in the late 1980s. The drafters of the Single European Act continued, in this respect, to follow the lines that could be expected in view of the Spaak Report: further progress towards qualified majority voting and, thus, further steps away from intergovernmentalism.

The White Paper itself was, like ancient Gaul, divided into three parts, dealing respectively with the removal of physical barriers, the removal of techni-

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<sup>38</sup> Bull. EC 3-1985, point 1.2.3.

<sup>39</sup> *Rapport des Chefs de Délégations aux Ministres des Affaires Etrangères* (Secretariat of the Intergovernmental Conference, Brussels, 21 April 1956). See Kapteyn and VerLoren van Themaat (Gormley ed.), op. cit., n. 6 above, pp. 14–16.

<sup>40</sup> See the bibliography in Kapteyn and VerLoren van Themaat (Gormley ed.), op. cit., n. 6, p. 34.

cal barriers, and the removal of fiscal barriers. Topped and tailed with an introduction and conclusion, the White Paper presented a strategic programme which was as astonishing in its breadth and as in its depth of vision. Without giving a detailed overview of all the issues discussed in the White Paper,<sup>41</sup> a few features particularly stand out for the purposes of this discussion: the abolition of systematic frontier controls and the associated improvements in controls on persons, transit and transport; the removal of fiscal barriers to trade; the new strategy and the new approach in relation to harmonisation; and the prevention of new obstacles to trade.

From the veritable explosion of interest and enthusiasm generated by the White Paper, the period of consolidation developed. However, of the features identified above, not all became what they might have become or were intended to become. The abolition of systematic frontier controls in movement between Member States has become a major achievement of the internal market, at least as far as the continental Member States are concerned, although the United Kingdom has not yet felt able to achieve this to the same degree. However, the improved rules relating to Community transit and the consolidation of customs legislation have been particularly successful; mountains of paperwork have been reduced, with resulting efficiencies in intra-Community trade.<sup>42</sup> From the point of view of the relaxation of controls on the movement of persons, the consequences of events in the Balkans rapidly put paid to any notion of complete elimination of passport controls, although obviously within the Schengen area these have been much reduced, so that (except when there are spot checks) internal frontiers have become (almost) an illusion. However, it is unsatisfactory that the internal market has not produced the intended common travel area throughout the territory of the European Union and that, even within Schengen, flying brigades regularly harass travellers by rail and more infrequently by car.<sup>43</sup>

The removal of fiscal barriers has resulted in what is still a transitional

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<sup>41</sup> For this, see the works cited in n. 8 and n. 9 above.

<sup>42</sup> See, generally, the contributions by J.A. Usher, 'Consequences of the customs union' and L.W. Gormley, 'Consolidation, codification and improving the quality of Community legislation – The Community Customs Code', in D. O'Keefe and N. Emiliou (eds), *The European Union and World Trade Law* (Chichester: Wiley, 1996), pp. 105–23 and pp. 124–35 respectively.

<sup>43</sup> The Court of Justice, however, gave short shrift to an attempt by a then MEP to challenge passport controls for intra-Community travel: Case C-378/97 *Criminal Proceedings against Wijsenbeek* [1999] ECR I-6207. See further, H. Toner, 'Passport controls at borders between Member States' (2000) 25 *European Law Review* 415–24 and E. Guild, 'The single market: Movement of persons and borders', in Barnard and Scott (eds), *op. cit.*, n. 9 above, pp. 295–310.

adaptation of the Sixth VAT Directive.<sup>44</sup> From the point of view of the transparency of legislative drafting, this has been a complete disaster, as the Directive is now virtually unfathomable; it is also still so hedged around with exceptions and derogations that it is fundamentally unsatisfactory as a coherent instrument. Without a doubt, though, the revised scheme, in practice, represents a major substantive improvement in terms of simplification and broad logic, even though the wholesale application of the original principle proved too much to swallow for all products. The failure to move to a definite system of VAT and to simplify legislation in this field is a major gap in the success of the internal market, as undoubtedly is the still chaotic situation in relation to excise duties. The attitude of Member States to fiscal deflections of trade is extremely strange and seems to rest on an immaculate misconception. For example, the United Kingdom's reaction to physical deflections of trade is simply to increase excise duties; and in the Netherlands, in the east of the country, motorists voted with their wheels in protest at Dutch petrol prices and filled their petrol tanks over the border in Germany. If Member States are concerned at the loss of revenue caused by fiscal deflections of trade, they should react in the obvious way by removing their cause (the disparities in the excise duties levied by Member States in respect of alcoholic beverages, tobacco and motor vehicle fuel) and lowering duties or harmonising them; simply sending customs officers out to harass those who take advantage of the market is not a viable long-term solution and forms an affront to the public in any event. Moreover, in the case of the United Kingdom, the methods of revenue protection adopted (seizing cars for example) have been wholly at odds with the internal market philosophy.<sup>45</sup>

Reliance on the principle of mutual recognition became a major platform of the White Paper, enabling many harmonisation proposals pending before the Council to be withdrawn, and the Commission's staff abandoned even more drafts of future proposals. The extension of the mutual recognition principle beyond the domain of goods into services and *mutatis mutandis* into the fiscal sphere, proved to be a major step forward, although the Court was very soon not afraid to draw the Commission's attention to the limits of this principle.<sup>46</sup> While mutual recognition has not always proved to be the expected panacea,

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<sup>44</sup> To deal with intra-Community transactions; see the literature cited in n. 22 above.

<sup>45</sup> The Commission decided on 20 October 2004 to commence proceedings against the United Kingdom: see Commission Press Release IP/04/1255 (20 October 2004), but the proceedings have not yet been lodged at the Court, pending further attempts to achieve satisfactory compliance with the Reasoned Opinion.

<sup>46</sup> See the insurance and reinsurance judgments decided on 15 December 1986, including, for example, Case 205/84 *Commission v Germany* [1986] ECR 3755.

as the Court's case-law has made plain,<sup>47</sup> it is a principle which Member States ignore at their peril when drafting legislation.<sup>48</sup> The Commission itself recognised that it could not completely replace harmonisation by mutual recognition. It thus took the view that harmonisation would remain necessary in two instances: first, when residual barriers were justified by essential requirements such as health, technical security or consumer protection (the question of justification implying testing against the principle of proportionality); and, secondly, when harmonised rules on standards were necessary for industry to obtain economies of scale and compatibility in a homogeneous market. While mutual recognition and free movement created, in the Commission's vision, an internal market for traders and consumers, harmonisation added a common market for the benefit of producers.<sup>49</sup> Although the approach of delegating the task of adopting European standards and technical requirements to CEN, CENELEC, and later also to ETSI attracted some controversy,<sup>50</sup> that has disappeared; the voluntary nature of standards makes them rather different from binding technical rules.<sup>51</sup> In any event, the importance of standards as potential barriers to trade has been highlighted, in particular, in the field of public procurement.<sup>52</sup> A single market demands a single approach, even in the voluntary sector. In relation to the mutual recognition of qualifications, the adoption of Directive 89/48<sup>53</sup> on the general system, and its counterpart,

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<sup>47</sup> See Case 188/84 *Commission v France* [1986] ECR 419 and Case C-293/93 *Criminal Proceedings against Houtwipper* [1994] ECR I-4249.

<sup>48</sup> See Case C-184/96 *Commission v France (Foie Gras)* [1998] ECR I-6197. See, furthermore, the Commission's interpretative communication, OJ 2003 C265/2. The mutual recognition principle extends also to goods from the whole of the European Economic Area (EEA) and Turkey, *ibid.*, point 2.

<sup>49</sup> Harmonisation takes different forms, according to the type of problems being tackled: minimum harmonisation has become politically more popular than total harmonisation; the Community Rules only partially occupy the field, thus the scope of pre-emption is more limited. The Member States in any event remain bound to respect the general rules of the EC Treaty (free movement and non-discrimination). The Member States are additionally bound by the obligations of Article 10 EC *not* to undermine the effectiveness of the Community harmonising rules.

<sup>50</sup> Discussed by L.W. Gormley, 'Some reflections on the internal market and the free movement of goods' (1989/1) *Legal Issues of European Integration* 9–20 at 12. CEN is the Comité Européen de Normalisation, CENELEC is the Comité Européen de Normalisation Electrotechnique and ETSI is the European Telecommunications Standards Institute.

<sup>51</sup> See generally, H. Schepel and J. Falke, *Legal Aspects of Standardisation in the Member States of the European Community and EFTA*, vol. 1 (Luxembourg: ECOP, 2000) and J. McMillan, *Qu'est-ce que la normalisation? Normes et règles techniques et libre circulation des produits dans la Communauté*, (1985) 284 RMC 93–98.

<sup>52</sup> Case 45/87 *Commission v Ireland* [1988] ECR 4929.

<sup>53</sup> OJ 1989 L19/16, as amended.

Directive 92/51,<sup>54</sup> heralded a triumphal move away from the sclerosis of sector-by-sector negotiations; these have now formed the basis for further modernisation and development of the mutual recognition of qualifications.<sup>55</sup>

The Commission has certainly been very successful in relation to the prevention of new obstacles to trade: the adoption of Directive 83/189<sup>56</sup> and its expanded successor, Directive 98/34,<sup>57</sup> have placed highly original and also highly effective weaponry in the Commission's arsenal of internal market supervision, on the basis that prevention is even better than cure.<sup>58</sup>

The period of consolidation of the internal market came to a natural review point at the end of 1992. By that time, the initial enthusiasm had been watered down by the weight of negotiations and the changing political climate; not everything was straightforward in the implementation of the White Paper programme. The United Kingdom had long before rewarded Lord Cockfield by not re-nominating him, and the days of the Commission acting almost as the unpaid legal advisers of traders challenging barriers to trade started to come to an end. Politically, the emphasis had very much shifted to getting legislation through the Council, so that the market citizens were thrown back upon the mercies of lawyers. The shift in focus to legislation rather than infringement proceedings is, in part, a natural result of the White Paper initiative, but it also represented a succumbing to political pressure on the Commission to be less rigorous in its approach. The emphasis turned to the resolution of issues in package meetings, which unsurprisingly turned out to be fora for horse trading; in this they came to resemble meetings of the infringement *chefs de cabinet*. However, more legislation does not necessarily make better legislation, and the Sutherland Report – *The Internal Market after 1992: Meeting the Challenge*<sup>59</sup> – noted the need for a considerable simplification of Community legislation. The adoption of the Customs Code<sup>60</sup> and its

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<sup>54</sup> OJ 1992 L209/25, as amended.

<sup>55</sup> See Directive 2005/36 (OJ 2005 L255/22) on the recognition of professional qualifications.

<sup>56</sup> See n. 32 above.

<sup>57</sup> OJ 1998 L204/37, amended by Directive 98/48 (OJ 1998 L217/18) and the Act of Accession (2003).

<sup>58</sup> See the literature cited in n. 32, above, and the examples cited by Gormley loc. cit., n. 50 above, pp. 13–14.

<sup>59</sup> SEC (92) final. The Report was published as a small (72 page) booklet, with a foreword by M. Bangemann and K. van Miert, in non-standard citable form.

<sup>60</sup> Regulation 2913/92 (OJ 1992 L302/1), as amended; see the works cited in n. 11 above.

implementing Regulation<sup>61</sup> remains the most dynamic example of achievement in the sphere of simplification in the early 1990s.<sup>62</sup>

By the end of 1992, the political landscape had started to change further, as the Community expanded its internal horizons. The focus of attention started to turn to institutional matters, and the internal market became less prominent as a dynamic centre of activity. In the field of substantive law, the emphasis in legislation turned to regulated markets and to the utilities in particular. Conditions of competition on the internal market came more to the fore than the removal of barriers as such. To that extent, legislative activity seemed to return to the concept of a common market rather than be limited to the definition of the internal market in the EC Treaty. However, as has been indicated above, a substantial agenda remained, particularly in the fields of financial services, fiscal policy and the movement of persons.

Turning to the period of re-evaluation, a number of points deserve to be highlighted by way of initial scene-setting. The approach of the Court of Justice to the use of the free movement of goods provisions as the force of integration<sup>63</sup> seemed to take a decisive knock with the judgment in *Keck*.<sup>64</sup> At once the Lorelei sought to lead the trusty sailors of the good ship internal market onto the rocks: pressure to apply *Keck* outside its particular circumstances grew, but fortunately has met with considerable resistance.<sup>65</sup> In perspective, *Keck* may better be seen as a somewhat impulsive reaction to the over-use of the free movement of goods provisions in circumstances of scant integrationist merit; but any suggestion of the death of *Dassonville* is, like the

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<sup>61</sup> Regulation 2454/93 (OJ 1993 L 53/1), as amended.

<sup>62</sup> See Gormley, *op. cit.*, n. 42 above, p. 124.

<sup>63</sup> With a seemingly ever wider use of Article 28 EC; see L.W. Gormley, 'Two years after *Keck*' (1996) 19 *Fordham International Law Journal*, 866–86 at 870–76.

<sup>64</sup> Joined Cases C-267 and 268/91 *Criminal Proceedings against Keck and Mithouard* [1993] ECR I-6097. While the myriad views on this judgment vary widely (see the literature cited in Kapteyn and VerLoren van Themaat (Gormley ed.), *op. cit.*, n. 6 above, p. 320, and P. Oliver (with M. Jarvis), *Free Movement of Goods in the European Community*, 4th edn (London: Sweet and Maxwell, 2003), p. 124). All commentators agree that the reasoning is scarcely a model of clarity. Beyond doubt is also the consideration that Article 28 EC was becoming a bit of a charlatan's charter.

<sup>65</sup> See, for example, Case C-384/93 *Alpine Investments BV v Minister van Financiën* [1995] ECR I-1141 at 1177–78 (paras 35–38); Case C-415/93 *Union Royale Belge des Sociétés de Football Association v Bosman* [1995] ECR I-4921 at 5070–71 (paras 102–103); Case C-98/01 *Commission v United Kingdom* [2003] ECR I-4641, at 4662–63 (paras 45–47). The Court has always stated that the national measures concerned were not comparable to those dealt with in *Keck*. See, further, M. Poiras Maduro, 'Harmony and dissonance in free movement', in M. Andenas and W.-H. Roth (eds), *Services and Free Movement in EU Law* (Oxford: Oxford University Press, 2002), pp. 41–68.

newspaper reports of Mark Twain's death, much exaggerated.<sup>66</sup> It seemed for a time that the Court of Justice was moving the motor of integration into the realm of rules affecting the movement and conditions of persons,<sup>67</sup> including discriminatory tax treatment of persons and companies,<sup>68</sup> but more recent case-law suggests that the battle is still being fought on all fronts, with the development of real significance for Community citizenship being especially important.<sup>69</sup> On the other hand, the Court has been unwilling to allow the achievement of the internal market to confer unlimited powers of harmonisation upon the Community,<sup>70</sup> but this is scarcely surprising when the Community tries to justify harmonisation on the basis of unconvincing arguments. It may be thought that the Community has lost sight of the strategy of the White Paper in this regard. Certainly, the question of the Community acting within its competence reflects a real concern that sight must not be lost of basic principles. The period of re-evaluation of the internal market may yet see the circle complete: the Community legislature will have to be prepared to take the logical next steps. The Court is starting to resume its 'motor' mode: not to engage in activism, but to remind the Member States, the Community institutions, and all market participants of logical consequences of what has been agreed.<sup>71</sup> In that perspective, the internal market is very much alive; still at the forefront of judicial attention.

However, that the internal market still is far from complete is all too evident from the Commission's own reports,<sup>72</sup> as well as from the political evaluation

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<sup>66</sup> The Court expressly did not overrule *Dassonville* or *Cassis de Dijon*, but nuanced the application of the basic principle in *Dassonville*. See further, G. Tesaro, 'The Community's internal market in the light of the recent case-law of the Court of Justice' (1995) *Yearbook of European Law* 1–16, and M. Poiares Maduro, *ibid*.

<sup>67</sup> See, for example, *Bosman*; Case C-55/94 *Gebhard v Consiglio dell' Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4165; Case C-237/94 *O'Flynn v Adjudication Officer* [1996] ECR I-2617; and Case C-168/91 *Konstantinidis v Stadt Altensteig* [1993] ECR I-1191.

<sup>68</sup> See, for example, Case C-364/01 *Heirs of H. Barbier v Belastingdienst* [2003] ECR I-5013; Case C-107/94 *Asscher v Staatssecretaris van Financiën* [1996] ECR I-3089; Case C-324/00 *Lankhorst-Hohorst GmbH v Finanzamt Steinfurt* [2002] ECR I-11779; Case C-250/95 *Futura Participations SA & Singer v Administration des Contributions* [1997] ECR I-2471; and Case C-35/98 *Staatssecretaris van Financiën v Verkooijen* [2000] ECR I-4071.

<sup>69</sup> See, for example, Case C-85/96 *Martínez Sala v Freistaat Bayern* [1998] ECR I-2691; Case C-138/02 *Collins v Secretary of State for Work and Pensions* [2004] ECR I-2703; and Case C-200/02 *Zhu and Chen v Secretary of State for the Home Department* [2004] ECR I-9925.

<sup>70</sup> Case C-376/98 *Germany v Parliament and Council* [2000] ECR I-8419.

<sup>71</sup> See Pescatore, *op. cit.*, n. 24 above.

<sup>72</sup> See the *Internal Market Strategy (2003–2006)* COM (2003) 238 final and the *Implementation Report* COM (2004) 22 final.

by the Kangaroo Group.<sup>73</sup> A few examples will suffice to demonstrate the difficulties. There is still serious hostility to the logical application of the concept of mutual recognition based on home state control. This has more recently manifested itself in the reactions to the Commission's proposal relating to services<sup>74</sup> and, in relation to registered partnerships, in the new Directive on rights of residence.<sup>75</sup> Other areas of activity are also controversial. The proposed Community Patent<sup>76</sup> is also seen as a key means of reaching the targets set by the Lisbon Strategy;<sup>77</sup> the proposed directive on the patentability of computer-implemented inventions<sup>78</sup> no less so, and company law and corporate governance have also seen flurries of activity.<sup>79</sup> Public procurement has seen the achievement of new rules,<sup>80</sup> and the Financial Services Action Plan<sup>81</sup> has been largely achieved, but much still remains to be done.

## CONCLUSION

This overview of the history of the internal market demonstrates that it is one thing to launch great initiatives to (almost) universal political acclaim; but it is

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<sup>73</sup> See their *Initiative for the Completion of the European Home Market*, available at: [http://sico.acteco.com/kangaroo2004/www.kangaroo2004.be/db\\_beelden/Initiative\\_final.pdf](http://sico.acteco.com/kangaroo2004/www.kangaroo2004.be/db_beelden/Initiative_final.pdf).

<sup>74</sup> COM (2004) 2 final, p. 3. Council adopted its common position on 24 July 2006 (see Council Document 10003/06).

<sup>75</sup> See Directive 2004/58 (OJ 2004 L229/35), Article 2(1)(b).

<sup>76</sup> COM (2000) 412 final. See Council Document 7119/04.

<sup>77</sup> The strategy agreed at Lisbon in March 2000, see Bull. EU 3-2000, point I.1. As to recent political attitudes as to how to tackle the achievement of the Lisbon aims, see further, COM (2005) 24; SEC (2005) 192; and the Speech by Commissioner McCreevy, European Policy Forum, London, 24 January 2005 (RAPID ref. SPEECH 05/33).

<sup>78</sup> COM (2002) 92 final. However, this proposal was defeated when the common position was rejected by the European Parliament on 6 July 2005. See Bull. EU 7/8-2005, point 1.3.33.

<sup>79</sup> See e.g. Regulation 2157/2001 (OJ 2001 L294/1) on the Statute for a European Company; Directive 2001/86 (OJ 2001 L294/22) relating to employee participation therein, and Directive 2004/25 (OJ 2004 L142/12) on takeover bids. See, further, the Commission's Communication COM (2003) 284 and Directive 2005/56 on cross-border mergers of limited liability companies (OJ 2005 L310/1).

<sup>80</sup> See Directive 2004/17 (OJ 2004 L134/1, corr. L358/35) on procurement by the utilities; Directive 2004/18 (OJ 2004 L134/114) on classic procurement (both amended most recently by Regulation 2083/2005 (OJ 2005 L333/28) and Decision 2005/15 (OJ 2005 L7/7), implementing Directive 2004/18, Article 30.

<sup>81</sup> COM (1999) 232 final. See, further, the Commission White Paper on Financial Services Policy 2005–2010, COM (2005) 629 final.



quite another thing to obtain the political support to translate those initiatives into a legislative framework. Although the Court can point out the way forward (through its well-known development of the home state control basis for mutual recognition in relation to the various free movement provisions in the EC Treaty), the logical consequences of such a principle remain unpalatable to many, in particular to those who seek to stifle competitiveness through ‘nanny’ rules which serve principally to protect local self-interest by making competition impractical. If the internal market is to live up to expectations, a radical rethink on the part of national politicians, civil servants, and industrial and financial market participants in particular is called for. At the level of the Union too, a rethink of regulatory mechanisms and styles would not be out of place: ‘non-legal’ regulatory mechanisms are a scant substitute for mechanisms firmly founded in the legal bases and instruments at the Union’s disposal; the need to ensure that proper judicial review of Community and national action is available must also not be overlooked. Regulatory pluralism may have its charms, but it does not make for coherence in the face of the complex challenges facing the internal market in the coming years.

## 2. Supply of and demand for internal market regulation: strategies, preferences and interpretation

**Stephen Weatherill\***

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### INTRODUCTION

This chapter is inspired by the surprising absence of clear rules about the constitutional character of some aspects of the law governing the internal market. It aims to demonstrate how vital but unsettled constitutional questions about the allocation of competence bear heavily on the type of internal market that is being, and can be, created. It is legislative harmonisation in particular that invites exploration in this vein.

The examination of the scope and purpose of legislative harmonisation is constructed around three connected questions. All three were touched on by the Court in its most spectacular recent exploration of these realms, *Tobacco Advertising*,<sup>1</sup> but neither there nor subsequently have the conundrums been resolved. *First question* (Q.1): what is the scope of harmonisation envisaged by the EC Treaty? The EC Treaty confers no competence to harmonise *per se*; the competence is more limited than that and is, in short, tied to the process of market-building. Also, what exactly is at stake in determining how much harmonisation is constitutionally permitted? *Second question* (Q.2): what is the impact of legislative harmonisation on the scope of residual national competence? One might suppose that the pursuit of a level (commercial) playing field would dictate that EC rules displace local autonomy, but that may be subject to criticism as damaging to regulatory experimentation, heedless of special local concerns and, more generally, incompatible with trends towards flexibility in EU practice in recent years. *Third question* (Q.3): to what extent is it permitted or required that the legislature take account of – in short – ‘non-market’ values in selecting the *quality* of the harmonised regime to be adopted at European level? Agreeing that there shall be a common rule does not, of

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\* This paper was completed in the Autumn of 2004.

<sup>1</sup> Case C-376/98 *Germany v Parliament and Council* [2000] ECR I-8419.

itself, reveal anything about the choice of level of intensity of regulation asserted by such a common rule. This issue is the subject of in-depth treatment by Bruno de Witte in Chapter 3, but it is also relevant here as a factor that may dictate the shaping of strategies by consumers of legislation.

The constitutional issues raised at each stage of the analysis have inevitable inter-connections. Concerned interest groups seeking to secure satisfaction of their preferences are strategically well-advised to assess with care the implications of these questions. For example – and this is an inevitably compressed and superficial illustration – the proponent of a highly deregulated European market might be expected to be more receptive to a wide interpretation of the scope of the competence to harmonise (Q.1) and to a generous exercise of that competence if confident that a clean effect pre-empting national variation (Q.2) would be assured and that the chosen European regime would apply a light regulatory touch (Q.3). Thus, ‘Europeanising’ the site of regulation would be employed as a consciously deregulatory strategy. In contrast, the party that is sceptical about the political readiness or constitutional aptitude of the European regulator to take seriously perceived market failures and inequities (Q.3) might be expected to be eager to take a narrow view of the scope of the competence to harmonise (Q.1) and/or to press strongly for an interpretation of the effect of any adopted rule that maximises space for local regulatory flexibility, even if damaging to the process of economic integration (Q.2).

It bears repetition that this summary offers simply a taste, and is not at all designed to be comprehensive of possible aspirations; for example, commercial operators might prefer a rather heavy-handed rule for the European market if they are anxious to exclude potentially powerful competitors working to different standards elsewhere in the world. It is also pertinent to remember that fixing the scope of the rules of free movement has a direct impact on the role of harmonisation. The more that national barriers are, first, vulnerable to attack and, secondly, ruled unjustified under the law of free movement, the greater the scope for deregulation and inter-jurisdictional competition under the framework of ‘negative law’, and the less extensive the need for harmonisation. The Court’s choices about the scope of the EC Treaty rules governing free movement condition the development of the harmonisation programme both constitutionally (insofar as the reach of Articles 28 et al. may condition the reach of Articles 95 et al.) but also in practical terms (insofar as its rulings might focus political minds on the need for legislation to clarify a position left unappealingly imprecise by the accidents of litigation). The key point, however, is that insofar as the answers to the three identified questions remain unsettled, there are real problems for those engaged in seeking to plan a strategy at EU level that is likely to extract a legislative outcome appropriate to their needs.

The current proposed Directive on control of Unfair Commercial Practices

offers a stimulating case study.<sup>2</sup> The field of consumer protection holds particular appeal in this context because the EC Treaty offers two routes to law making, Articles 95 and 153 EC, which are marked by constitutional distinctions that tie into the three questions set out above. It is Q.2 in particular that invites examination. The Court has lately come to interpret harmonisation directives in a manner apt to distinguish their pre-emptive scope sharply from measures adopted under sector-specific legal bases elsewhere in the EC Treaty, including Article 153. This may be criticised for neglect of the historical context in which many harmonisation measures were in fact adopted, but it appears that the Court's stance has, in part, already influenced the Commission in its recent legislative proposals in the field. Under the influence of such controversial choices is the internal market shaped, and re-shaped.

## QUESTION 1: WHAT IS THE SCOPE OF HARMONISATION ENVISAGED BY THE EC TREATY?

The EC Treaty confers no competence to harmonise *per se*. As noted at the outset, the competence is more limited than that and is, in short, tied to the process of market-building. However, what exactly is at stake in determining how much harmonisation is constitutionally permitted? A sub-set of questions asks: what principles condition the exercise of a competence once it is determined that it in principle exists? This is the terrain of subsidiarity and of proportionality.

### **The Law and Practice of Harmonisation**

Article 5(1) EC asserts that the Community is competent only where so provided by its Treaty, but the competence to harmonise laws has always been part of its armoury. Where laws differ state by state, the creation of an integrated market is impeded. Some such disparities between national laws will be unlawful, as in the landmark *Cassis de Dijon* ruling<sup>3</sup> and many others subsequently. Some national laws will, nevertheless, be justifiable and remain in place as lawful trade barriers. The classic EC response is the harmonisation of such laws in order to establish a common Community rule. In this way Community laws come into existence to integrate the market, although their incidental effect is additionally to (re-)regulate it. And insofar as the national

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<sup>2</sup> COM (2003) 356 final.

<sup>3</sup> Case 120/78 *Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649.

rules subjected to the discipline of harmonisation are rules of XXX, the end product is a form of 'Europeanised' policy governing XXX. So develop academic sub-disciplines, spilling over from the functionally broad programme of harmonisation.<sup>4</sup> Treaty provisions such as Articles 6, 95(3), 152(1) and 153(2) EC confirm the legislature's need to attend to the content of the EC's common regime.

The original Treaty of Rome empowered the Community to enact legislation designed to approximate national provisions which directly affect the establishment or functioning of the common market. This was found in Article 100, which is now re-numbered as Article 94 EC. A further provision was inserted into the EC Treaty by the Single European Act in 1987 to accelerate the process of law making needed to achieve a completed internal market by the end of 1992. This was Article 100a, now amended and re-numbered as Article 95 EC. This permits the adoption of harmonisation legislation in the areas to which it refers by qualified majority voting in the Council. States may be outvoted and bound by legislation with which they disagree, although in practice this remains relatively uncommon.

Nevertheless, it must be conceded that some measures of legislative harmonisation make little visible contribution to market-making. Directive

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<sup>4</sup> For example: on private law, see H.W. Micklitz, 'Principles of social justice in European private law' (2000) 19 *Yearbook of European Law*, 167–204; and S. Grundmann, 'The structure of European contract law' (2001) vol. 9:4 *European Review of Private Law* 505–28. On consumer law, see S. Weatherill, 'Consumer policy', in P. Craig and G. de Búrca (eds), *The Evolution of EU Law* (Oxford: Oxford University Press, 1999), pp. 693–720; J. Stuyck, 'European consumer law after the Treaty of Amsterdam: Consumer policy in or beyond the internal market?' (2000) vol. 37:2 *Common Market Law Review* 367–400; G. Howells and T. Wilhelmsson, 'EC consumer law: Has it come of age?' (2003) vol. 28:3 *European Law Review* 370–88; and N. Reich and H.W. Micklitz, *Europäisches Verbraucherrecht* (Baden-Baden: Nomos, 2003). On environmental law, see J. Scott, *EC Environmental Law* (London: Longman, 1998); and J. Jans, *European Environmental Law* (Groningen: Europa Law Publishing, 2000), esp. Chapters I and III. On labour market regulation and social policy more generally, see J. Kenner, *EU Employment Law: From Rome to Amsterdam and Beyond* (Oxford: Hart Publishing, 2003); T. Hervey, *European Social Law and Policy* (London: Longman, 1998) and C. Barnard, *EC Employment Law*, 2nd edn (Oxford: Oxford University Press, 2000). On family law, see E. Caracciolo di Torella and A. Masselot, 'Under construction: EU family law' (2004) vol. 29:1 *European Law Review* 32–51. On health care law, see T. Hervey, 'Mapping the contours of European Union health care and policy' (2002) vol. 8:1 *European Public Law* 69–105 and T. Hervey and J. McHale, *Health Law and the European Union* (Cambridge: Cambridge University Press, 2004). More generally, on how a programme presented as an exercise in securing market freedom inevitably involves a sustained commitment to rule-making, see M. Egan, *Constructing a European Market* (Oxford: Oxford University Press, 2001).

85/577,<sup>5</sup> to take a notorious example, states in its Preamble that the practice of doorstep selling is the subject of different rules in different Member States, and that 'any disparity between such legislation may directly affect the functioning of the common market'. It is hard to believe this laconically stated claim. The measure's dominant concern appears to be consumer protection not market integration, and its Preamble cheerfully refers to the political importance of developing a consumer policy for the EC which is manifest in a series of soft law instruments adopted in the wake of the commitment made at the Paris Summit of 1972 to broaden the appeal of the EC. In truth the Member States, acting unanimously in the Council, had 'borrowed' the competence to harmonise in the EC Treaty in order to advance consumer protection at EC level, even though at the time this was not explicitly authorised by the Treaty.

Comparable stories can be told in the field of environmental protection. Directive 76/160,<sup>6</sup> the 'Bathing Water' Directive, was based on *what were* Articles 100 and 235 (both requiring unanimous votes in Council). The Preamble asserts that the surveillance of bathing water is necessary in order to attain the Community's objectives 'as regards the improvement of living conditions, the harmonious development of economic activities throughout the Community and continuous and balanced expansion' (a reference to *what was* Article 235); also, that national laws in the field directly affect the functioning of the market (Article 100). A contribution to environmental protection was also mentioned in the Preamble and this was really the core of the measure. The Treaty at the time afforded no competence to pursue such a policy in its own right, but unanimity in Council and a readiness to take a functionally expansive view of existing competences, including that governing harmonisation, launched the EC as an active environmental regulator. This process of 'creeping' centralisation is familiar in many systems of divided power,<sup>7</sup> and it constitutes a troubling challenge to the system's legitimacy. Where the central authorities, though lacking a constitutionally approved mandate, act in a

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<sup>5</sup> Directive 85/577 to protect the consumer in respect of contracts negotiated away from business premises, OJ 1985 L372/31.

<sup>6</sup> OJ 1976 L31/1.

<sup>7</sup> Cf. K. Nicolaidis and R. Howse (eds), *The Federal Vision: Legitimacy and Levels of Governance in the United States and the European Union* (Oxford: Oxford University Press, 2001), esp. J. Donahue and M. Pollack, 'Centralization and its discontents: The rhythms of federalism in the United States and the European Union', Chapter 3, and D. Lazer and V. Mayer-Schoenberger, 'Blueprints for change: Devolution and subsidiarity in the United States and the European Union', Chapter 4; E. Young, 'Protecting Member State autonomy in the European Union: Some cautionary tales from American federalism (2002) 77 *New York University Law Review* 1612-737; L. Catá Becker, 'Restraining power from below', *Federal Trust Paper* 15/04, July 2004, available via <http://www.fedtrust.co.uk>.

manner apt to gnaw away at local autonomy, resistance in some form is inevitable.

### Harmonisation Without End? The Backlash

More recently, this politically ambitious reading of the reach of the EC's competence has come under closer and more sceptical scrutiny. In *Tobacco Advertising*,<sup>8</sup> the Court annulled Directive 98/43<sup>9</sup> on the advertising of tobacco products on the application of Germany (which had been outvoted in the Council). The measure had been adopted as part of the harmonisation programme.<sup>10</sup> The Court was unimpressed. It insisted that harmonisation measures 'are intended to improve the conditions for the establishment and functioning of the internal market'. The Directive in question went far beyond the permitted limits. It prohibited the advertising of tobacco products in circumstances remote from the imperatives of market-making – for example, on ashtrays and parasols used on street cafés. This was, in effect, public health policy, for which the Community possesses a competence, but the relevant provision (Article 152 EC), expressly forbids harmonisation. In declaring that the Community legislature does not enjoy 'a general power to regulate the internal market'<sup>11</sup> the Court accordingly gave practical force to the constitutionally fundamental principle of attributed competence found in Article 5(1) EC.

The ruling in *Tobacco Advertising* has to be understood against the background of the evolution of competence in the EC. One of the key tensions that pervades the constitutional dimension of the EC's legislative activity since 1987 is how to reconcile the pre-Single European Act reality that some harmonisation legislation was not really about market-making at all with the post-Single European Act reality that sector-specific legal bases had been (and continued to be) created – with the awkward implication that some previous practice might need to be unravelled in order to allocate matters previously dealt with within the harmonisation programme to sector-specific legal bases that involved different rules from those pertaining to the making of measures of harmonisation. The unravelling is by no means complete. However, the

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<sup>8</sup> See n. 1 above; see also, T. Hervey, 'Community and national competence in health after *Tobacco Advertising*' (2001) vol. 38:6 *Common Market Law Review* 1421–46 and J. Usher, 'Annotation' (2001) vol. 38:6 *Common Market Law Review* 1519–43.

<sup>9</sup> OJ 1998 L213/9.

<sup>10</sup> Pursuant to Article 100a (now Article 95 EC), and also Articles 57(2) and 66 (now Articles 47(2) and 55 EC), governing the services sector.

<sup>11</sup> *Tobacco Advertising*, esp. at para. 83.

functionally broad ‘spillover’ of regulatory activity propelled by generous resort to Articles 94 and 95 (ex 100 and 100a) and Article 308 (ex 235) EC<sup>12</sup> must now be seen in a very different constitutional light.

Consumer law is the area chosen as the focus of this chapter’s investigation, but it is by no means the only candidate.<sup>13</sup> Some older measures of harmonisation are today vulnerable to challenge. The ‘Doorstep Selling’ Directive,<sup>14</sup> for example, was largely motivated by the prevailing political consensus in favour of EC consumer protection and, as already mentioned, its Preamble pays only lip-service to the perspective of market-making. The Preamble refers more revealingly to the Council Resolutions of 1975 and 1981 on a consumer protection and information policy.<sup>15</sup> The Directive was supported by unanimity in Council and the question of whether such consumer law making dressed up in the clothes of harmonisation was truly constitutionally valid was not addressed in any practically significant manner.<sup>16</sup> A new awareness that the limits of EC competence must be taken seriously pervades some more recent policy documents. The Commission’s 2001 Communication on European Contract Law initiated a debate about how best to shape a European dimension to contract law<sup>17</sup> and this was followed up by a 2003 Action Plan on a more coherent European Contract Law.<sup>18</sup> The 2001 Communication on Contract Law called explicitly for information on whether diversity between national contract laws ‘directly or indirectly obstructs the functioning of the internal market, and if so to what extent’, with a view to considering appropriate action by the EC. The 2003 Action Plan refers to having unearthed ‘implications for the internal market’ arising from legal

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<sup>12</sup> See n. 4 above.

<sup>13</sup> For a good example of *Tobacco Advertising*-inspired ‘competence anxiety’, see I. Katsirea, ‘Why the European broadcasting quota should be abolished’ (2003) vol. 28:2 *European Law Review* 190–209.

<sup>14</sup> Directive 85/577, see n. 5 above.

<sup>15</sup> OJ 1975 C92/1 and OJ 1981 C133/1.

<sup>16</sup> However, see G. Close, ‘Harmonisation of laws: Use or abuse of powers under the EEC Treaty?’ (1978) 3 *European Law Review* 461–81, for an early example of ‘competence anxiety’.

<sup>17</sup> COM (2001) 398; see D. Staudenmayer, ‘The Commission Communication on European Contract law and the future prospects’ (2002) vol. 51:3 *International and Comparative Law Quarterly* 673–88.

<sup>18</sup> COM (2003) 68; see J. Karsten and A. Sinai, ‘The Action Plan on European Contract Law: Perspectives for the future of European contract law and EC consumer law’ (2003) vol. 26:2 *Journal of Consumer Policy* 159–95; M. Kenny, ‘The 2003 Action Plan on European Contract Law: Is the Commission running wild?’ (2003) vol. 28:4 *European Law Review* 538–50; and D. Staudenmayer, ‘The Commission Action Plan on European Contract Law’ (2003) vol. 11:2 *European Review of Private Law* 113–27.



diversity. The shadow of the *Tobacco Advertising* judgment looms large, even if the Commission in these documents prefers to avoid tackling the matter head on.<sup>19</sup>

Admittedly, the precise dimensions of the shadow cast by *Tobacco Advertising* are not yet known. The Court's point is that the threshold of a required sufficient contribution to the improvement of the conditions for the establishment and functioning of the internal market must be crossed before the Treaty-conferred competence to harmonise exists, but this offers plenty of scope for detailed argument about what is really at stake.<sup>20</sup> Also, in subsequent applications of the threshold test, the Court has offered no relief to applicants seeking the annulment of measures.<sup>21</sup> Moreover, one needs only to scratch the legislative surface to reveal measures that seem questionable in the light of *Tobacco Advertising*, yet which even subsequently to that judgment have sailed through unopposed on a wind of unanimous support in Council. Some more recent harmonisation measures affecting the consumer and the investor assert in their Preambles a concern to introduce common rules not simply to cure competitive distortion affecting sellers but also to strengthen consumer and investor confidence.<sup>22</sup> This suggests a more active role for legislative harmonisation than is suggested by *Tobacco Advertising*. It remains to be seen how this more ambitious rationale rooted in the generation of consumer or investor confidence will fare if tested before the Court. The relevant questions surround the sophistication of the regulatory infrastructure that is required to make pan-European markets viable and also the aptitude of legal regulation to induce such necessary improvements in confidence.<sup>23</sup>

The main point of *Tobacco Advertising* is not that it reveals that the competence to harmonise is not open-ended (we knew this) but rather that this point

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<sup>19</sup> S. Weatherill, 'European contract law: Taking the heat out of questions of competence' (2004) vol. 15:1 *European Business Law Review* 23–32.

<sup>20</sup> Note the use of revealingly imprecise adjectives and adverbs in the judgment such as 'genuinely', 'likely', 'probable', 'appreciable' and 'remote and indirect' in paras 84, 86, 97, 108 and 109 of the judgment respectively.

<sup>21</sup> See Case C-377/98 *Netherlands v Parliament and Council* [2001] ECR I-7079 and Case C-491/01 *R. v Secretary of State ex parte British American Tobacco (Investments) and Imperial Tobacco* [2002] ECR I-11543.

<sup>22</sup> See, for example, N. Moloney, 'New frontiers in EC capital markets law: From market construction to market regulation' (2003) vol. 40:4 *Common Market Law Review* 809–44 and G. Ferrarini, 'The European Market Abuse Directive' (2004) vol. 41:3 *Common Market Law Review* 711–41.

<sup>23</sup> Contrast S. Weatherill, 'The Commission's options for developing EC consumer protection and contract law: Assessing the constitutional basis' (2002) vol. 13:6 *European Business Law Review* 497–515 with T. Wilhelmsson, 'The abuse of the "confident consumer" as a justification for EC consumer law' (2004) vol. 27:3 *Journal of Consumer Policy* 317–37.

of constitutional principle has practical significance and that the EC Treaty limits will be policed by the Court (if the eccentric patterns of litigation give it a chance). So, although the legal base governing harmonisation is functionally broad, it is not limitless and it may be exposed as inadequate to support proposed or adopted legislation; and the sector-specific legal bases elsewhere in the EC Treaty are themselves marked by relatively carefully defined textual limits placed on the grant of competence to the Community. Article 153(3)(b) EC is available to support consumer protection that cannot be tied to market-making, but the textual limits of Article 153 EC must be respected and, in particular, it would not be sturdy enough to support harmonisation. This brings into sharp focus the constitutional differences between harmonisation as a legal base and other sector-specific legal bases, against a historical background that reveals a long-term lack of scrupulous attention to such demarcation. The implications of changing practice also require consideration in connection with the pre-emptive effect of EC rules, considered as Q.2 below. And yet – a matter of even greater concern – crucial though these questions are in the shaping of the internal market, they are not currently susceptible to straightforward answers. *Tobacco Advertising* is a landmark, but even with its help we cannot easily answer the question ‘what are the pre-conditions for reliance on the competence to harmonise laws granted by the Treaty?’

### **Subsidiarity and Proportionality**

The main concern of this part of the chapter is the scope of the competence to act, but it should be added for the sake of completeness that a competence that exists need not be exercised. In *BAT and Imperial Tobacco*, the challenged Directive was found to fall within the permitted (post-*Tobacco Advertising*) scope of Article 95 EC, and therefore it complied with Article 5(1) EC. It was accordingly, in principle, susceptible to review for compliance with the principle of subsidiarity in Article 5(2), provided it fell in an area that is *not* within the exclusive competence of the Community. The EC Treaty fails to identify such areas but the Court, choosing not to follow the view expressed 2 years earlier by Advocate-General Fennelly in *Tobacco Advertising*, concluded that harmonisation pursuant to Article 95 EC does not entail an ‘exclusive competence to regulate economic activity on the internal market, but only a certain competence for the purpose of improving the conditions for its establishment and functioning’.<sup>24</sup> Thus, subsidiarity applies. The Court then adopted an approach which makes it hard to imagine circumstances in which a harmonisation measure will fall foul of the demands of subsidiarity. The Directive’s

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<sup>24</sup> *BAT and Imperial Tobacco*, para. 179.

objective is to eliminate the barriers raised by the differences between state laws. This objective cannot be sufficiently achieved by the Member States individually – indeed it is the variety of approaches taken that causes the problem! The Court concluded that the matter therefore called for action at Community level. It appears that the Court has neatly sustained subsidiarity as a legal principle on paper, while conceding much in practice to legislative discretion. Once it is determined that a competence to establish common rules exists, the political decision to exercise that competence seems *in practice* immune from judicial subversion.<sup>25</sup>

The proportionality principle is applied with a touch less deference but the Court still insists on allowing a broad discretion to the decision-maker, in particular where complex social and economic choices are at stake.<sup>26</sup> The Court's concern to avoid intrusion on the perceived proper domain of political judgment is evident – and, as a general observation, it is thematically consistent with the practice of judicial review of legislative and administrative acts within the Member States.

## QUESTION 2: WHAT IS THE IMPACT OF LEGISLATIVE HARMONISATION ON THE SCOPE OF RESIDUAL NATIONAL COMPETENCE?

One might suppose that the pursuit of a level (commercial) playing field would dictate that the adoption of harmonised EC rules displace local regulatory autonomy in the relevant field. However, such a firm stance in favour of an upwards transfer of regulatory competence may be vulnerable to criticism on several grounds. It may be damaging to the encouragement of regulatory experimentation and thereby lead to the ossification of standards at EU level. It may be insensitive to special local concerns. More generally, it may be incompatible with the trends towards flexibility in EU practice evident in recent years, which found expression in the Convention on the Future of Europe's depiction of a Europe 'united in its diversity' in the Preamble to its draft Constitution of July 2003, subsequently endorsed as the EU motto in

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<sup>25</sup> There are echoes of the Court's earlier ruling in Case C-84/94 *United Kingdom v Council* [1996] ECR I-5755, albeit that that ruling did not squarely address subsidiarity; see subsequently, in the same vein, Case C-103/01 *Commission v Germany* [2003] ECR I-5369, esp. para. 47.

<sup>26</sup> See, for example, *BAT and Imperial Tobacco*, paras 122–41; *Commission v Germany*, para. 48; Case C-15/00 *Commission v European Investment Bank* [2003] ECR I-7281, paras 161–62. See more generally, T. Tridimas, *The General Principles of EC Law* (Oxford: Oxford University Press, 1999), Chapter 3.

Article I-8 of the August 2004 text of the draft Treaty establishing a Constitution for Europe.<sup>27</sup>

### The Scope of Pre-emption

This issue is another that is evidently constitutionally weighty yet surprisingly bereft of clear rules. As a general observation, which need not be confined to the harmonisation programme, the Treaty is singularly unhelpful in defining the nature of an EC competence relative to national competence.<sup>28</sup> A particularly striking example of the prevailing elusiveness is offered by Article 5(2) EC's reference to exclusive competence. The Treaty neither defines this phenomenon nor identifies areas in which it operates. It is to the Court's case-law that one must turn to understand what is at stake and the relevant decisions, inevitably piecemeal, offer no comprehensive account of the precise material scope of exclusive competence.<sup>29</sup>

The current system also includes other types of competence conferred on the EC by its Treaty that are less brutal in their exclusion of State action than exclusivity. The Community acquired competence to act in the field of public health under the Maastricht Treaty, but although it may adopt incentive measures, harmonisation of laws is explicitly excluded by (what is now) Article 152(4) EC. This proviso lies, of course, in the background to the legislature's preference to use Article 95 EC as a base for the public health-inspired Tobacco Advertising Directive which the Court famously annulled. The same limitation is true of cultural policy under Article 151(5) EC. Moreover, both provisions (along with Article 153 EC – governing consumer protection) emphasise the Community's role in *supporting* and *supplementing* Member State action. Articles 137, 153 and 176 EC, governing competence to legislate in the fields of environmental protection, social policy and consumer protection respectively, stipulate that

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<sup>27</sup> OJ 2003 C169/1.

<sup>28</sup> See A. Von Bogdandy and J. Bast, 'The European Union's vertical order of competences: The current law and proposals for its reform' (2002) vol. 39:2 *Common Market Law Review* 227–68, esp. pp. 239–50; G. de Búrca and B. de Witte, 'The delimitation of powers between the EU and its Member States', in A. Arnulf and D. Wincott (eds), *Accountability and Legitimacy in the European Union* (Oxford: Oxford University Press, 2002), pp. 201–22; F. Mayer, 'Die Drei Dimensionen der Europäischen Kompetenzdebatte' WHI-Paper 2/02 (Walter Hallstein Institut, available via <http://www.whi-berlin.de>); V. Michel, 'Le défi de la répartition des compétences' (2003) vol. 38:1–2 *Cahiers de Droit Européen* 17–86; and D. Hanf and T. Baumé, 'Vers une clarification de la répartition des compétences entre l'Union et ses Etats Membres?' (2003) vol. 38:1–2 *Cahiers de Droit Européen* 135–56.

<sup>29</sup> See K. Lenaerts and P. Van Nuffel, *Constitutional Law of the European Union* (London: Sweet and Maxwell, 1999), paras 4-036 to 4-041.

national measures that are stricter than the agreed Community standard are permitted. This insistence on common rules of a *minimum* nature indicates that integration and uniformity are inapt as paramount guiding values in realms remote from the orthodox core of the market-building imperative and that space should be preserved for diverse local preference and for regulatory experimentation, albeit that this is disciplined by the stipulation in Articles 137, 153 and 176 EC that stricter national measures shall be compatible with the Treaty<sup>30</sup> and, in the latter two instances, that the Commission be notified of such stricter measures. In an increasingly wide range of areas, the Community typically does not occupy the field entirely, to the exclusion of Member State choice, but rather both rule-makers remain active in the field and, one may hope, can learn from each other.<sup>31</sup> More broadly still, there are close associations between scepticism about the value or even the sheer feasibility of securing uniformity in the wider sweep of Community activity and the developing ‘flexibility debate’ within which authority in the wider framework of the Union is increasingly layered.<sup>32</sup>

However, what of Article 95 EC? It has its own special procedure for managing state preference to depart the agreed rule in its paragraphs (4) to (9).<sup>33</sup> This procedure’s existence is one feature that distinguishes Article 95 from the dormant Article 94.<sup>34</sup> Indeed, its inclusion was evidently a key

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<sup>30</sup> The most obvious implication is that they must not fall foul of the provisions on free movement. One may suppose that the more sophisticated/protective the Community regime, the tougher the job of a state in showing that its stricter rules are justified.

<sup>31</sup> For example, the Commission reports that a four-year concession made on accession allowing Austria, Finland and Sweden to apply stricter environmental and health standards generated a review that led to the adoption of higher EU-wide standards in a number of relevant areas (see COM (98) 745). Research into whether this claim is well-founded would be worthwhile.

<sup>32</sup> For collections revealing the breadth of this dimension of EU practice (also with copious bibliographic references), see G. De Búrca and J. Scott (eds), *Constitutional Change in the EU: From Uniformity to Flexibility?* (Oxford: Hart Publishing, 2000); and B. de Witte, D. Hanf and E. Vos (eds), *The Many Faces of Differentiation in EU Law* (Antwerp: Intersentia, 2001). Use of ever more novel instruments, reflecting these tensions, persists – i.e. D. Hodson and I. Maher, ‘The open method as a new mode of governance’ (2001) vol. 39:4 *Journal of Common Market Studies* 719–46; J. Nergelius, ‘De-legalize it – On current tendencies in EC constitutional law’ (2002) 21 *Yearbook of European Law* 443–70; see also the contribution to this volume by Erika Szyszczak (Chapter 4).

<sup>33</sup> See N. De Sadeleer, ‘Procedures for derogations from the principle of approximation of laws under Article 95 EC’ (2003) vol. 40:4 *Common Market Law Review* 889–915.

<sup>34</sup> A point made by the Court in Case C-183/00 *González Sánchez v Medicina Asturiana SA* [2002] ECR I-3901, examined below.

feature of the bargain struck at a very late stage in the Single European Act negotiations that persuaded the Member States to surrender their veto of harmonisation legislation.<sup>35</sup> The granting of such an authorisation to apply stricter rules would upset the pursuit of an integrated market and, according to the Court, it is therefore to be treated as exceptional.<sup>36</sup> It has proved to be relatively infrequently invoked and its use even less frequently authorised, although the procedure is no dead letter.<sup>37</sup>

A simple question asks: beyond the limited sphere of variation conceded by Articles 95(4)–(9) EC and subjected thereunder to Commission management, are measures adopted under Articles 94 and 95 EC at all receptive to state preference to set stricter rules than the agreed norm? However, there is no simple answer.

One answer could be that there is no scope for States to set rules stricter than the harmonised norm, other than via Articles 95(4)–(9) EC. This would maximise the capacity of harmonisation measures to level the playing field by ruling out the possibility of national variation. It would also sharpen the distinction between the effect on national competence of legislative action undertaken pursuant to Article 95 EC and legislative action which belongs under the sector-specific legal bases mentioned above which include explicit concessions to a degree of State autonomy even after the Community has acted. However, plausible though this may seem, this is an answer on which the Treaty does not insist and it is not one that the Court has authoritatively chosen.

An alternative answer could be that there is scope for Member States to set rules stricter than the harmonised norm, provided that this is permitted by the particular measure of harmonisation in question. On this view, the matter has not been settled by the Treaty and is therefore, in effect, delegated to the legislature which, after considering a particular sector, may prefer to set a harmonised rule that is pitched at only a minimum level. This would make only a limited contribution to market-making. Also, in the matter of effect on State competence, it would tend to blur the divide between harmonisation and the above-mentioned sector-specific legal bases. Moreover, one may readily anticipate that the legislature would frequently fail to make plain its precise intent, with the consequence that awkward questions of interpretation would

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<sup>35</sup> See C.D. Ehlermann, 'The internal market following the Single European Act' (1987) 24 *Common Market Law Review* 361–404.

<sup>36</sup> See Case C-41/93 *France v Commission* [1994] ECR I-1829; and Case C-319/97 *Criminal Proceedings against Antoine Kortas* [1999] ECR I-3143 (the problem that arose in *Kortas* was removed by the amendments made by the Amsterdam Treaty).

<sup>37</sup> See, for example, Case C-3/00 *Denmark v Commission* [2003] ECR I-2643 (Commission refusal of authorisation annulled by the Court).

proliferate. On the other hand, such an approach would allow space for local concerns to be reflected in rules that go beyond what is deemed appropriate for the EU-wide market. Plausible though this answer may also seem, it too is one on which the Treaty does not insist. Nor has the Court authoritatively upheld the ability of the legislature to adopt this type of ‘minimum harmonisation’.

The main point of this chapter is to draw attention to rather fundamental constitutional questions that remain unsettled in the shaping of the internal market; and to add that this may make it perilous to settle on a legislative bargain at EC level for which the supposed ground-rules may prove to be unstable. The two paragraphs above make this case without the need for any further analysis. The discussion of case-law and legislative practice is plainly worthwhile in order to reveal where the current points of tension lie – in particular in seeking to elucidate how much space, if any, is left for the phenomenon of minimum harmonisation.<sup>38</sup> The impression is that the Court has lately become disinclined to allow Member States to set rules stricter than a measure of harmonisation insofar as that will cause an impediment to cross-border trade, although it has not asserted this unambiguously as a constitutionally durable principle.

### Harmonisation and Market-making

The easiest case first. Competence to regulate in the field occupied by a harmonising directive other than under the terms stipulated by the directive is commonly treated as entirely excluded or ‘pre-empted’ in pursuit of the creation of conditions akin to an internal market. The Court has been prepared to interpret the absence of any clause in the measure permitting States to set stricter rules to mean that they should not be so permitted. For example, in *Commission v United Kingdom* (the ‘Dim-Dip’ case),<sup>39</sup> the United Kingdom required that all new vehicles carry dim-dip lights, a specification that was not listed in Directive 76/756.<sup>40</sup> This excluded cars made in other Member States not equipped with such lights. Directive 76/756 was held exhaustive as regards the lighting devices which might be made compulsory for motor vehicles. The UK could not regulate the matter, given the comprehensive coverage of the

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<sup>38</sup> See M. Dougan, ‘Minimum harmonisation and the internal market’ (2000) vol. 37:4 *Common Market Law Review* 853–85; P. Rott, ‘Minimum harmonisation for the completion of the internal market? The example of consumer sales law’ (2003) vol. 40:5 *Common Market Law Review* 1107–36; B. Kurcz, ‘Harmonisation by means of directives – Never-ending story?’ (2001) vol. 12:11–12 *European Business Law Review* 287–307.

<sup>39</sup> Case 60/86, [1988] ECR 3921.

<sup>40</sup> OJ 1976 L262/1.

Directive. The Court, faced with submissions by the UK that the dim-dip mechanism improved road safety, refused even to consider the merits of the claim. The adoption of EC legislation had put an end to the competence of the host State unilaterally to invoke such concerns and its only route to regulatory reform would be to persuade its partners of the need to amend the Community rules themselves.<sup>41</sup> In this way the perceived need to establish Community-wide ground-rules is reflected in a mandatory regime that all States are required to implement. Products are then free to circulate throughout the entire territory of the EC and cannot be subjected to further requirements imposed by a host-State concerning their composition unless, exceptionally, the EC measure explicitly permits this.<sup>42</sup>

This clear, straightforward transfer of power from national to Community level is vital to the building of a cross-border market. Pre-emption of national competence secures a basis for commercial confidence in the legal rules of the internal market game. This approach is not confined to measures harmonising rules concerning product composition. A similar approach motivated the Court in *Pippig Augenoptik v Hartlauer* to refuse to allow scope for national suppression of comparative advertising that met the requirements of Directive 97/55.<sup>43</sup> Hartlauer had advertised its spectacles on the basis of their relatively inexpensive prices when compared with Pippig's goods. Pippig sought to suppress the comparative advertising as misleading. The point of current relevance was whether stricter national provisions on protection against misleading advertising could be applied to suppress comparative advertising of the type envisaged and allowed by the Directives – that is, treated as not misleading for EC purposes. The Court began its analysis by observing that the objective of Directive 84/450<sup>44</sup> as amended is 'the establishment of conditions in which comparative advertising must be regarded as lawful in the context of the internal market'. Article 7(1) of Directive 84/450 allows Member States to apply stricter national provisions in that area, to ensure greater protection of

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<sup>41</sup> See similarly, for example, Case 148/78 *Criminal Proceedings against Ratti* [1979] ECR 1629; Case 190/87 *Oberkreisdirektor des Kreises Borken and others v Moormann* [1988] ECR 4689; Case 150/88 *Parfümerie-Fabrik v Provide* [1989] ECR 3891; Case C-83/92 *Pierrel SpA and others v Ministero della Sanità* [1993] ECR I-6419, and Case C-101/01 *Criminal Proceedings against Lindqvist* [2003] ECR I-12971.

<sup>42</sup> In fact, de Búrca has uncovered a surprisingly high number of specific exemptions allowed to individual or small groups of States under harmonisation directives: see, 'Differentiation within the core: the case of the common market', in de Búrca and Scott (eds), *op. cit.*, n. 32 above, pp. 133–72.

<sup>43</sup> Case C-44/01, [2003] ECR I-3095; Directive 97/55, OJ 1997 L290/18 (as amended).

<sup>44</sup> OJ 1984 L250/17.



consumers in particular, but Article 7(2) expressly provides that Article 7(1) does not apply to comparative advertising so far as the comparison is concerned. The aim of Directive 97/55 is ‘to establish conditions under which comparative advertising is to be permitted throughout the Community’. For the Court:

[i]t follows that Directive 84/450 carried out an exhaustive harmonisation of the conditions under which comparative advertising in Member States might be lawful. Such a harmonisation implies by its nature that the lawfulness of comparative advertising throughout the Community is to be assessed solely in the light of the criteria laid down by the Community legislature. Therefore, stricter national provisions on protection against misleading advertising cannot be applied to comparative advertising as regards the form and content of the comparison.<sup>45</sup>

The Court proceeded to provide interpretative advice on the circumstances in which comparative advertising might be considered to be impermissible under the Directives, referring to a test of whether the presumed expectations of the average consumer would be upset.

### **Harmonisation and Consumer Protection**

However, there are individual directives formally adopted as measures of harmonisation designed to advance the building of an integrated market which contain a minimum clause. This is common in the batch of measures harmonising the legal protection of the economic interests of consumers – although, as *Hartlauer* reveals, it is not universal among such measures. For example, the Directive on Unfair Terms in Consumer Contracts<sup>46</sup> is minimum in character and therefore does not preclude the application of stricter control of unfair terms under national law. Directive 85/577 governing ‘Doorstep Selling’ provides another example.<sup>47</sup> In *Buet v Ministère Public*,<sup>48</sup> a French decision to ban doorstep selling of certain materials was not treated as preempted by the existence of the Directive which governs exactly that marketing practice and which requires only that the consumer be given a seven-day cooling off period after concluding such a contract. The Court took the view that because the Directive, though adopted under what was then Article 100 (and is now Article 94 EC), provides explicitly in Article 8 that the Directive ‘shall not prevent Member States from adopting or maintaining more favourable provisions to protect consumers in the field which it covers’,

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<sup>45</sup> *Hartlauer*, para. 44.

<sup>46</sup> Directive 93/13, OJ 1993 L95/29.

<sup>47</sup> See n. 5 above.

<sup>48</sup> Case 382/87, [1989] ECR 1235.

stricter rules were allowed even where they obstructed imported goods, provided only that they were justified (which the Court thought they could be, given their function of protecting vulnerable consumers).

One might ask how market-building under Article 100 could rationally permit such fragmentation. The correct answer *at the political level* would be that Directive 85/577 in fact had little to do with market-building and was instead, and as explained above, an instance of the Council borrowing the Treaty-conferred competence to harmonise laws in order to express its unanimous political preference for the development of a legislative programme of consumer protection at a time when the Treaty conferred no relevant competence in that field. The inclusion of a ‘minimum’ clause was part of the political deal. However, read *formally*, it seemed that Directive 85/577 demonstrated that even harmonisation under the core internal market provisions of Articles 94 and 95 EC may incorporate scope for persisting market division, insofar as residual competence vested in a host State could be exercised in a manner that would restrict trade yet remain lawful according to the *Cassis de Dijon* formula. This practice seems to acknowledge the viability of a model of ‘minimum harmonisation’. A ‘pure’ model of an integrated market is sacrificed to the possibility of local preference to set stricter rules of market regulation even where they may impede cross-border trade. Harmonisation, albeit of a minimum nature, goes part of the way to levelling the commercial playing field, while also respecting a limited space for the expression of local regulatory autonomy, provided it is justified under the Community’s rules governing free movement.<sup>49</sup>

### The Challenge of Recent Case-law

Our understanding of the law on this point appears now to be radically changed – or at least challenged – by the Court’s ruling in *Tobacco Advertising*. As explained, this decision poses general questions about the nature and purpose of the harmonisation programme. It reveals the readiness of the Court to quarrel with the views of the majority in Council on the reach of the EC Treaty by insisting that a tighter connection between ‘re-regulation’ and the building of an internal market must be demonstrated than has been (occasional) past legislative practice. However, the decision also has a detailed impact on the separation of legal bases in the Treaty with reference to the pre-emptive effect of secondary legislation adopted under them.

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<sup>49</sup> See J. Stuyck, ‘Patterns of justice in the European constitutional charter: Minimum harmonisation in the field of consumer law’, in L. Krämer, H. Micklitz and K. Tonner (eds), *Law and Diffuse Interests in the European Legal Order* (Baden-Baden: Nomos, 1997) pp. 279–89.

One may imagine two forms of minimum harmonisation, differing according to whether market access is allowed to out-of-State goods conforming to the minimum Community rule but not the host State's chosen stricter rule. If such market access is allowed, the value of the regime of minimum harmonisation to the regulating State is plainly diminished, for its goals may be undermined by non-conforming imports which cannot be excluded. However, if market access is denied under such a minimum model, integration is damaged. This is, in the first instance, a preference for prioritising home-State control and, in the latter, a preference for prioritising host-State control. Or, put another way, the former accelerates a type of inter-State regulatory competition that increases the probability that the minimum rule will, in practice, become also a maximum rule, while a 'race to the top' seems dependent on the latter model, that is, on the *absence* of a market access presumption in favour of goods from a low-regulating State targeted at a high-regulating State. Denying market access is necessary to ensure that the low-regulator has an incentive to emulate the high-regulator.<sup>50</sup> The assumption underpinning *Buet* seems to be that harmonisation legislation may employ the latter model, that is, that stricter rules above the minimum may be applied to imports as well as to domestic goods, provided they are justified under Article 28's *Cassis de Dijon* formula. However, *Tobacco Advertising* appears to insist that a harmonisation measure must ensure access to the market of conforming imported goods, and confines the application of stricter rules to domestic goods alone. The Court criticised Directive 98/43 on the advertising of tobacco products because it 'contains no provision ensuring the free movement of products which conform to its provisions, in contrast to other directives allowing Member States to adopt stricter measures for the protection of a general interest'.<sup>51</sup> This, among other unfavourable findings, deprived the Directive of a valid basis under Articles 57(2), 66 and 100a (now Articles 47(2), 55 and 95 EC).

So, it seems, only one limited type of minimum harmonisation is permitted via Article 95 EC: that which favours home-State control, albeit that the home State must apply (as a minimum) the agreed Community rules. This, one

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<sup>50</sup> On the state of EC law from this perspective, see S. Weatherill, 'Pre-emption, harmonisation and the distribution of competence to regulate the internal market', pp. 41–74, and C. Barnard and S. Deakin, 'Market access and regulatory competition', pp. 197–224, both in C. Barnard and J. Scott (eds), *The Law of the Single European Market* (Oxford: Hart Publishing, 2002). Also, more generally, D. Esty and D. Geradin, *Regulatory Competition and Economic Integration* (Oxford: Oxford University Press, 2001); and S. Princen, *EU Regulation and Transatlantic Trade* (The Hague: Kluwer, 2002).

<sup>51</sup> *Tobacco Advertising*, para. 104.

would suppose, will frequently make it unappealing for the host State even to bother to take the trouble to set standards above the minimum, for it will thereby be imposing costs on its own traders which it cannot extend to importers. In the subsequent ruling in *BAT and Imperial Tobacco*, a plank in the Court's reasoning approving the validity of that measure of harmonisation was the *presence* of a market access clause.<sup>52</sup> Over a decade ago, in *ex parte Gallaher*,<sup>53</sup> the Court interpreted Directive 89/622, a measure adopted as harmonisation,<sup>54</sup> to mean that a State could apply stricter rules governing warnings on tobacco products provided they were confined to domestic products. Imports satisfying the Community standard could not be denied access to the market.<sup>55</sup> However, the more recent decisions suggest a principle of broader application. The implication is that it is a condition of the validity of a measure of harmonisation that it excludes the possibility of States making stricter demands of imports than are envisaged by the EC act itself. 'Minimum harmonisation' is a misnomer insofar as it is intended to refer to a standard which Member States must introduce but may surpass even if to do so is to create obstacles to cross-border trade. A State must resort to the relatively narrow authorisation procedure in Article 95(4) et seq. to secure a valid basis for such an impediment to trade. This unquestionably strengthens the capacity of legislative harmonisation to integrate markets. Perhaps that is the intent of Article 95. The Court has thereby set up a much cleaner model of demarcation between Article 95 (pre-emption) and Articles 153, 176 et al. (minimum rules). However, it is hard to reconcile this with past practice, both legislative and judicial. Also, more generally, it is antagonistic to the preservation of local regulatory autonomy and space for experimentation.

The impression that the Court has embarked on a newly vigorous campaign to interpret the legal provisions governing harmonisation in a fashion devoted to market integration and potentially harmful to local regulatory diversity also emerges from *González Sánchez*, which concerns Directive 85/374, the Product Liability Directive.<sup>56</sup> Directive 85/374 covers liability for defective products; its legal base is Article 100, now Article 94 EC. So, as the Court pointed out, the minimum clause now found in Article 153(5) EC was of no

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<sup>52</sup> *BAT and Imperial Tobacco*, paras 74–75.

<sup>53</sup> Case C-11/92 *R. v Secretary of State for Health ex parte Gallaher Ltd* [1993] ECR I-3545.

<sup>54</sup> Now repealed and replaced by Directive 2001/37, the measure that survived the challenge in *BAT and Imperial Tobacco*.

<sup>55</sup> For a similar approach to *export* restrictions, see Case C-1/96 *R. v Minister of Agriculture, Fisheries and Food ex parte Compassion in World Farming* [1998] ECR I-1251.

<sup>56</sup> OJ 1985 L210/29.

relevance. Article 13 of the Directive provides that the Directive shall not affect any rights which an injured person may have according to the rules of the law of contractual or non-contractual liability or a special liability system existing at the moment when the Directive is notified. Ms González Sánchez sued Medicina Asturiana for compensation for injury allegedly caused on their premises in the course of a blood transfusion. She claimed to have been infected by the Hepatitis C virus. The Spanish court concluded that the rights afforded to consumers under pre-existing Spanish law were more extensive than those available under the rules introduced to transpose Directive 85/374 into domestic law. The European Court was asked for a preliminary ruling on the question whether Article 13 of the Directive should be interpreted as precluding the restriction or limitation, as a result of transposition of the Directive, of rights granted to consumers under the legislation of the Member State.

The Court identified the purpose of the Directive in establishing a harmonised system of product liability as ‘to ensure undistorted competition between traders, to facilitate the free movement of goods and to avoid differences in levels of consumer protection’.<sup>57</sup> Within its field of application, harmonisation is complete.<sup>58</sup> Article 13 could not be interpreted as giving the Member States the possibility of maintaining a general system of product liability different from that provided for in the Directive.

If one were searching for instances in which scope for improved consumer protection had been subordinated to the desire to establish an integrated economic space in Europe, this judgment would be pure gold. It is surprisingly rigid.<sup>59</sup> It is hostile to local diversity and to scope for upgrading consumer protection. Thematically it is connected to *Tobacco Advertising* as part of a trend of making more clear-cut the differences in pre-emptive effect between Articles 94 and 95 EC on the one hand, and other more recently introduced provisions of the Treaty such as Article 153 that are not tied explicitly to the internal market programme and which are more generous to the preservation of State regulatory autonomy. One might see these judgments as the Court’s

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<sup>57</sup> *González Sánchez*, para. 26.

<sup>58</sup> The same identification of a ‘complete’ system of harmonisation emerges from the Court’s two other rulings of the same day dealing with Directive 85/374: Case C-52/00 *Commission v France* [2002] ECR I-3827 and Case C-154/00 *Commission v Greece* [2002] ECR I-3879.

<sup>59</sup> It provoked a rather alarmed Council Resolution of 19 December 2002 on amendment of the liability for defective products Directive, OJ 2003 C26/02, considering ‘that against this background there is a need to assess whether Directive 85/374/EEC, as amended by Directive 1999/34/EC, should be modified in such a way as to allow for national rules on liability of suppliers based on the same ground as the liability system in the Directive concerning liability of producers’. Perhaps the Council should have attended to this earlier.

response to the rising appeal of differentiation as a guiding principle in EU practice: and it is a negative, even intolerant, response, which is rooted deeply in the assumption that a common market needs common rules. The Court may be taken to be anxious to insulate the internal market from the ‘corrupting’ influence of initiatives that will upset the ‘level playing field’ required for the purposes of fostering an efficiently functioning pan-European border-free market, but the accusation that market integration may damage local preference and regulatory protection thereby gains ground.

### **Which Interests Should Prevail?**

In the wake of *Tobacco Advertising*, the annulled measure was replaced by a more tightly drawn Directive – which duly includes an explicit free movement/market access clause.<sup>60</sup> The case of unfair commercial practices, revealing the same preference, is considered below. Legislative practice begins to suggest an assumption that the Court answered the ‘simple question’ posed above to the effect that there is no scope for States to set rules stricter than the harmonised norm, other than via Articles 95(4)–(9) EC. This would mean that it is no longer permissible to adopt a harmonising directive with an explicit minimum clause which permits stricter rules to be applied even against imports that comply with the standard set by the Community measure. It is at least arguable that under the Court’s current interpretative stance, insofar as any legislative concession to States to set stricter rules than a harmonised standard serves to impede cross-border trade or to cause competitive distortion, the validity of reliance on Article 94 or 95 EC is called into question because the contribution to market-making is insufficient. A legal base would have to be sought elsewhere – under a sector-specific legal base which explicitly envisages that the EC rules are of a minimum nature, while also taking seriously the more refined textual limits on EC action imposed by such provisions in contrast with the functionally broad competence to harmonise laws. As suggested, this may appeal as a means of clearly separating Articles 94 and 95 – no minimum rules, excepting only via the managed procedure provided by Article 95(4) et seq. – and provisions such as Articles 153 and 176 which clearly allow for minimum rules. However, the problem is that this applies a reading of the current Treaty, which is relatively rich in legal bases, to some older legislative measures of consumer policy adopted at a time when the constitutional context was very different. Legislative harmonisation never was always predominantly about market-making. Especially before the Single European Act, it was frequently predominantly about consumer protection and

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<sup>60</sup> Directive 2003/33, OJ 2003 L152/16, Article 8.

environmental protection, and the political assumption was that the Member States would have room to set stricter rules. However, if the Court is now truly intent on undermining the very notion of ‘minimum harmonisation’, the scope envisaged by the EC legislature for local regulatory autonomy at the time of the bargaining that led to the adoption of the older measures will be stripped away.

It seems impossible to be confident about the Court’s position until this case-law develops further.<sup>61</sup> It is submitted that there is scope to rule that ‘minimum harmonisation’ is allowed under Article 95 even though it is imperfect as a means of immediately bringing about an integrated market in the relevant sector. The introduction of minimum rules brings the position closer to that which would prevail in a single market than that which obtained previously. Harmonisation would on this model be conceived as a process of moving towards a single market, possibly involving two or more stages – though, of course, there would have to be shown an adequate connection with market-making so that the measure does not fall under suspicion as a circumvention of the restricted competence to act in particular sectors allowed elsewhere in the Treaty, as in *Tobacco Advertising*. This has some resonance within existing case-law approving a step-by-step approach to harmonisation, albeit that it is typically there assumed that variation will ultimately be eliminated,<sup>62</sup> whereas a true minimum clause carries no such assumption.

The core problem with this more permissive analysis is that it seems incompatible with the assumptions made about the purpose of harmonisation found in recent case-law. *Tobacco Advertising* and *González Sánchez* seem to confine minimum rules at most to the setting of rules that are stricter than the Community norm but which do not impede cross-border trade. In this vein the apparently contradictory ruling in *Buet* could be explained as a pre-*Keck*<sup>63</sup> decision that would today be disposed of on the basis that the French rules in question did not even constitute trade barriers within the meaning of Article 28, with the result that France could apply them despite the existence of the Directive. That might, as a side-wind, raise a question whether the Directive, as an exercise in harmonising national measures that are not trade barriers, is

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<sup>61</sup> See Howells and Wilhelmsson, *op. cit.*, n. 4 above; and M. Dougan, ‘*Vive la différence?*: Exploring the legal framework for reflexive harmonisation within the single European market’ (2002) 1 *Annual of German and European Law* 113–65.

<sup>62</sup> See, for example, Case 37/83 *Rewe Zentrale AG v Direktor der Landwirtschaftskammer Rheinland* [1984] ECR I-1229; Case C-63/89 *Les Assurances du Crédit SA and Compagnie Belge d’Assurance Crédit SA v Council and Commission* [1991] ECR I-1799; and Case C-193/94 *Criminal Proceedings against Skanavi and Chrysanthakopoulos* [1996] ECR I-929. See also, Case C-377/98 (n. 21 above).

<sup>63</sup> Joined Cases 267 and 268/91 *Criminal Proceedings against Keck and Mithouard* [1993] ECR I-6097.

even constitutionally valid,<sup>64</sup> but for present purposes this reasoning would serve to reconcile *Buet's* apparent embrace of the model of minimum harmonisation with its stern rejection in *Tobacco Advertising*. On such a reading, minimum rule-making would not be allowed insofar as it authorised scope for persisting obstacles to cross-border trade confronted by goods complying with the EC standard.

True, there were other reasons in *Tobacco Advertising* for annulling the Directive, so it might be a mistake to read too much into the part of the judgment that dealt with the absence of a market access clause in favour of complying goods. In *González Sánchez*, there was no minimum clause and in fact the Court there took the opportunity to include in its reasoning the observation that 'unlike, for example, Council Directive 93/13 . . . on unfair terms in consumer contracts . . . the Directive contains no provision expressly authorising the Member States to adopt or to maintain more stringent provisions in matters in respect of which it makes provision, in order to secure a higher level of consumer protection'.<sup>65</sup> In *DocMorris*<sup>66</sup> and *Karner*,<sup>67</sup> the Court seemed to revert to the assumption already found in *Buet* that states may be able to justify rules above the harmonised norm provided the directive expressly authorises this possibility, although it did not mention *Tobacco Advertising* at all. However, to repeat, there is no recent case in which the validity of a minimum clause of the type found in most of the directives dealing with the harmonisation of laws protecting the economic interests of consumers has been directly addressed by the Court. So the status of 'minimum harmonisation' is not settled.

And that is, in a nutshell, the core argument made in this chapter: that key questions surrounding the shaping of the internal market remain open. This, in turn, means that interest groups seeking to secure the adoption of EC rules must be wary. If, for example, an EC measure is to be treated as having eliminated national competence to act in the relevant field, then a constituency concerned to strengthen regulatory protection must direct its efforts to EC level and cannot assume that access to national law-making procedures will suffice to secure an adequately protective regime. The answer to Q.2, therefore, connects intimately with concern to address Q.3.

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<sup>64</sup> In short, does Article 28 EC drive Article 95? Are *Keck* and *Tobacco Advertising* two sides of the same coin? The matter is unsettled: see the literature cited at nn. 22 and 23 above.

<sup>65</sup> *González Sánchez*, para. 27.

<sup>66</sup> Case C-322/01 *Deutscher Apothekerverband eV v 0800 DocMorris NV and Jacques Waterval* [2003] ECR I-14887.

<sup>67</sup> Case C-71/02 *Karner Industrie-Auktionen GmbH v Troostwijk GmbH* [2004] ECR I-3025.



QUESTION 3: TO WHAT EXTENT IS IT PERMITTED OR REQUIRED THAT THE LEGISLATURE TAKE ACCOUNT OF – IN SHORT – ‘NON-MARKET’ VALUES IN SELECTING THE QUALITY OF THE HARMONISED REGIME TO BE ADOPTED AT EUROPEAN LEVEL?

Agreeing that there shall be a common rule does not, of itself, reveal anything about the choice of level of intensity of regulation asserted by such a common rule. Harmonisation inevitably involves debate about the quality of the regime established at EU level in partial or total replacement for national choices. This is recognised in both the Treaty and the relevant case-law.

The indissociable linkage between harmonisation as a tool of market integration and harmonisation as an exercise in selecting the appropriate technique for regulating the European market is recognised in Article 95(3) EC. This provides that ‘[t]he Commission, in its proposals envisaged in paragraph 1 concerning health, safety, environmental protection and consumer protection, will take as a base a high level of protection, taking account in particular of any new development based on scientific facts. Within their respective powers, the European Parliament and the Council will also seek to achieve this objective’. Moreover, there are relevant horizontal provisions in the EC Treaty which dictate that the choice of the content of the harmonised regime is not value-free. For example, Article 153(2) states that ‘[c]onsumer protection requirements shall be taken into account in defining and implementing other Community policies and activities’. Article 6 performs a similar horizontal function for environmental protection. The *quality* of a harmonised regime is constitutionally relevant: this is not simply an exercise in plotting a deregulated market for Europe. Moreover, the point that harmonisation is not simply about opening up markets is further supported by the Court’s acceptance that harmonisation directives are apt to produce *rights* held by those envisaged as enjoying regulatory protection in the event that a Member State fails to put in place the envisaged regime.<sup>68</sup>

*Tobacco Advertising* is once again relevant in revealing what is stake. This is not a case which denies the connection between market-making and the interests of consumer protection and public health. Quite the reverse. The Court accepted that Article 129(1) (now 152(1)) EC provides that public health requirements are to form a constituent part of the Community’s other policies whereas, in addition, Article 100a(3) (now 95(3)) makes an express connection between harmonisation and ensuring a high level of human health

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<sup>68</sup> See, for example, Case C-91/92 *Faccini Dori v Recreb Srl* [1994] ECR I-3325 and Joined Cases C-178 etc./94 *Dillenkofer and others v Germany* [1996] ECR I-4845.

protection.<sup>69</sup> The judgment does not, therefore, support the view that the Community is unable, by harmonisation, to adopt a re-regulatory standard that restricts particular forms of trade throughout the territory of the EU. Were it otherwise, the validity of measures such as Directive 84/450, which forbids misleading advertising or even, at the extreme, Directive 92/59, now replaced by Directive 2001/95, prohibiting the marketing of dangerous goods would be imperilled.<sup>70</sup> Indeed, in one of the few previous judgments exploring the reach of (what was) Article 100a, another but on this occasion unsuccessful application for annulment by Germany, the Court accepted the validity of Commission procedures to track unsafe goods.<sup>71</sup> The Court has not been lured down a path which envisages the internal market being built by the EC only on the basis of market freedoms unfettered by regulatory prohibition. *Tobacco Advertising* identifies harmonisation as a process which involves close attention being paid to the quality of the harmonised regime, not simply to the mere fact of its common market-making application, although the threshold of a required sufficient contribution to the improvement of the conditions for the establishment and functioning of the internal market (Q.1 above) must be crossed. The Community is a re-regulator, not a *de novo* regulator, and so of course it reflects policy concerns underpinning choices made at national level in fixing the quality of the Community regime.<sup>72</sup> The territory of the Community, subject to historically explicable variation in regulatory coverage, does not come as a clean slate on which the Community may choose freely to act; but the Community is, though required to act within constitutional limits, nevertheless competent to suppress regulatory competition between the Member States.

So, in both *Tobacco Advertising* and the subsequent decision in *BAT and Imperial Tobacco*, the Court accepts that protective concerns should play a central role in fixing the content of harmonising measures. This policy association is guaranteed by the EC Treaty in Articles 95(3), 152(1) and 153(2). The Court's point is only that the threshold demand that a measure adequately contribute to improving the conditions for the establishment and functioning of the internal market must be crossed before any question about the quality of the European-level protective regime may be (and must be) addressed.

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<sup>69</sup> *Tobacco Advertising*, paras 78 and 88. Case C-233/94 *Germany v Parliament and Council* [1997] ECR I-2405, the 'Deposit Guarantee' case, provides a further example, although in that case the Court, while accepting the inter-relation of market-building and concerns to achieve consumer protection, rejected the submission that the latter had been unlawfully subordinated to the former in a Community regime that caused depreciation of standards of protection in some Member States.

<sup>70</sup> See OJ 1984 L250/17 and OJ 2002 L11/4 respectively.

<sup>71</sup> Case C-359/92 *Germany v Council* [1994] ECR I-3681.

<sup>72</sup> See also paras 64–66 of Advocate-General Fennelly's Opinion in *Tobacco Advertising* ('the Community is not acting in a policy vacuum').

The precise level of protection achieved is then dictated by the political debate. Practice is tracked more fully by Bruno de Witte in his contribution to this volume in Chapter 3. However, the Treaty does not establish preconceptions about a light touch. Also, to connect with the theme of this chapter, this in turn affects the strategies that may be chosen by actors likely to be influenced by the possibility of intervention by the EC legislature.

## A CASE STUDY: UNFAIR COMMERCIAL PRACTICES

A case study may help to illuminate the tensions that attend the legislative debate as a result of these constitutional ambiguities. A Green Paper on Consumer Protection was published in October 2001.<sup>73</sup> It tracked the heap of diverse national laws that are relevant to the regulation of marketing practices.<sup>74</sup> The Green Paper describes the sheer number of legal obligations that arise in the Member States as ‘off-putting’ to ‘nearly all businesses but those who can afford to establish in all Member States’, and, in addition, a brake on consumer confidence.<sup>75</sup> This plainly connects to the debate about EC competence to intervene (Q.1 above). A follow-up document in 2002 reported that consultation had showed strong support for the adoption of a framework directive in the field.<sup>76</sup> This was followed by a Draft Directive published by the Commission in June 2003,<sup>77</sup> proposing a prohibition against unfair business-to-consumer commercial practices. In accordance with the orthodox impact of harmonisation of laws, the adoption of a common EU-wide regime would be designed *both* to eliminate barriers to trade caused by diverse national approaches to the regulation of unfair practices *and* to achieve a high level of consumer protection. It is not intended that the measure impinge on the field of contract law. In April 2004, a supportive legislative resolution was adopted by the Parliament<sup>78</sup> and in May 2004, the Council reached a political agreement on the Directive,<sup>79</sup> which was welcomed by the Commission.<sup>80</sup> Adoption of a Directive some time in 2005 seems likely.<sup>81</sup>

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<sup>73</sup> COM (2001) 531.

<sup>74</sup> See H.W. Micklitz and J. Kessler, *Marketing Practices Regulation and Consumer Protection in the EC Member States and the US* (Baden-Baden: Nomos, 2002).

<sup>75</sup> Op. cit., n. 73 above, para. 3.1.

<sup>76</sup> COM (2002) 289.

<sup>77</sup> See n. 2 above.

<sup>78</sup> A5-0188/2004, 20 April 2004.

<sup>79</sup> 2003/0134 (COD), 25 May 2004.

<sup>80</sup> IP/04/658, 18 May 2004.

<sup>81</sup> After this chapter was completed, the measure was eventually adopted as Directive 2005/29, OJ 2005 L149/22.

From the perspective of both trader and advocate of consumer protection the vital question is what is envisaged by an *unfair* commercial practice. This is not the current concern but, in summary, the draft Directive sets out two general conditions to apply in determining whether a practice is unfair. First, that the practice is contrary to the requirements of professional diligence; secondly, that the practice materially distorts consumers' behaviour. Two particular categories of unfairness are envisaged: *misleading* and *aggressive* practices. An annex to the Directive lists some practices that are banned in all circumstances.

What of the lobbying for pre-emptive effect? The Commission's draft Directive on Unfair Commercial Practices was presented as a measure which pre-empts national competence. Article 4 of the Commission's draft, sub-titled *Internal Market*, provided:

1. Traders shall only comply with the national provisions, falling within the field approximated by this Directive, of the Member State in which they are established. The Member State in which the trader is established shall ensure such compliance.
2. Member States shall neither restrict the freedom to provide services nor restrict the free movement of goods for reasons falling within the field approximated by this Directive.

So Member States must suppress practices that are unfair within the meaning of the Directive. Member States may not suppress practices that are judged fair under the standard of control envisaged by the Directive. The same rules are to apply in all Member States and traders are not to face diverse regulatory expectations once they step beyond the confines of their own Member State. Home-State control prevails. In this sense, the draft Directive on Unfair Commercial Practices simply follows the model identified by the Court as shaping the regime governing comparative advertising in *Hartlauer*. It also conforms to the approach in *Tobacco Advertising* and in the cases of 2002 concerning the Product Liability Directive, which were considered above.

In the Council, this was far from uncontroversial. In the first place, the Council chose to delete Article 4.1 of the Commission's proposal. The Commission has agreed to this on the understanding that the intent of full harmonisation is unaffected by the change. The UK, the Netherlands, Luxembourg and Estonia regretted the deletion but stated that the measure remained one that sets maximum rules, and urged that steps be taken to communicate this to economic operators so that they be given the confidence to operate within the internal market on this basis. By contrast, Denmark and Sweden voted against the proposal in Council. They took the view that the model of full harmonisation would be likely to exert a negative impact on the level of consumer protection in specific areas where Member States already

possess stricter rules than provided for in existing minimum measures. Changes should be achieved only by revising existing measures, not in the sweeping manner envisaged by the proposal at hand.

The minimum formula written into many of the directives' harmonising rules protecting the economic interests of consumers has been discarded. Is this a change of regulatory strategy? Or is it simply the case that this reveals that the draft on unfair commercial practices (and the advertising measures) are truly dedicated to integrating markets, whereas older directives such as those on credit and doorstep selling never were market-making measures at all but were instances of the harmonisation legal base being borrowed as a cover for the political preference to make a consumer policy for the EC even in advance of any commitment made in the Treaty? If so, the point may be that those older measures are arguably constitutionally invalid but, of broader relevance, it may now be that the Commission has decided to adopt the steer lately given by the Court and to abandon the whole notion of 'minimum harmonisation'. Minimum rule-making is to be excluded under Article 95 – it belongs under sector-specific legal bases which are concerned with EC objectives other than the making of an integrated market.

Dirk Staudenmayer, an official of the Commission (for whom I have great respect), has identified Directive 2002/65 on distant selling of financial services as the first to emerge from this new policy preference.<sup>82</sup> It renounces the minimum formula and applies a model of total harmonisation to the field in question, though a small concession was made to national deviation in Article 4 governing pre-contractual information, which Staudenmayer explains was the result of the anxiety of the Member States not to deprive themselves of some leeway in this matter. He also mentions that this is the Commission's preferred model in its proposal for recasting the consumer credit Directives.<sup>83</sup>

The model may be identified in an earlier measure that would not normally be classified principally as a measure of consumer protection: Directive 2000/31 on e-commerce.<sup>84</sup> The occupied field is carefully defined in Article 1.

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<sup>82</sup> Staudenmayer, *op. cit.*, n. 18, p. 122; Directive 2002/65, OJ 2002 L271/16.

<sup>83</sup> COM (2002) 443.

<sup>84</sup> OJ 2000 L178/1; for an overview see G. Pearce and N. Platten, 'Promoting the information society: The EU Directive on Electronic Commerce' (2000) vol. 6:4 *European Law Journal* 363–78; A. Lopez-Tarruella, 'A European Community regulatory framework for electronic commerce' (2001) vol. 38:6 *Common Market Law Review* 1337–84; and A. Halfmeier, 'Waving goodbye to conflict of laws? Recent developments in European Union consumer law', in C. Rickett and T. Telfer (eds), *International Perspectives on Consumers' Access to Justice* (Cambridge: Cambridge University Press, 2003), pp. 384–406. See also, on questions of competence and enforcement in particular, S. Weatherill, 'The regulation of e-commerce under EC law:

Article 3(1) covers the obligation imposed on a home State to supervise compliance with the rules by operators established on its territory. Article 3(2) provides that ‘Member States may not, for reasons falling within the co-ordinated field [Article 2], restrict the freedom to provide information society services from another Member State’. This is the corollary; it is the host-State’s responsibility to allow access to its market for services emanating from another Member State. For matters falling within the field covered by the Directive, the home State shall secure compliance with the relevant rules and the host State must not exercise powers to exclude services for reasons falling within the occupied field.<sup>85</sup> The home State secures observance of the rules; the host State may not demand conformity with stricter or even different rules. Home-State control is thus strongly emphasised. And that is not all. Even if the Directive’s rules are violated, the host State is entitled to cut off market access only in extreme and carefully defined circumstances, set out in Articles 3(4) and 3(5). The strong assumption is that it is the home State’s job to enforce the rules. The impetus towards the integration of markets is strongly emphasised by the almost total surrender of host State competence to retaliate against breach of the agreed Community rules by closing off its market to infringing services.<sup>86</sup>

The Commission’s Consumer Policy Programme for 2002–2006 reveals a growing preference for full harmonisation.<sup>87</sup> It advocates a ‘move away from the present situation of different sets of rules in each Member State towards a more consistent environment for consumer protection across the EU’. As far as the protection of consumers’ economic interests is concerned, it is stated that there is a need ‘to review and reform existing EU consumer protection directives, to bring them up-to-date and progressively adapt them from minimum harmonisation to full harmonisation measures’. A key priority in this move to full harmonisation is ‘to minimise variations in consumer protection rules across the EU that create fragmentation of the internal market to the detriment of consumers and business’. It also states that:

It is also important that consumers have comparable opportunities to benefit fully from the potential of the internal market in terms of choice, lower prices, and the

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The distribution of competence between home and host states as a basis for managing the internal market’, in H. Snijders and S. Weatherill (eds), *E-commerce law: National and Transnational Topics and Perspectives* (The Hague: Kluwer Law International, 2003), pp. 9–26.

<sup>85</sup> Article 3(3) excludes fields referred to in the Directive’s Annex from the application of these two paragraphs.

<sup>86</sup> See similarly, the Television without Frontiers Directive, Directive 89/552, OJ 1989 L298, amended by Directive 97/36, OJ 1997 L202, examined in this vein by Weatherill, *op. cit.*, n. 50 above.

<sup>87</sup> COM (2002) 208 final, OJ 2002 C137/2.

affordability and availability of essential services. Barriers to cross-border trade should therefore be overcome in order that the consumer dimension of the internal market can develop in parallel with its business dimension. EU consumer policy therefore aims at setting a *coherent and common environment ensuring that consumers are confident in shopping across borders throughout the EU*.<sup>88</sup>

The same theme emerges from other policy documents. The Green Paper on European Union consumer protection claims that, '[f]or consumers, the lack of clarity and security over their rights is an important brake on their confidence and trust' and such a lack of clarity follows from a situation in which fifteen sets of national rules are applied.<sup>89</sup> The Communication on sales promotions in the Internal Market suggests that the fragmented regulatory framework in the area 'may well explain why cross-border consumer demand in the European Union remains marginal'.<sup>90</sup>

This rejection of a minimum model reveals a triumph for the agenda that would sanctify the level playing field as apt to serve both the business interest and the consumer interest. The Commission, of course, does not neglect a policy commitment to levelling that field at a high standard of consumer protection, but what this means, and how/whether it can be guaranteed, is evidently important. This chimes with the thematic connection between the three questions set out above: once Q.2 is answered in favour of total pre-emptive effect, the proponent of intense regulatory protection must win arguments about the quality of protection at EC level (Q.3) or else deny the very competence to act at EC level in the first place, thereby preserving national competence (Q.1). There is, of course, also a fourth option, which arises only periodically – lobbying for revision of the Treaty to undo the work of the Court and the legislature.<sup>91</sup>

There are several reasons for scepticism about whether the concordance of interest assumed between commercial operators and consumers is appropriate.<sup>92</sup> Commercial interests seek a common set of rules for the purposes of

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<sup>88</sup> Ibid., p. 7 (emphasis as in the original).

<sup>89</sup> COM (2001) 531, p. 9.

<sup>90</sup> COM (2001) 546, p. 7.

<sup>91</sup> Perhaps, *inter alia*, to widen the grounds envisaged by Article 95(4) EC et seq.? Perhaps to loosen the fetters on EC action taken under Article 153 EC? Perhaps to bring Articles 95 and 153 into closer alignment? For some proposals advanced in the context of the latest round of Treaty revision, see H. Micklitz, N. Reich and S. Weatherill, 'EU Treaty Revision and Consumer Protection' (2004) 27 *Journal of Consumer Policy* 367–99.

<sup>92</sup> See Wilhelmsson, *op. cit.*, n. 23 above; H. Micklitz, 'De la nécessité d'une nouvelle conception pour le développement du droit de la consommation dans la communauté européenne', in J. Calais-Auloy (ed.), *Liber amicorum Jean Calais-Auloy, Études de Droit de la Consommation* (Paris: Dalloz, 2004), pp. 729–50.

gearing up for a pan-European market, thereby reducing transactions costs and releasing economies of scale. This is by no means inevitably inconsistent with the consumer interest. However, the risk from the consumer perspective is that common rules will – at least for some groups of consumers, in some Member States – result in a depreciation in standards of protection from market failure and/or market inequities. Moreover, the space for regulatory experimentation is closed off. It is assumed that the Community level alone is adequate to provide a reliable basis for consumer protection to the exclusion of state or sub-state initiatives. And yet it is striking that the argument in favour of harmonisation as a means of promoting consumer confidence, visible thus far in connection with measures setting minimum standards such as Directive 93/13 on unfair terms, has now been transplanted to the realms of total harmonisation.

For present purposes it suffices to make the point that the Commission appears to have signed up remarkably eagerly to the Court's new mistrust of the very notion of 'minimum harmonisation', combined with a desire to make a sharp demarcation between Article 95 EC and provisions such as Articles 153 and 176, which are less decisive in terminating residual State competence in the field occupied by the EC measure. In fact the Commission may have pre-empted the Court, for, as already explained, the Court's position on the legal status of minimum rules in harmonisation measures is by no means unambiguous. So one may, as a minimum, express surprise that the Commission has chosen to set aside the historical and political understanding within which the programme of consumer protection has been developed at EC level without initiating a fuller debate about the virtue of switching to a preference for maximum harmonisation that suppresses diversity and space for regulatory experimentation.

This shift in answering Q.2 has implications both for the consequences of previously-answered Q.1 and Q.3, and for future incentives entertained by interest groups wishing to influence the EC legislative process. The activist confronted by pre-emption as the answer to Q.2 will need reassuring in respect of the judgements made about the quality of the harmonised rule (Q.3) or else will fall back on concern to draw the competence to harmonise itself in a narrow manner (Q.1). The Commission may simply be asserting a new policy preference when it identifies maximum harmonisation as appropriate to serve both the commercial and the consumer interest, but part of the problem for those seeking to oppose this policy, and instead to assert the virtue of minimum rule-making, is that they may be confronted not simply by debate about the merits but also by the objection that there is a constitutional impediment to making an internal market according to a model of minimum standards. This is why the way in which this chapter's Q.2 is answered is of such enduring importance.



## CONCLUSION

It would exceed the relatively modest ambitions of this chapter to offer any extended reflection on the ways in which these conundrums could and should be unravelled, although a specific proposal is that *Tobacco Advertising* not be taken at face value on the question of pre-emptive effect: minimum harmonisation, whereby stricter rules may be applied against imports provided they are justified, should remain a viable legislative option and one that should be preferred when diversity has a strong claim to survival in the relevant harmonised realm. The purpose of this contribution is principally to draw attention to the significant institutional and constitutional implications of choices made at an apparently technical level about matters that one might naively have supposed to have been long settled. In fact allocations of power in any system of multi-tier governance vary over time, especially when, as has been shown to be the current position in the EC, the relevant constitutional texts are so ambiguous. Moreover, nothing in the draft Treaty establishing a Constitution for Europe resolves these ambiguities and indeed that document's aspiration to build a Europe 'united in diversity' once again spotlights the awkward tensions between centralised rules and local autonomy which this chapter has tracked in the particular context of the harmonisation programme. So the apparently simple but important question 'what is the effect on national competence of a measure of harmonisation?' has no simple answer – still. Constitutional finality? Not now. Not ever?

### 3. Non-market values in internal market legislation

**Bruno de Witte<sup>1</sup>**

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#### INTRODUCTION

The overall title of this volume, *Regulating the Internal Market*, is problematic in view of the famous statement by the European Court of Justice (ECJ) in the *Tobacco Advertising* case that Article 100a (now Article 95) EC does not vest in the Community legislature ‘a general power to regulate the internal market’.<sup>2</sup> Rather, measures based on Article 95 EC are permissible only if they actually and genuinely contribute to eliminating obstacles to trade and to removing distortions of competition.<sup>3</sup> These two aims correspond to the two most often cited justifications for uniformity of legal rules and principles in the economic analysis of law literature: transboundary externalities and fair competition.<sup>4</sup> The judgment of the Court was welcomed by most commentators as a long needed restraint on the accretion of powers to the Community, and also as a well-timed contribution to the constitutional debate on the delimitation of European Union (EU) competences (a debate which was officially launched by the Nice Declaration adopted by the European Council two

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<sup>1</sup> Many thanks to Evangelia Psychogiopoulou, PhD researcher at the European University Institute, for establishing a data set of internal market legislation post-1992 incorporating non-market concerns.

<sup>2</sup> Case-376/98 *Germany v Parliament and Council* [2000] ECR I-8419, para. 83.

<sup>3</sup> *Ibid.*, para. 95. It is clear from the rest of the judgment that the word ‘and’, used by the Court in this paragraph, should be read as ‘or’: internal market legislation must eliminate obstacles to trade *or* remove distortions of competition. I mention this in order to emphasise that individual ECJ sentences are not always carefully drafted and should not always be taken literally. My chapter is predicated on the view that ECJ jurisprudence should be taken in its broad outlines, without giving undue importance to single words and sentences or even single cases.

<sup>4</sup> See, for example, A. Ogus, ‘Competition between national legal systems: A contribution of economic analysis to comparative law’ (1999) vol. 48:2 *International and Comparative Law Quarterly*, 405–18 at 416.

months later).<sup>5</sup> In this chapter, the judgment will be looked at more narrowly in terms of its consequences for the question of the permissible aims and content of internal market legislation.

The paragraphs of the *Tobacco Advertising* judgment mentioned above may be misleading if taken out of context, since they could hide the fact that, apart from the transboundary externality and fair competition arguments, there is a third type of justification for making national rules more uniform, namely the achievement of *non-economic common objectives*. Nothing prevents a group of States from deciding that they want to achieve such goals, irrespective of whether there is an economic benefit involved in their achievement. This third type of justification for the harmonisation of national laws and regulations is central to many policies of the EU (environment, social policy, agriculture, migration),<sup>6</sup> but it is also very much present in internal market legislation alongside the typical ‘market’ objectives mentioned above. Just to give one recent example: the Commission’s proposal for a directive on fitting safety belts in motor vehicles other than passenger cars (specifically, in coaches),<sup>7</sup> which is based on Article 95 EC, has clearly as its principal aim the improvement of safety on European roads. As usual in such cases, some Member States have already made it compulsory to install seat belts in coaches, and others not, so that the Europe-wide extension of such a requirement will also have the effect of facilitating the trade of buses. However, this transboundary externality can hardly be considered a central objective of this proposal, compared to the non-market concern of saving the lives or good health of coach passengers.

Internal market legislation of this kind is frequently being proposed and adopted. In view of the restrictive language of the *Tobacco Advertising* decision, one could wonder whether this institutional practice is legitimate. The object of my chapter is to explore the constitutional framework for, and institutional practice of, incorporating non-market values or objectives in internal market legislation, that is, legislation based mainly on Articles 95, 94, 93, 40,

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<sup>5</sup> See, among many others, the view of Slot that the *Tobacco Advertising* judgment ‘sends a clear signal to the Member States that the Court will see to it that the creation of new Community powers or the extension of existing ones . . . will not lead to an unlimited exercise of Community jurisdiction’ (P.J. Slot, ‘A contribution to the constitutional debate in the EU in the light of the Tobacco Judgment’ (2002) vol. 13:1–2 *European Business Law Review*, 3–27 at 20). See also ‘Editorial comments: Taking (the limits of) competence seriously’ (2000) vol. 37:6 *Common Market Law Review* 1301–305.

<sup>6</sup> Although the term ‘harmonisation’ or ‘approximation’ usually does not appear in the EC Treaty chapters dealing with these policies, they often involve the harmonisation of national laws or Regulations, just as much as internal market legislation.

<sup>7</sup> COM (2003) 363.

57(2) and 66 EC.<sup>8</sup> With the term ‘non-market objectives’, I intend to refer to a whole cluster of objectives including, for example, the protection of the environment, social policy, cultural policy, the protection of health and safety, and the protection of fundamental rights. Pursuing those objectives may in fact have an economically beneficial effect, but the economic cost/benefit analysis is not their driving concern. The objective of consumer protection is not dealt with in this chapter (apart from the protection of the consumers’ health and safety), since consumer protection can be considered to be a *market* concern (it relates to the demand side of the market, rather than the supply side) rather than a non-market one. This is not to deny that the inclusion of consumer protection objectives in internal market legislation raises many similar issues to the ones described in this chapter.<sup>9</sup>

This chapter will try to show that the ECJ’s phrase denying the existence of a general power to ‘regulate the internal market’ gives a distorted picture of the present state of EU law and institutional practice; and it will be argued that there is ample evidence of, and scope for, non-market concerns being incorporated in internal market legislation. Thus, this chapter is about the content of internal market law, and more particularly about the balance between market integration and policy integration. It corresponds, in part, to a traditional interest of EC lawyers in the legal limits to the content of internal market legislation. Legal writing on this subject has come in waves: one small wave in the late 1970s and early 1980s, in the face of the generous use made by the European Economic Community (EEC) institutions of the harmonisation competence in Article 100 EEC; a somewhat larger wave of legal writing describing the emergence of an ‘internal market unlimited’<sup>10</sup> after the *Titanium Dioxide* judgment of the ECJ in 1991;<sup>11</sup> and a new surge of interest after the *Tobacco Advertising* judgment in 2000, which is also reflected in several contributions to this volume. However, this chapter aims also to move beyond this constitutional issue and to develop our understanding of the substantive nature of EU law, more particularly by contributing some new

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<sup>8</sup> The scope of this chapter is limited to *legislation*, although one should not lose sight of the fact that internal market policy also, and increasingly, uses non-legislative instruments, such as executive decisions of the Commission (with or without comitology), soft law measures and the activity of Community agencies.

<sup>9</sup> See S. Weatherill, ‘Consumer policy’, in P. Craig and G. de Búrca (eds), *The Evolution of EU Law* (Oxford: Oxford University Press, 1999), pp. 693–720 at 702ff., and the chapter by Stephen Weatherill in this book.

<sup>10</sup> Cf. the article with this title by R. Barents in the *Common Market Law Review* (‘The internal market unlimited: Some observations on the legal basis of Community legislation’ (1993) vol. 30:1 *Common Market Law Review* 85–109); see also S. Crosby, ‘The single market and the rule of law’ (1991) 26 *European Law Review* 451–65.

<sup>11</sup> Case C-300/89 *Commission v Council (Titanium Dioxide)* [1991] ECR I-2867.

insights to the deregulation/re-regulation debate in European legal and political studies. It aims to complement the chapter by Stephen Weatherill in this volume.

The chapter is organised as follows. Having addressed the current constitutional framework, the current institutional practice relating to the inclusion of a number of non-market objectives in internal market legislation will then be examined. Before that, however, the earlier evolution of internal market law through the main stages of the European integration process will be briefly recalled.

## THE HISTORICAL PERSPECTIVE<sup>12</sup>

### **Before the Single European Act**

The Court's statement (in *Tobacco Advertising*) that the European Community (EC) does not have a general power to regulate the internal market is a counterpoint to almost 30 years of EC legislative activity that had the semblance of doing precisely that, namely regulating the internal market. This kind of activity was explicitly acknowledged and strongly boosted by the Paris summit conference of heads of State and government of EEC States in October 1972. The Declaration adopted by the conference included the following statement: 'Economic expansion is not an end in itself . . . It should result in an improvement in the quality of life as well as in standards of living. As befits the genius of Europe, particular attention will be given to intangible values and to protecting the environment, so that progress may really be put at the service of mankind.'<sup>13</sup> Following this rather pompous phrase, the heads of state and government assembled in what was not yet known as the European Council and called for the development of a regional policy, a social policy and an environmental policy by the European (Economic) Community. Those policies were indeed developed in the following years, and the Paris Summit may, with hindsight, be seen as the single most important expansion of the scope of EC activity outside Treaty revisions.

In developing those policies, and in the absence of specific Treaty provisions allowing for the adoption of regional development, social or environ-

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<sup>12</sup> For a more general account of the evolution of internal market law, see the contribution to this volume by Laurence Gormley (Chapter 1); see also, P. Craig, 'The evolution of the single market', in C. Barnard and J. Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Oxford: Hart Publishing, 2002) pp. 1–40.

<sup>13</sup> Declaration adopted at the Paris Summit of 19–21 October 1972, published in the *Sixth General Report on the Activities of the Communities 1972*, p. 7.

mental measures, the institutions made use of the general competence clause of Article 235 EEC (now Article 308 EC) as well as of the general harmonisation power conferred by Article 100 EEC (now Article 94 EC). As examples of legislative measures based exclusively on Article 100 in those new fields, one may cite: in the field of environmental policy,<sup>14</sup> Directive 73/404 on the biodegradability standards for detergents,<sup>15</sup> and Directive 85/210 on the lead content of petrol;<sup>16</sup> and in the field of social policy, Directive 75/129 on collective redundancies,<sup>17</sup> and Directive 77/187 of 14 February 1977 on the safeguarding of employees' rights in the event of transfers of undertakings.<sup>18</sup>

Article 100 EEC empowered the Council to adopt, by a unanimous vote, directives for 'the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market'. This Article echoed the Treaty objective formulated in Article 3(h) EEC ('the approximation of the laws of Member States to the extent required for the proper functioning of the common market') but, in fact, it became increasingly used from the 1970s onwards as an instrument for achieving another Treaty objective formulated in Article 3(f), namely 'the institution of a system ensuring that competition in the common market is not distorted'. Thus, applied for example to environmental protection, the policy argument went (and still goes) as follows:

different national environmental legislation, since it would affect production and marketing costs, would create unequal conditions of competition between producers in different Member States, and . . . therefore, to prevent distortion of competition, it was necessary to ensure that all producers throughout the Community were bound by the same rules.<sup>19</sup>

In the legislative acts themselves, justifications for the use of this Common Market power were scant, throughout this period between the Paris Summit and the adoption of the Single European Market. No attempt was made, in the preambles of the relevant legislative acts, to argue why exactly the unharmonised state of national laws directly affected the common market. A

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<sup>14</sup> On the competence issues raised by the use of Article 100 in this field, see E. Rehbinder and R. Stewart, 'Environmental Protection Policy' in M. Cappelletti, M. Seccombe and J. Weiler (gen. eds), *Integration Through Law* (Berlin and New York: De Gruyter, 1985), pp. 15–28.

<sup>15</sup> OJ 1973 L347/51 (amended since).

<sup>16</sup> OJ 1985 L96/25 (amended since).

<sup>17</sup> OJ 1975 L48/29 (amended since).

<sup>18</sup> OJ 1977 L61/26 (amended since).

<sup>19</sup> J. Usher, 'The development of Community powers after the Single European Act', in R. White and B. Smythe (eds), *Current Issues in European and International Law* (London: Sweet & Maxwell, 1990), pp. 3–18 at 5.

typical ‘non-argument’ is the one offered in the preamble to Directive 77/187 on transfer of undertakings, in which the Council simply included the following considerations:

Whereas differences still remain in the Member States as regards the extent of the protection of employees in this respect and these differences should be reduced;

Whereas these differences can have a direct effect on the functioning of the common market.

This breezy reasoning and the sweeping breadth of some of the directives based on Article 100 aroused some controversy. The UK House of Lords, in particular, decided to have a debate on the legitimacy of this practice.<sup>20</sup>

However, the practice was not formally challenged by any of the Member State governments for the simple reason that, given the unanimity requirement in Article 100 EEC, they all agreed with each of the measures adopted on that basis. Due to this general consensus among Member State governments, the ECJ did not have much opportunity either to examine the constitutionality of this legislative practice, and when it did have the opportunity, it gave its backing without much explanation or justification. In the *Detergents* case (decided in 1980), which was an infringement action taken by the Commission against Italy for its failure to transpose the directive on the biodegradability of detergents, the Court was confronted with a half-hearted attempt by Italy to argue that there was no competence for the EC to adopt a directive on this matter. The Court held that:

it is by no means ruled out that provisions on the environment be based upon Article 100 of the Treaty. Provisions which are made necessary by considerations relating to the environment and health may be a burden upon the undertakings to which they apply and if there is no harmonisation of national provisions on the matter, competition may be appreciably distorted.<sup>21</sup>

It thereby gave support to the use of the common market harmonisation competence to iron out disparities between national laws even where these did not create a concrete impediment to the trade in goods or services – a kind of practice which did not flow self-evidently from the language of Article 100.

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<sup>20</sup> For a useful presentation of this controversy, and a justification of the Commission’s practice in those years, see G. Close, ‘Harmonisation of laws: Use or abuse of the powers under the EEC Treaty?’ (1978) 3 *European Law Review* 461–73.

<sup>21</sup> Case 91/79 *Commission v Italy* [1980] ECR 1099, para. 8.

## After the Single European Act

The original *raison d'être* of the Single European Act (SEA) was to facilitate EU decision-making on internal market legislation. By providing for qualified majority voting in the new Article 100a (though not in the 'old' Article 100) and in most of the specific internal market legal bases, the authors of the SEA contributed indeed to the smooth legislative implementation of the internal market programme set out in the Commission's White Paper of 1985. However, the SEA, and the Maastricht and Amsterdam Treaties later on, also had the effect of reducing the substantive scope of internal market legislation through the creation of specific legal bases for sector-specific policies. Because of these additional Treaty bases, legislative measures that used to be based on the common market competence could now be based on more explicit Community competences. This shift started with the creation, by the SEA, of a legal basis for environmental protection, and for the health and safety of workers; it continued with the Treaty of Maastricht's creation of a broader social policy competence (if only for 11 of the 12 Member States, who 'opted out' of the United Kingdom's (UK) obstructive presence in this policy domain, until the Labour government came to power in 1997), and with the Treaty of Amsterdam's creation of new harmonisation competences in the fields of migration, civil law and procedure, and for some aspects of the protection of health.

The tension created by these Treaty changes is put as follows by Stephen Weatherill in his contribution to this volume:

how to reconcile the pre-Single European Act reality that much harmonisation legislation was not really about market-making at all with the post-Single European Act reality that sector-specific legal bases had been (and continued to be) created, with the awkward implication that some previous practice might need to be unravelled in order to allocate matters previously dealt with within the harmonisation programme to sector-specific legal bases that involved different rules from those pertaining to the making of measures of harmonisation.<sup>22</sup>

Despite this new difficulty of choosing among different potential legal bases, and despite this need to 'unravel' previous legislative practice, the SEA did not put an end to the particular practice of pursuing non-market values in internal market legislation. In fact, the SEA itself indicated that this practice was legitimate and could be continued, by means of language introduced in the new Article 100a (now Article 95 EC). Paragraph 2 of that Article excluded recourse to the legal basis of Article 100a to adopt provisions 'relating to the

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<sup>22</sup> See Chapter 2 by Stephen Weatherill in this volume.



rights and interests of employed persons', which presupposes that those rights and interests would otherwise, in the absence of the exclusion clause, be a proper object of internal market law – and in fact, they are thus confirmed to be within the scope of Article 100 rather than Article 100a. Paragraph 3 of Article 100a was even more telling since it instructed the Commission to strive at a high level of protection for health, safety, environmental protection and consumer protection in its proposals for legislation based on Article 100a. This presupposes, obviously, that pursuing these non-market objectives is a legitimate part of internal market law-making.

Furthermore, the changes in legislative decision-making made by the SEA, and at Maastricht and Amsterdam, tended to reinforce the incorporation of non-market values in a number of ways. The shift to qualified majority voting in the Council allowed the building of a 'regulatory majority' against the opposition of one or more States, and the newly gained decision-making influence of the European Parliament allowed this institution to effectively act as the 'champion of diffuse interests'.<sup>23</sup> A celebrated example of this regulatory impact of the European Parliament was the decision-making process on the car emissions directive in which the Parliament, acting under the post-SEA (but pre-Maastricht) co-operation procedure, was able to force the Council to enact a more environment-friendly directive than originally envisaged.<sup>24</sup> If one considers these various factors, it becomes clear why, during the 15 years following the entry into force of the SEA, non-market concerns continued to be as actively pursued in the framework of internal market legislation as they were during the preceding 15 years after the Paris Summit.

## THE CURRENT CONSTITUTIONAL FRAMEWORK

Today, Article 95(3) EC continues to offer clear constitutional backing for the incorporation of health, safety and environmental concerns in harmonisation measures based on Article 95.<sup>25</sup> The *Tobacco Advertising* judgment, despite its otherwise restrictive language mentioned above, confirmed this. In fact, the

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<sup>23</sup> M.A. Pollack, 'Representing diffuse interests in EC policy-making' (1997) vol. 4:4 *Journal of European Public Policy*, 572–90 at 586.

<sup>24</sup> See the detailed account by C. Hubschmid and P. Moser, 'The co-operation procedure in the EU: Why was the European Parliament influential in the decision on car emission standards?' (1997) vol. 35:2 *Journal of Common Market Studies* 225–42.

<sup>25</sup> Article 95, para. 3: 'The Commission, in its proposals envisaged in paragraph 1 concerning health, safety, environmental protection and consumer protection, will take as a base a high level of protection, taking account in particular of any new development based on scientific facts. Within their respective powers, the European Parliament and the Council will also seek to achieve this objective.'

Court implicitly extended the remit of the integration clause of Article 95(3) EC to the specific legal bases for harmonisation used in the fields of establishment and services. Indeed, the clause of Article 95(3) is not repeated in the Treaty articles granting specific internal market competences for establishment and services which also served as a legal basis for the tobacco advertising directive, but despite this the Court made a general statement that the directive could aim at a high level of protection for health, without excepting the establishment and services dimension of the directive.

The legal status of other non-market values, those not mentioned in Article 95(3), is less obvious. However, there are some other norms of EU constitutional law that make it legitimate or compulsory (depending on the case) for the internal market legislator to take them fully on board. The possibility to pursue *cultural policy* objectives where appropriate, also through internal market laws, results from Article 151(4) EC, the mildly worded mainstreaming clause for culture.<sup>26</sup> In contrast to this soft clause, the protection and promotion of *fundamental rights* is a firm duty for the internal market legislator. That duty is imposed with so many words by Article 51(1) of the EU Charter of Fundamental Rights which, even today, is arguably binding on the EU institutions on the basis of the self-imposed commitment undertaken in their solemn proclamation made at Nice.<sup>27</sup> However, even leaving aside (for now) the Charter, that duty results from the fact that fundamental rights are part of the general principles of Community law so that internal market legislation can be held invalid if it positively infringes a fundamental right or omits to give sufficient protection to it.<sup>28</sup>

It can be argued, more broadly, that the possibility to pursue non-market values does not depend on whether a particular value is expressly recognised by the text of the Treaty or as a general principle of Community law. That possibility also arises, more generally, as a reflection and counterpart of the market integration doctrines developed by the ECJ. Indeed, the Court has held,

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<sup>26</sup> ‘The Community shall take cultural aspects into account in its action under other provisions of this Treaty, in particular in order to respect and to promote the diversity of its cultures.’ For a discussion of the impact of this clause in a range of EU policies, see R. Craufurd Smith, ‘Community intervention in the cultural field: Continuity or change?’, in R. Craufurd Smith (ed.), *Culture and European Union Law* (Oxford: Oxford University Press, 2004), pp. 19–78 at 53ff.

<sup>27</sup> Article 51(1) of the EU Charter of Fundamental Rights states that the institutions shall ‘respect the rights, observe the principles and promote the application thereof in accordance with their respective powers’.

<sup>28</sup> For further discussion of the impact of the Charter on internal market law, see S. Weatherill, ‘The internal market’, in S. Peers and A. Ward (eds), *The EU Charter of Fundamental Rights: Politics, Law and Policy* (Oxford: Hart Publishing, 2004), pp. 183–210.

in a well-known line of cases,<sup>29</sup> that Member State derogations from common market freedoms cease to be admissible where EC law has harmonised the relevant subject matter. This doctrine presupposes that the policy concerns underlying the Member State derogations have been addressed in the harmonisation measure, or at least that the European legislator had the competence to do so. Otherwise, there would be a true regulatory gap in the Community system: the Community legislator could only harmonise away such disparate national requirements, but could not adopt EC-wide measures that give recognition to the common public policy values that underlie those disparate rules in the Member States. Therefore, all the public policies that have been accepted by the Court, in the course of the years, as justifying the creation or preservation of Member State obstacles to trade or mobility (they form a long and open-ended list) may, by logical extension, also form an aim of internal market harmonisation. So, if Member States are allowed to maintain restrictions to the free movement of goods or services when justified for the protection of public health, media pluralism or the national artistic heritage (to name but a few of the interests recognised by the Treaty or by the Court), then the European Community can address these same concerns when adopting harmonisation measures designed to eliminate the restrictions. For instance, the EC could legitimately adopt Directive 93/7 on the return of cultural objects as an internal market measure based on Article 95 because that directive was aimed at remedying the impediment to market integration caused by the divergent (but legitimate) national rules restricting the export of works of art.<sup>30</sup>

The example of Directive 93/7 is revealing of another facet of the constitutional framework of internal market legislation, namely the fact that policy concerns can be pursued through internal market legislation even when those concerns cannot otherwise be addressed by EU legislation. Cultural policy is, in fact, an area in which the EC is barred, by Article 151(5) EC, from adopting legislation which harmonises national laws and policies. However, the prohibition of cultural harmonisation in Article 151 clearly does not prevent the harmonisation of national laws that regulate cultural activities when such

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<sup>29</sup> Starting with Case 148/78 *Criminal Proceedings against Ratti* [1979] ECR 1629.

<sup>30</sup> OJ 1993 L74/74. The Directive provides for a mechanism for the physical return of cultural goods removed from the territory of a Member State in contravention of its cultural heritage laws. Before 1993, many States sought to enforce these laws by means of border controls on exported goods. In view of the EC's decision to remove all border controls on goods by 1 January 1993, the Directive was enacted as a 'compensatory measure' offering an alternative means of enforcing national heritage laws in a border-free Europe. For further elaboration of this example, see A. Biondi, 'The merchant, the thief and the citizens: The circulation of works of art within the European Union' (1997) vol. 34:5 *Common Market Law Review* 1173–95.

harmonisation appears necessary for the smooth functioning of the internal market. The Directive on Television without Frontiers (TWF), for instance, which was first adopted in 1989 and then revised in 1997,<sup>31</sup> is legally based on the internal market objective of facilitating the provision of (television) services from one European country to the others; but it is also, at the same time, a cultural policy measure, most clearly perhaps in its Article 4, which seeks to promote the diffusion of TV programmes of European origin.<sup>32</sup> Similarly, the more recent Directive of 2001, harmonising national rules concerning the resale rights of artists (that is, their right to obtain a percentage of the proceeds of any later sales of their work),<sup>33</sup> was based on Article 95 EC, and justified as a measure that would create a level playing-field for the trade in works of art. By extending the resale right to all EU countries, including for example the UK where it did not exist before, the Directive aimed at reducing the phenomenon of ‘auction shopping’, whereby the sale of works of art is displaced to countries that do not provide for the *droit de suite* of artists. Obviously, a level playing field could also have been achieved in the opposite way, by abolishing the resale right in the countries where it existed. So, the choices made by the authors of the Directive reflect a cultural policy concern to strengthen the legal position of artists as against that of the art trade sector.

Further examples could be given, but the general point to be noted is that the prohibition of cultural harmonisation contained in Article 151 has not prevented the occasional use of European law-making powers to harmonise national cultural policy rules ‘through the backdoor’. On each of these occasions, a question arises whether the European legislator has given adequate (or exaggerated) consideration to cultural diversity concerns when adopting a measure which, legally speaking, is primarily aimed at achieving economic (internal market) goals. A major object of controversy in this respect was, and still is, the Directive on TWF. Whereas some observers have criticised it for privileging market efficiency over cultural policy concerns, others have argued that its provisions reserving a quota of television programming for works of European origin are an undue element of protectionism that

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<sup>31</sup> Directive 89/552, OJ 1989 L298/23, as amended by Directive 97/36, OJ 1997 L202/60.

<sup>32</sup> On the cultural policy aspects of this Directive, see for instance B. de Witte, ‘The European content requirement in the EC Television Directive: Five years after’ 1 *Yearbook of Media and Entertainment Law* (Oxford: Oxford University Press, 1995), 101–27, and P. Keller, ‘The new Television Without Frontiers Directive’ (1997–98) 3 *Yearbook of Media and Entertainment Law*, 177–95 at 179ff.

<sup>33</sup> Directive 2001/84 on the resale right for the benefit of the author of an original work of art, OJ 2001 L272/32. For a detailed analysis, see K. Schmidt-Werthern, *Die Richtlinie über das Folgerecht des Urhebers des Originals eines Kunstwerks* (Baden-Baden: Nomos, 2003).

artificially obstructs the functioning of the internal market for television programmes.<sup>34</sup>

To conclude on this point: there is ample evidence and solid legal justification for the view that there is no *a priori* substantive limit to the kinds of public policy concerns that the European legislator may take into account when enacting internal market laws. This does not mean, obviously, that the way in which those public policies are pursued at the EU level will be identical to the way they were pursued at the national level. The EU legislator could also decide, in a given case, to overlook the non-market concerns in order to facilitate market integration, but this is a pure policy choice and not a choice dictated by constitutional principle.

The argument made in the previous paragraphs is so obviously important in defining the scope of permissible internal market legislation that one would expect it to be made explicitly in some famous Court judgment. In fact, as far as I can see, there is no such famous judgment. There are, however, some less well-known cases in which the Court adopts such reasoning. A particularly illuminating example is a judgment of 2000, in *Luxembourg v Parliament and Council*, in which Luxembourg brought an action for the annulment of the Directive on the freedom of establishment of lawyers, arguing *inter alia* that, by allowing foreign-trained lawyers to work in Luxembourg without prior training in domestic law, the Directive failed to take account of the interests of consumers and of the proper administration of justice.<sup>35</sup> This argument prompted the Court to make the traditional point that the Member States may legitimately maintain barriers to freedom of movement if justified for the protection of public interests. It went on to hold that, when the Community legislature uses its free movement competence to eliminate such national obstacles, it 'is to have regard to the public interest pursued by the various Member States and to adopt a level of protection for that interest which seems acceptable in the Community', adding however that the Community legislature 'enjoys a measure of discretion for the purpose of its assessment of the acceptable level of protection'.<sup>36</sup> So, in the particular case of the lawyers' Directive, the Council and the Parliament had a duty to consider the proper administration of justice (one of the public interests pursued by the States when previously restricting the activity of foreign-trained lawyers) and the Court could, and did, examine whether they had remained within their discretion in deciding the appropriate level of protection for that interest.

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<sup>34</sup> For a recent discussion, see J. Holmes, 'European Community Law and the cultural aspects of television', in R. Craufurd Smith (ed.), *Culture and European Union Law* (Oxford: Oxford University Press, 2004), pp. 169–203 at 192–7.

<sup>35</sup> Case C-168/98 *Luxembourg v Parliament and Council* [2000] ECR I-9131, para. 30.

<sup>36</sup> *Ibid.*, para. 32.

This judgment was rendered one month after *Tobacco Advertising*. It serves as a reminder that, when assessing the Court's case-law, one should not focus too much on a striking sentence about the absence of a power to regulate the internal market in a high profile case such as *Tobacco Advertising*, but pay attention above all to the systematic links between negative and positive integration principles, and to the statements by the Court in a number of lesser known judgments. Whereas the Court, in direct legal basis challenges, tends to be defensive (as in *Tobacco Advertising*) or confusing (as in *Biotechnology*),<sup>37</sup> it tends to be more candid and straightforward in other cases (whether direct actions or preliminary rulings) in which the legal basis of the act is not the central object of the legal dispute. In those routine cases, it does not question the legitimacy of incorporating non-market concerns into internal market legislation and, indeed, it sometimes uses language (as in the lawyers' Directive case, mentioned above) which makes it sound compulsory for the EU institutions to do so.

In some cases, the Court even seems to accept that non-market objectives can be predominant over the internal market objective, or at least become predominant in the course of time. In *INPS v Barsotti and others*, a judgment of 4 March 2004, the Court referred as a matter of course to 'the social objective' of Directive 80/987 on the protection of employees in the event of the insolvency of their employer; the fact that this Directive was based on ex-Article 100 EEC (now Article 94 EC) and should, in principle, (also) be aimed at improving the functioning of the common market was passed over and was obviously seen as irrelevant for the interpretation of the text.<sup>38</sup>

In some other recent judgments, the Court seems to accept that economic and non-market objectives that are simultaneously present in a piece of internal market law do not necessarily have to be consistent with one another and that there may be an internal tension between those objectives that requires a

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<sup>37</sup> Case C-377/98 *The Netherlands v European Parliament and Council* [2001] ECR I-7079. The confusion in the judgment arises, in my opinion, from the fact that the Court holds (in para. 27) that the *aim* of the Directive on the legal protection of biotechnological inventions was 'to promote research and development in the field of genetic engineering in the European Community' and the *way* to achieve this aim was by approximating national laws, but then states in the following paragraph that 'approximation of the legislation of the Member States is *therefore* not an incidental or subsidiary objective of the Directive but is its *essential purpose*' (emphasis added). In my view, the Court was right in para. 27, but wrong in para. 28. It would have been better advised to admit candidly what everybody knows, namely that the Directive indeed aimed at promoting the European genetic engineering sector, and then add that it also sufficiently contributed to the smooth functioning of the internal market, thereby justifying recourse to Article 95 as a legal basis of the Directive.

<sup>38</sup> Joined Cases C-19/01, C-50/01 and C-94/01 *INPS v Barsotti and others* [2004] ECR I-12447, paras 34 and 35; Directive 80/987, OJ 1980 L283/23.

balanced interpretation. Thus, in *Lindqvist*, the Court stated that the Directive on the free movement of personal data seeks to ensure not only the free flow of such data within the European market, but also the safeguarding of the fundamental rights of individuals; it then added that ‘those objectives may of course be inconsistent with one another’,<sup>39</sup> and that the Directive contains the ‘mechanisms allowing these different rights and interests to be balanced’.<sup>40</sup> In *RTL Television*, the most recent in a long series of judgments interpreting the TWF Directive, the Court was called to interpret its Article 11, which sets limits to the frequency of advertising breaks in the middle of audiovisual works transmitted on TV.<sup>41</sup> The Court stated that Article 11 ‘is intended to establish a balanced protection of the financial interests of the television broadcasters and advertisers, on the one hand, and the interests of the rights holders, namely the writers and producers, and of consumers as television viewers, on the other’.<sup>42</sup> So, the Court did *not* state that the free movement objective is the primary aim and should be given precedence in the interpretation of this legislative provision. This contrasts with an earlier judgment about the same provision in which the Court failed to refer to this ‘balanced protection’ of the various interests, but rather adopted the more traditional formal (and pro-market) approach that the main purpose of the Directive was to ensure freedom to provide television services and that any exceptions to that freedom imposed by the Directive ‘must be given a restrictive interpretation’.<sup>43</sup> How to read these two judgments together? Is there a shift in the Court’s thinking about these matters, or do we simply find here an example of inconsistent views by different Chambers of the Court, or (worse) an example of the Court being unaware that it overruled an earlier judgment?

In the end, the one firm limit to the incorporation of non-market values in internal market legislation is that resulting from the existence of a specific competence elsewhere in the Treaty to legislate in pursuit of those values, for instance for the protection of the environment or for the protection of workers’ rights. In this regard, the Court uses its well-known criterion of the ‘centre

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<sup>39</sup> Case C-101/01 *Criminal Proceedings against Lindqvist* [2003] ECR I-12971, para. 79.

<sup>40</sup> *Ibid.*, para. 82.

<sup>41</sup> For an analysis of the many problems of interpretation raised by this part of the Directive, see L. Woods and A. Scheuer, ‘Advertising frequency and the Television without Frontiers Directive’ (2004) vol. 29:3 *European Law Review* 366–84.

<sup>42</sup> Case C-245/01 *RTL Television v Niedersächsische Landesmedienanstalt für privaten Rundfunk* [2003] ECR I-12489, para. 62.

<sup>43</sup> Case C-6/98 *ARD v Pro Sieben* [1999] ECR I-7599, paras 28, 30 and 31. For a convincing critique of the Court’s interpretative approach in that earlier judgment, see R. Mastroianni’s case comment in (2000) vol. 37:6 *Common Market Law Review*, 1445–64 at 1460ff.

of gravity'; it identifies what is the principal aim, as opposed to the ancillary object, of the measure concerned.<sup>44</sup> Where the principal aim of the measure is to improve the functioning of the internal market, it must be based on an internal market legal basis; where, on the contrary the principal aim is to achieve one of the goals of the EC's substantive policies, the EC legislator must use the sector-specific legislative competence. However, the Court confirmed in the *Tobacco Advertising* case that this 'choice of legal basis' rule only applies where the two competing legal bases both allow for harmonisation. If a given non-market objective cannot be pursued by means of a sector-specific harmonisation measure, because a power of harmonisation is not provided by the Treaty in that policy field, then the internal market competence can be used irrespective of whether the non-market objective is ancillary to the internal market objective or not. Thus, in *Tobacco Advertising*, the Court at no point sought to determine whether the health protection objective of the Directive was dominant or ancillary to the internal market objective. In later tobacco-related cases, the Court accepted with so many words that health protection was the *decisive* factor in the adoption of the act.<sup>45</sup> One may therefore doubt the validity of a conclusion sometimes drawn from *Tobacco Advertising*, namely that 'the EU institutions may not use their internal market competencies to promote a model of socio-economic regulation that prizes health promotion *above* internal market objectives'.<sup>46</sup> Instead of the word *above* one should probably just read the word *disregarding*. I concur with Weatherill's assessment that:

... the Court's point is only that the threshold demand that a measure adequately contribute to improving the conditions for the establishment and functioning of the internal market must be crossed before any question about the quality of the European-level protective regime may be (and must be) addressed. The precise level of protection achieved is then dictated by the political debate. ... But the Treaty does not establish preconceptions about a light touch.<sup>47</sup>

The conclusion is, therefore, that internal market legislation, to be constitutionally valid, *must* satisfy a specific internal market test, in the sense that the authors of the act must make a plausible case that the act either helps to remove disparities between national provisions that hinder the free movement

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<sup>44</sup> For a detailed study of the Court's case-law on this point, see R.H. van Ooik, *De keuze der rechtsgrondslag voor besluiten van de Europese Unie* (Deventer: Kluwer, 1999).

<sup>45</sup> Case C-210/03 *Swedish Match* [2004] ECR I-11893, para. 31.

<sup>46</sup> T.K. Hervey, 'Mapping the contours of European Union health law and policy' (2002) vol. 8:1 *European Public Law*, 69–105 at 104 (emphasis added).

<sup>47</sup> See Chapter 2 by Stephen Weatherill in this volume.



of goods, services or persons, or helps to remove disparities that cause distorted conditions of competition. However, these need not be, and cannot logically be, the only purposes of internal market legislation. Such legislation also invariably and legitimately pursues other public policy objectives. The statement, as made in an article by Alan Dashwood, that internal market legislation ‘must be seen to be about contributing to the well-functioning of the internal market mechanism; and not about something else, however worthy, such as public health or the protection of the environment’,<sup>48</sup> sounds plausible, but it is not quite correct. Internal market legislation is always *also* ‘about something else’, and that something else may, in fact, be the main reason why the internal market measure was adopted. The multifaceted nature of internal market legislation is one of the inherent characteristics of that legislation and not a perverse ploy of European actors seeking to extend the range of their competences.

In this matter, the entry into force of the Constitution for the EU would not cause any dramatic changes. In fact, it is fair to say that neither the Convention on the Future of the Union nor the subsequent Intergovernmental Conference have paid any attention to the question of whether to redefine the scope of the EU’s internal market competence.<sup>49</sup> There was a debate, within the Convention, as to whether the internal market competence should be ranged within the category of *exclusive* EU competences or rather that of *shared* competences, and this debate was correctly settled in favour of the latter option.<sup>50</sup> However, the actual legal bases for internal market legislation were left untouched. The text of Article 95 (to mention just the most important internal market legal basis) is repeated, almost word for word, in Article III-172.<sup>51</sup> There are a few drafting amendments reflecting structural changes made elsewhere by the Constitution (for example, the reference to laws and framework

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<sup>48</sup> A. Dashwood, ‘The limits of European Community powers’ (1996) vol. 21:2 *European Law Review*, 113–28 at 120.

<sup>49</sup> See J.P. Keppenne, ‘Le marché intérieur et la Convention: une occasion manquée’, in O. De Schutter and P. Nihoul (eds), *Une Constitution pour l’Europe: Réflexions sur les transformations du droit de l’Union européenne* (Bruxelles: Larcier, 2004), pp. 325–40.

<sup>50</sup> On the question of the appropriate categorisation of the EU’s internal market competence, see G. de Búrca and B. de Witte, ‘The delimitation of powers between the EU and its Member States’, in A. Arnall and D. Wincott (eds), *Accountability and Legitimacy in the European Union* (Oxford: Oxford University Press, 2002), pp. 201–22 at 209.

<sup>51</sup> What is now Article 94 (former Article 100 EEC) will be put immediately *after* what is now Article 95, in Article III-173. This new order of priority will better reflect the order of importance of the two provisions. However, the formulation of Article III-173, and also the extent of its residual scope compared to that of Article III-172, will remain as opaque as before.

laws as the instruments to be used for internal market legislation), but they do not affect the substance of the competence domain, or the range of objectives that may be or must be pursued by the European legislator. The drafters of the Constitution have also been unimaginative in deciding where to place this ‘new Article 95’. The Constitutional Treaty chapter entitled ‘Internal Market’<sup>52</sup> starts with a section called ‘Establishment and Functioning of the Internal Market’, which is where one would expect to find the text of Article 95. Instead, one must proceed to the very end of that chapter to find a miscellaneous section called ‘Common provisions’ which contains what is now Article 95.

This is not to say that the Constitutional Treaty will not cause *any* change to the issues addressed in this chapter. In fact, it strengthens the position of non-market values in the EU legal order, both through the incorporation of the Charter of Rights in Part II, and through the inclusion of a number of new general provisions in Part I that put extra emphasis on the need to accommodate non-market values through the whole range of EU policies – including therefore internal market law.<sup>53</sup> Particularly intriguing, in this regard, is the inclusion of the ‘highly competitive social market economy’ as an overall objective in Article I-3(3). The concept of social market economy originated in German post-war legal-economic thought, but its significance in the context of the European Constitution is not at all clear;<sup>54</sup> depending on whether one emphasises the word ‘social’ or the word ‘market’, it can provide ammunition both to those who think that the EU should act in a more market-oriented way and to those who argue that it should intervene more actively to regulate the operation of the market.

## THE INSTITUTIONAL PRACTICE

After considering, in the previous section, the issues of constitutional principle and Court doctrine, the recent practice of the political institutions of the EU will now be addressed. When examining their approach to internal market law-making, it is appropriate to distinguish between the general or so-called

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<sup>52</sup> Part II, Title III, Chapter 1 of the Treaty establishing a Constitution for the European Union (Articles III-130 to III-176).

<sup>53</sup> For a collection of essays examining the role of values in European constitutional law, with an emphasis on the text of the new Constitutional Treaty, see S. Millns and M. Aziz (eds), *Values in the Constitution of Europe* (forthcoming, 2006).

<sup>54</sup> See C. Joerges and F. Rödl, “‘Social market economy’ as Europe’s social model?’, EUI Working Paper, LAW No. 2004/8, available at <http://webdb.iue.it/FMPro>.

strategic internal market documents and the specific legislative measures, since there is a discrepancy between these two levels.

The most recent overall *Internal Market Strategy* proposed by the Commission in May 2003,<sup>55</sup> and endorsed by the Competitiveness Council in September 2003, pays hardly any attention to non-market objectives. This document, the policy importance of which was enhanced by the fact that it has become a component of the ‘guidelines package’ of the Lisbon Process, alongside the Broad Economic Policy Guidelines and the Employment Guidelines, lists 10 priorities for the EU’s internal market policy, all of which are about reducing obstacles and facilitating the mobility of goods and services.<sup>56</sup> Indicative of its deregulatory bias are two of the document’s ten priorities: ‘simplifying the regulatory environment’ and ‘improving conditions for business’. This new *relance* of the single market programme focuses heavily on improving economic performance, which is understandable in view of the competitiveness context in which the document is made to fit, but is also rather one-sided where it purports to set out a legislative programme (contained in the Annex to the document) that is exclusively geared towards achieving the 10 ‘priority objectives’. Non-market values are almost absent from the programme. There is just one reference to environmentally-friendly product standards, which is mentioned under the priority objective ‘facilitating the free movement of goods’, and takes the form of a proposed framework directive on the integration of environmental aspects in product design and of a Commission communication on the integration of environmental aspects into the (self-regulatory) standardisation process.

A similar tone is set in one of the major elements of the legislative programme contained in the Internal Market Strategy, namely the recently launched proposal for a Directive on Services in the Internal Market.<sup>57</sup> This controversial draft legislation proposes across-the-board liberalisation, applying the country of origin and mutual recognition principles to all services except those that are specifically excepted (mainly services covered by existing sector-specific EC legislation). The proposal does not aim at total liberalisation, since it provides for measures of so-called horizontal harmonisation that come under the heading ‘quality of services’ and aim at the protection of

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<sup>55</sup> *Internal Market Strategy – Priorities 2003–2006*, COM (2003) 238.

<sup>56</sup> The same 10 priorities reappear in COM (2004) 22, *Report on the Implementation of the Internal Market Strategy (2003–2006)*, submitted to the Spring 2004 meeting of the European Council.

<sup>57</sup> COM (2004) 2, Proposal for a Directive on Services in the Internal Market (available on the Commission’s internal market website, at [http://europa.eu.int/comm/internal\\_market/index\\_en.htm](http://europa.eu.int/comm/internal_market/index_en.htm)). For a comment on this proposal by a Commission official, see S. D’Acunto, ‘La proposition de directive sur les services dans le marché intérieur’ (2004) *Revue du Droit de l’Union Européenne* 201–48.

consumers of commercial services.<sup>58</sup> However, the Commission's draft does not propose any harmonisation related to non-market concerns. In fact, this would have been difficult to include in a horizontal directive dealing with all services, given that those non-market concerns tend to be service-specific (for example, the concern for the administration of justice relates to legal services, the concern for cultural diversity relates to broadcasting services, and so on). These concerns appear in the Commission's draft only as *grounds for derogation*, in Article 19. However, these grounds of derogation are drawn much more narrowly<sup>59</sup> than the general interest grounds for restriction recognised by the Court in its case-law on Member State restrictions to the trade in services, and the question arises whether they aim to *replace* the Treaty-based grounds of derogation recognised by the Court in this area of common market law.

Non-market values are thus exclusively seen as grounds of derogation, to be rolled back as far as possible, and not as positive objects for Community regulation. If this general directive on services were to be approved as originally proposed by the Commission,<sup>60</sup> it would make it more difficult subsequently to argue for specific measures of harmonisation in service sectors, since the present draft Directive purports to identify in overall terms what really needs to be harmonised and what, on the contrary, can be left to mutual recognition and home country regulation.

This emphasis on economic competitiveness in the central internal market policy documents is, however, counterbalanced by other policy documents of the Commission, and resolutions of the Council, which start from the opposite angle. These are documents dealing with the role of the EU in the field of the environment, health and safety, culture and human rights. There, the institutions underline the importance of fully integrating or mainstreaming non-market concerns in internal market legislation. Those documents have less political weight than the overall strategy papers mentioned above, but that does not necessarily mean that they are less influential in shaping the content of concrete legislative measures.

It is to this actual legislative process, as it occurred during the last decade, that this chapter now turns, although only a selective and fragmentary view of this process can be given here. Evidence that non-market values have been incorporated is most obvious when these values are formally inscribed among the objectives of the legislative measure. One typical formula consists in

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<sup>58</sup> Article 26 and ff. of the draft Directive.

<sup>59</sup> The following grounds are recognised: 'the safety of services, including aspects relating to public health'; 'the exercise of a health profession' and 'the protection of public policy, notably aspects related to the protection of minors'.

<sup>60</sup> At the time of writing this chapter it seemed more likely that the original Commission proposal will be heavily amended before it will be adopted by Council and Parliament.

mentioning the dual objective in Article 1 of the relevant Community act. A recent example of this is Regulation 648/2004 on detergents, based on Article 95 EC (this is a further amendment to a directive originally adopted in 1973); its Article 1(1) defines its aims as follows: ‘This Regulation establishes rules designed to achieve the free movement of detergents and surfactants of detergents in the internal market while, at the same time, ensuring a high degree of protection of the environment and human health’.<sup>61</sup> Regulation 1829/2003 on genetically modified food and feed is a more prominent example of EC legislation in which the multifaceted nature of the measure is openly spelled out; its Article 1 states that its objective is to ‘provide the basis for ensuring a high level of protection of human life and health, animal health and welfare, environment and consumer interests in relation to genetically modified food and feed, whilst ensuring the effective functioning of the internal market’.<sup>62</sup>

However, this commendable practice, whereby the complex set of objectives of an internal market law is clearly spelled out at the outset, is not systematically adopted; far from it. There are many other internal market laws that simply do not have an article on *objectives* and start off by describing the *object*, namely the set of national rules that are being harmonised, whereas the possible non-market objectives of the measure are either semi-hidden in the preamble, or can only be read by implication in the substantive provisions of the act. Take, for example, the important Directive 2001/29 on harmonisation of certain aspects of copyright and related rights in the information society, based on Articles 47(2), 55 and 95 EC (all of which are internal market competences).<sup>63</sup> Its Article 1, entitled ‘scope’ indicates that it ‘concerns the legal protection of copyright and related rights in the framework of the internal market, with particular emphasis on the information society’, which does not add much information to that provided by the title of the Directive and the reference to its Treaty basis. A provision, hidden in the preamble to the Directive, alerts us to the fact that the proposed harmonisation also ‘relates to compliance with the fundamental principles of law and especially of property, including intellectual property, and freedom of expression and the public interest’,<sup>64</sup> but no further guidance is given either there or in the body of the Directive as to how its economic aims ‘relate’ to the aim of respecting those

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<sup>61</sup> OJ 2004 L104/1.

<sup>62</sup> OJ 2003 L268/1. The legal bases of the Regulation are Articles 37 (agriculture), 95 (internal market) and Article 152(4)(b) (protection of animal and plant health) of the EC Treaty. Some of the non-market objectives listed in Article 1 correspond to the policy objectives underlying Articles 37 and 152, but others are to be ascribed to the internal market competence itself.

<sup>63</sup> OJ 2001 L167/10.

<sup>64</sup> Third recital of the preamble.

fundamental rights, nor to the way the Directive ensures ‘compliance’ with the potentially conflicting demands of the fundamental right of intellectual property and the fundamental right of freedom of expression. The preamble further states that the Directive seeks to promote cultural creation (by ensuring appropriate rewards to authors) but also access to culture (by allowing particular exceptions to the exclusive rights of authors).<sup>65</sup> Again, this complex cultural policy aim pursued by the Directive is not clearly acknowledged in its opening articles, nor is it made clear which provisions of the Directive promote one or both of the specific cultural concerns mentioned in the preamble.

One might wonder, at this point, whether there is a *legal obligation* on the EU institutions to disclose the objectives pursued by means of a legislative act. In fact, the ECJ has repeatedly held that the duty to give reasons (imposed by Article 253 EC), in the case of legislative measures, requires an indication of the ‘general objectives’ which the measure intends to achieve.<sup>66</sup> However, this duty does not imply that a specific article of the directive or regulation must be devoted to the definition of its objectives. It is enough, it seems, that those objectives can be gleaned from the recitals of the preamble.<sup>67</sup>

Occasionally, public policy concerns are deliberately included in internal market legislation after a public campaign by interest groups or individual states. Two examples from the last decade are the Posted Workers Directive and the reform of public procurement legislation. The enactment of the Posted Workers Directive in 1996 constituted a controversial use of internal market competences to favour social policy ends. This is a Directive based on Articles 57(2) and 66 EC,<sup>68</sup> the legal basis for measures to facilitate the free movement of services. In fact, this Directive applies horizontally to all service provision across intra-Community borders involving the sending of personnel abroad (the so-called ‘posting’ of workers). Social policy concerns became dominant during the elaboration of the Directive,<sup>69</sup> its main aim being to prevent social

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<sup>65</sup> Respectively in recitals 9 to 12, and in recital 14.

<sup>66</sup> See, for example, Case C-168/98 *Luxembourg v Parliament and Council* [2000] ECR I-9131, para. 62.

<sup>67</sup> *Ibid.*, para. 64.

<sup>68</sup> In the post-Amsterdam numbering, Articles 47(2) and 55 EC; Directive 96/71, OJ 1996 L18/1.

<sup>69</sup> The original Commission proposal was from 1991, and the Council adopted it only in 1996. In the meantime, a number of host countries had adopted legislation unilaterally imposing some of their labour legislation on posted workers, thus putting added pressure on the other States for agreeing on the enactment of a directive that would reflect these social policy concerns. See the account by W. Eichhorst, ‘European social policy between national and supranational regulation: Posted workers in the framework of liberalised services provision’, Max-Planck-Institut für Gesellschaftsforschung, Discussion Paper 98/6, available at [http://www.mpi-fg-koeln.mpg.de/pu/dp97-99\\_en.html](http://www.mpi-fg-koeln.mpg.de/pu/dp97-99_en.html), 20–26.

dumping by making posted workers subject to the labour law rules of the host State as regards, for example, minimum wages. From the point of view of the firms providing cross-border services, the Directive forces them to comply with two different sets of labour law (those of their country of establishment and those of the country where they post workers), which is why some critics have argued that this Directive did not, in fact, *facilitate* the free movement of services (as its legal basis requires), but hinders it.<sup>70</sup> The policy debate has flared up again with the recent proposal for a general services Directive, mentioned above, since critics of this document have argued that it would undermine, directly or indirectly, the regulatory achievements of the Posted Workers Directive.

Public procurement law is another interesting area. Existing EC legislation on public procurement left a large amount of uncertainty as to whether awarding authorities could take into account environmental policy or social policy considerations in deciding which offer is the most economically advantageous. The Commission published interpretative communications on this question,<sup>71</sup> and the ECJ decided some well-known test cases.<sup>72</sup> The recently revised legislative framework for public procurement, while sticking to the rule that contracting authorities should use one of two award criteria only, namely the lowest price or the most economically advantageous tender, broadens somewhat the scope for weighing non-market concerns in deciding which tender is most economically advantageous. Environmental and social policy criteria are specifically mentioned in the main text or in the preamble.<sup>73</sup> The degree to

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<sup>70</sup> For a discussion of this point (and of the overall content of the Directive), see P. Davies, 'Posted workers: Single market or protection of national labour law systems?' (1997) vol. 34:3 *Common Market Law Review* 571–602; and M.A. Moreau, 'Le détachement des travailleurs effectuant une prestation de services dans l'Union européenne' (1996) vol. 123:4 *Journal du droit international* 889–908.

<sup>71</sup> European Commission, *Interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating environmental considerations into public procurement*, OJ 2001 C333/12; and *Interpretative Communication on the Community law applicable to public procurement and the possibilities for integrating social considerations into public procurement*, OJ 2001 C333/27.

<sup>72</sup> On environmental policy considerations, Case C-513/99 *Concordia Bus Finland v Helsingin Kaupunki and HKL-Bussiliikenne* [2002] ECR I-7213; and on social policy considerations, Case C-225/98 *Commission v France* [2000] ECR I-7445. For a comment on the case-law, see C. Bovis, 'Recent case-law relating to public procurement: A beacon for the integration of public markets' (2002) vol. 39:5 *Common Market Law Review*, 1025–56 at 1050–55.

<sup>73</sup> Directive 2004/18 on the co-ordination of procedures for the award of public work contracts, public supply contracts and public service contracts, OJ 2004 L134/114, Article 53(1)(a), and recitals 1 and 46 of the preamble.

which such non-market (but nevertheless ‘economic’!) criteria can be taken into account when awarding the contract was, in fact, the central issue opposing the Council and the Parliament in the conciliation procedure that led to a final agreement on the new legislation.<sup>74</sup>

More examples from institutional practice could be given. However, the examples mentioned point to the existence of a frequent pattern, in which internal market legislation is used to re-regulate the European market in order to achieve a variety of non-market objectives, based on values recognised by the European Treaties or derived from the public policies of the Member States. Yet again, there are also cases in which those values are *not* incorporated in EC acts where they could have been, or are given inadequate weight against competing market objectives. There is a well-known thesis, exposed perhaps most clearly by Fritz Scharpf, that positive integration is institutionally more difficult to achieve than negative integration.<sup>75</sup> So, by extension one might expect that, if an agreement is reached on the adoption of an internal market measure, its content might be close to a lowest common denominator between national interests and perhaps biased in favour of trade liberalisation and against re-regulation.

However, the reality is more complex than this simple model indicates. In order to arrive at meaningful conclusions about the substantive quality of internal market legislation, one would have to take a closer look at the inter-institutional dynamics, and the roles and attitudes of interest groups and non-governmental organisations, in a number of major examples of recently adopted or aborted internal market legislation. Among the key variables are the regulatory preferences of each of the central institutions (Commission, Council and European Parliament) and the way these preferences change over time, as well as the influence of interest groups representing the so-called diffuse interests in the European policy process.<sup>76</sup> Moreover, none of the three main institutions can be said to have homogeneous preferences. This is quite obvious for the Council (with its specialised formations and conflicting Member State interests) and the European Parliament (with its specialised committees and mobile ideological divides), but applies equally to the Commission. The regulatory mix in a Commission legislative proposal is the result of often competing priorities of the various parts of the institution. As

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<sup>74</sup> See Commission Press Release of 3 December 2003, IP/03/1649, ‘Public procurement: Commission welcomes conciliation agreement on simplified and modernised legislation’.

<sup>75</sup> F. Scharpf, *Governing in Europe: Effective and Democratic?* (Oxford: Oxford University Press, 1999), pp. 71ff.

<sup>76</sup> M. Pollack, ‘Representing diffuse interests in EC policymaking’ (1997) vol. 4:4 *Journal of European Public Policy* 572–90.



Simon Hix puts it crudely, ‘whereas some Commission Directorate-Generals are heavily linked to transnational business interests, others are “captured” by EU-level environmental, consumer and trade union groups’.<sup>77</sup> For example, one can observe a correlation between the development of the little ‘health’ unit of the Commission into a powerful Directorate-General (SANCO),<sup>78</sup> and the gradually more prominent recognition of health concerns in the Commission’s internal market proposals, although it is difficult to decide which is the cause and which the effect.

In a detailed overall examination, based on a number of in-depth case studies, Young and Wallace came to the conclusion that the EU regulatory model is sensitive to societal and political considerations and not just to corporate interests. The legislative process provides multiple access points for diffuse interests and the Member State governments see it often as their natural task to protect the ‘general interest’ in the face of economic liberalisation. Moreover, producer organisations in countries with high social or environmental standards may also want to export those standards to the other Member States through EC legislation, thus creating a more attractive ‘level playing field’ for themselves. One piece of internal market legislation in which Young and Wallace found a strong reflection of what they call civic interests is the Directive on Environmental Standards for Car Emissions.<sup>79</sup> However, their conclusions might be coloured by their choice of case studies, and it is easy to find counter-examples of internal market laws which ‘civic interests’ have been unable to shape. Take for instance the ‘Chocolate Directive’ of 2000, which was the result of long and bitter discussions in the Council and Parliament.<sup>80</sup> It was argued that the essential object of the Directive, namely to facilitate the free trade of all chocolate products, including those ‘inferior’ products using in part vegetable fats other than cocoa butter, conflicted with the interests of consumers and of cocoa producers in developing countries. Yet, when one reads the text of the Directive and its preamble, only the internal market objective is prominently mentioned, and no evidence is given that non-market values (such as development policy) have been taken into account by the European legislator.

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<sup>77</sup> S. Hix, *The Political System of the European Union* (Basingstoke: Macmillan, 1999), p. 239.

<sup>78</sup> This development is described by S. Guigner, ‘L’odyssée de l’administration européenne de la santé: la quête d’un leadership’ (2003) 11 *Politique européenne* 31–55.

<sup>79</sup> A.R. Young and H. Wallace, *Regulatory Politics in the European Union: Weighing Civic and Producer Interests* (Manchester: Manchester University Press, 2000), in particular Chapter 2; Directive 98/69, OJ 1998 L350/1.

<sup>80</sup> Directive 2000/36 relating to cocoa and chocolate products intended for human consumption, OJ 2000 L197/19.

A related issue is that EC legislation pursuing multiple objectives may, in practice, serve one aim better than the other, because the operational rules are geared, deliberately or not, towards achieving one of the aims rather than the other. Also, at the level of concrete implementation (that is, in most cases, within the Member States' legal orders), the duty to strike the right balance between possibly conflicting objectives is left to national authorities. One of the aims may be privileged over the other, depending on national value preferences or administrative routines. It has been suggested that EC legislation that seeks to achieve non-market objectives may be relatively under-implemented. Protective legislation may be unevenly implemented in the various countries or inadequately monitored by the Member States and the Commission. There are some indications that there may be an 'implementation deficit' with regard to positive integration measures compared with 'negative' market making.<sup>81</sup> Often, the uneven application of European regulatory standards is built into the legislative text itself, when it establishes only minimum harmonisation, allowing some Member States to adopt stricter standards than others, or when it contains country-specific derogations of a transitional or permanent nature.<sup>82</sup>

## CONCLUSION

This chapter has sought to examine the extent to which non-market values are present and acknowledged in EU legislation that regulates the operation of the internal market. It has questioned the continued validity of the 'regulatory gap thesis' that was first formulated in the mid-1980s: the thesis that the European Community was better, for legal and political reasons, at deregulating and abolishing national barriers to intra-European trade than at re-regulating and setting positive standards for the protection of the public interest at the European level. It is doubtful whether this thesis is valid in the EU as it currently functions. *Legally* speaking, the constitutional law of the EU does not press hard for deregulation. It is true that the Common Market freedoms

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<sup>81</sup> See S. Weatherill, 'Addressing problems of imbalanced implementation in EC law: Remedies in an institutional perspective', in C. Kilpatrick, T. Novitz and P. Skidmore (eds), *The Future of Remedies in Europe* (Oxford: Hart Publishing, 2000), pp. 87–116.

<sup>82</sup> See G. de Búrca, 'Differentiation within the core: The case of the common market', in G. de Búrca and J. Scott (eds), *Constitutional Change in the EU: From Uniformity to Flexibility?* (Oxford: Hart Publishing, 2000), pp. 133–71; and E. Vos, 'Differentiation, harmonisation and governance', in B. de Witte, D. Hanf and E. Vos (eds), *The Many Faces of Differentiation in EU Law* (Antwerpen: Intersentia, 2001), pp. 145–79.

occupy a privileged position in the EU legal order, but there are no major legal obstacles that prevent the inclusion of non-market considerations in internal market legislation, despite some occasionally unfortunate judicial language (as in some parts of the *Tobacco Advertising* ruling).

The qualitative content of internal market laws thus depends on the *political* dynamics in the institutional arena of the EU. Developments in recent years show contradictory trends in this regard. There is clearly a tension between the emphasis on competitiveness as the lodestar of the EU's internal market strategy, and the new prominence given, in European constitutional and political discourse, to fundamental rights and non-market values. One recommendation, to conclude this chapter, is that the underlying policy goals of internal market legislation need to be more clearly and systematically identified in the actual text than they are at present. If they are better articulated, then the interested European citizens can also better assess whether, in their opinion, the EU institutions have adequately taken into account the many mainstreaming clauses of the Treaty about environment, fundamental rights, culture, health and social protection and, more generally, whether the legislative act as a whole has struck an adequate balance between the objective of market integration and competing non-market objectives.

## 4. Competition and the liberalised market

**Erika Szyszczak**

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### INTRODUCTION

The growing maturity of the internal market programme, and the consequent changes to market structures and trade patterns in Europe, have led to a new dynamic in the relationship between competition policy and the free movement provisions. The relationship between the two policies was once seen as complementary; but the rapid movement towards competitive markets through liberalisation and privatisation of state activity previously shielded from the rules of competition has created a new relationship between the state, regulation and the competitive market, shifting the focus of attention upon the interconnectedness of the two policies.<sup>1</sup> The aim of this chapter is to explore some of the features of this relationship under three broad themes: first, the use of new forms of economic governance to regulate competition in liberalised markets; secondly, the emergence of new economic actors; and thirdly and finally, the position of the free movement and competition rules in the economic constitution and their role in polity building.

### NEW FORMS OF ECONOMIC GOVERNANCE

During the 1990s competition law underwent a subtle process of policy change and enforcement leading to a full scale modernisation programme in the new millennium. The constitutional legitimacy of the role of competition law in the integration project is derived from its Treaty basis but, in fact, the EC Treaty provides very few principles on how competition should materialise in the internal market. The sweeping statements of Articles 2 and 3(1)g EC only make sense when viewed in the light of the detailed decision-making powers of the Commission (involving also negotiation and mediation), the

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<sup>1</sup> Cf. the ideas of convergence between the two areas in K. Mortelmans, 'Towards convergence in the application of the rules on free movement and on competition' (2001) vol. 38:3 *Common Market Law Review* 613–49.

judgments of the European Courts, and in the application of Community competition law and principles by national courts and regulatory agencies.<sup>2</sup>

The internal market project created a different focus for competition law: first, in terms of addressing the continuing barriers to integration created by state intervention in the market;<sup>3</sup> and secondly, the need to address new problems as a result of the liberalisation processes of the 1990s, particularly the regulation of private power and new hybrid public/private bodies which have emerged. Public procurement was singled out as a crucial area in need of Community attention and, in the absence of an EC Treaty basis, a programme of detailed secondary legislation was adopted using the internal market as the basis of its provisions.<sup>4</sup>

The original European Economic Community (EEC) Treaty addressed only blatant examples of state intervention which might disrupt competition and trade between the Member States: state aids and public monopolies. These provisions were used sparingly until the 1990s, the Commission relying upon discretion and negotiation to monitor the Member States' behaviour, using soft law techniques to usher in policy change. Similarly, in relation to attacks upon public monopolies providing services of general economic interest, the Commission orchestrated a political debate using soft law, rather than attempting a radical hard law approach.

The growth in economic activity and the spill-over effects of the internal market forced a fundamental change in attitude towards the role of the state in competitive markets. This change in attitude was channelled into litigation, often in the national courts, which tested the legitimacy of shielding huge areas of economic activity from the full thrust of the competition and internal market rules. Central to this litigation was the scope of the limited provisions in the EC Treaty to protect Member States' interests where a public interest was at stake. This is seen in the focus around the scope of Article 86(2) EC, which shields services of general economic interest from the full force of Community law. The Commission used soft law processes to respond to the Member States' reluctance to draw up a normative framework for the regulation of services of general economic interest at the Community level. This process was aggravated by an increased use of litigation, often using proce-

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<sup>2</sup> For a fuller discussion, see P. Larouche, *Competition Law and Regulation in European Telecommunications* (Oxford: Hart Publishing, 2000), Chapter 3.

<sup>3</sup> W. Sauter, *Competition Law and Industrial Policy in the EU* (Oxford: Clarendon Press, 1997), p. 229.

<sup>4</sup> The Community simplified and clarified the public procurement directives in 2004: see Directive 2004/18, OJ 2004 L134/1, and Directive 2004/17, OJ 2004 L134/114. Details of the public procurement programme can be found at <http://europa.eu.int/scadplus/leg/en/s11000.htmpp>.

dural guarantees in Community law, which created a dual track, and sometimes inconsistent, approach towards policy change.<sup>5</sup>

An important feature of the internal market programme was the use of new forms of regulation to kick-start the stagnant integration project. This embraced closer monitoring by the Commission through scoreboards, utilising traditional enforcement techniques under Article 226 EC, but relying also upon peer pressure and the use of individual litigation to ensure that the Member States met their duties to implement the broad platform of Community measures to complete the ambitious programme of integration.<sup>6</sup> The Lisbon Presidency Conclusions of March 2000 generated further momentum in the process of economic and political integration, when political recognition was given to the need to use new forms of governance techniques to complement traditional methods of Community law and policy-making. It was here that the experimental techniques of co-operation and co-ordination, not to say convergence, were given an official label: the open method of co-ordination (OMC).<sup>7</sup>

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<sup>5</sup> European Commission, *Communication on Services of General Interest in Europe*, COM (2000) 580 final, p. 3; *Report to the Laeken European Council on Services of General Interest*, COM (2001) 598 final; *Non-Paper Services of General Economic Interest and State Aid*, 12 November 2002, available at [http://europa.eu.int/comm/competition/state\\_aid/others/1759\\_sieg\\_en.pdf](http://europa.eu.int/comm/competition/state_aid/others/1759_sieg_en.pdf); *Report from the Commission on the State of Play in the Work on the Guidelines for State Aid and Services of General Economic Interest*, available at [http://europa.eu.int/comm/competition/state\\_aid/others/sieg\\_en.pdf](http://europa.eu.int/comm/competition/state_aid/others/sieg_en.pdf); *Green Paper on Services of General Interest*, COM (2003) 270 final; and *White Paper on Services of General Interest*, COM (2004) 374 final. All of the above documents may be downloaded from [http://europa.eu.int/comm/competition/state\\_aid/others](http://europa.eu.int/comm/competition/state_aid/others). The political process was put on hold as the Court delivered a series of preliminary rulings on the financing of services of general economic interests and the compatibility of such financing with the state aid provisions of the EC Treaty; see Case C-280/00 *Altmark Trans GmbH v Nahverkehrsgesellschaft Altmark GmbH* [2003] ECR I-774.

<sup>6</sup> See P. Craig, 'The evolution of the single market', in C. Barnard and J. Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Oxford: Hart Publishing, 2002), pp. 1–40.

<sup>7</sup> Earlier labels had used the Presidency Conclusions to describe the new processes being introduced (for example, the Luxembourg Process and the Cardiff Process). A forerunner of the new approaches to economic governance is seen in the process of economic policy co-ordination found in the Broad Economic Policy Guidelines of the Member States and the Commission (BEPG) in Article 99 EC. The Barcelona Presidency Conclusions of 15 and 16 March 2002 led to co-ordination into a streamlined cycle of the new forms of economic governance seen in the adoption in Spring 2003 of the 'Implementation Package': the *BEPG Implementing Report*; *Recommendations to the Member States under the Employment Strategy in the Joint Employment Report*; a set of *Employment Guidelines*; and the *Implementation Report on the Internal Market Strategy*, in what the Commission describes as a co-ordinated

The impact and importance of the new forms of economic governance are seen in the way that conventional competence battle lines are avoided, shifting away from head-on conflicts with the Member States yet, at the same time, taking EU policy further and further into the sacred domain of sensitive areas of national policy-making.<sup>8</sup> The new forms of economic governance have had the effect of steering the Member States, as well as the various non-state actors involved, towards ideas of convergence on economic policies, conventionally seen as unsuitable, unthinkable and untouchable by Community law-making processes. The integration project was beginning to feel the strain of lacking a strong central government to give effect to the distinctive re-regulation project and, even after the Treaty of Amsterdam, issues of legitimacy continued to surface. The claims associated with the use of new tools of economic governance are that they allow flexibility, moving the EU forward by providing the tools for co-ordination of policies, while legitimating the processes through the involvement of various stakeholders in the integration process. In practice, little empirical analysis has been carried out on how far policy change can be attributed to such processes.

It is the sum of all the parts of this new governance which makes it a distinctive tool, since many of the individual aspects have been deployed in the past. The use of soft law, rather than the traditional institutional mechanisms to create hard law, is but one feature, and not a new feature, of Community governance techniques. Soft law is a flexible tool of governance with no clear demarcation between rule-making and rule-implementation. This again is not necessarily a new technique. It is a feature of rule and policy making used by the Commission in the past, especially in the arena of competition law. What is new is the open acceptance of this form of governance, hailed by the Community as a new approach to problem solving, embracing iteration, mutual co-operation, standard setting and mutual learning. The use of policy learning is regarded as a central key to the new governance processes. Yet very little research has been carried out on how policy transfer operates or if, indeed, it has any significant effect. The new techniques of governance leave even less room for the judicial forum to adjudicate upon the

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instrument for economic governance, COM (2003) 6 (01). See E. Szyszczak, 'Social Policy' (2003) vol. 52:4 *International and Comparative Law Quarterly* 1013–58.

<sup>8</sup> The OMC is being used in different ways and at different levels in a number of sensitive areas. A typology can be drawn up by categorisation into (1) *Developed Areas*: the BEPG and the European Employment Strategy; (2) *Adjunct Areas*: modernisation of social protection, social inclusion and pensions; (3) *Minimal Evolution*: innovation and research and technological development, education, the information society, environmental policy, health care, and immigration. There is also the use of *unacknowledged OMC processes* in the field of direct taxation.

legality of such processes.<sup>9</sup> An additional feature of the new governance processes is the interaction of what are described as top-down learning processes combined with bottom-up learning processes, making use of new sites of decision-making with an emphasis upon the use of networks rather than hierarchies, involving new political actors and stressing participation by civil society.

The internal market programme set precedents for the development of the new forms of economic governance, especially for the use of greater transparency, accountability and monitoring of the Member States' behaviour. Scoreboards, peer group pressure and early warning systems have been introduced to ensure the maintenance and efficiency of the free trade principle. Now these new tools of governance, derived from the internal market programme, have been extended to competition policy. The Stockholm Council of 2001 steered attention towards the imperative to regulate state aid more closely, introducing the use of the state aid scoreboard<sup>10</sup> and monitoring reports, as well as introducing greater transparency in the use of the state aid register.<sup>11</sup> These tools replicate the techniques of peer pressure, a name and shame approach to the surveillance of state aid, as well as introducing a normative dimension by defining acceptable state aid. This is seen in the persuasion used to shift the focus of state aid to horizontal schemes, away from sectoral state aid.

Paradoxically, the period from the late 1990s to the present day has seen the consolidation of much of the Commission soft law approaches towards state aid control concretised in hard law measures, bringing state aid regulation into the modernisation era. However, new challenges, particularly the need to manage the 2004 enlargement of the EU, have seen the continued use of soft law, the aim being to free up the Commission's investigatory and enforcement time, and so to prioritise scrutiny of state aid which will have a significant impact upon the operation of the internal market. This fits with an overall trend towards de-centralisation of competition law combined with a re-centralisation of Community integration priorities.

Another example of the use of new forms of economic governance is seen in the Commission's soft law approach to regulating services of general interest. The Court was asked to rule on the scope of Article 86(2) EC in a series of challenges brought against public monopolies in the 1990s. The very nature

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<sup>9</sup> Cf. the Court's willingness to examine the new tools of governance in the form of recommendations in relation to the excessive deficit procedure adopted under Article 104(7) EC in Case C-27/04 *Commission v Council*, [2004] ECR I-6649. Cf. also, Case T-2/04 *Korkmaz, The Corner House and The Kurdish Human Rights Project v Commission*, order of the CFI, 30 March 2006; see OJ 2004 C71/32.

<sup>10</sup> Available at [http://europa.eu.int/comm/competition/state\\_aid/scoreboard](http://europa.eu.int/comm/competition/state_aid/scoreboard).

<sup>11</sup> Available at [http://europa.eu.int/comm/competition/state\\_aid/register](http://europa.eu.int/comm/competition/state_aid/register).



of Article 234 EC proceedings led to an inconsistent and casuistic approach to regulating a sensitive area of the Member States' sovereignty.<sup>12</sup> The response by the Commission was to orchestrate a number of soft law communications which stated that they explained the Court's case-law, but which in reality acquired a normative status in delineating the boundaries between the reach of Community law and domain of the Member States.<sup>13</sup>

The new forms of economic governance deploy a number of regulatory techniques which tend towards the soft side of regulation: Commission communications, Green and White Papers, notices, press releases, non-papers, and speeches of the Commissioner for competition.<sup>14</sup> Within the regulatory tools, a number of techniques are employed to create a consensus of what the Community policy should be, and how it should be achieved. Such techniques involve the use of general goals to be achieved and the establishment of targets and timetables. A weakness of this approach is the lack of sanctions. The techniques of enforcement are peer pressure, the creation of common indicators, benchmarking and exchange of best practice.

Underpinning the new approach to economic governance in competition law is a drive towards modernisation of the Community's policies, its goals and the means by which such goals will be achieved. The focus upon competition law and its relationship with the internal market can be viewed as unfinished business from the internal market modernisation project of the 1980s, a realisation of the emphasis upon free trade during this period, and a recognition of the need to bring competition law up to speed on the challenges facing the EU. The focus upon modernisation is a direct result of the functioning of the internal market, leading to greater cross-border activity, mergers and restructuring of markets, particularly in the wake of liberalisation. What is significant is that instead of engaging in a major overhaul of the relationship between competition and the internal market, the new techniques of economic governance are preferred. Even in the Constitutional Treaty for the EU, the rules relating to competition policy are unscathed from revision, and remain virtually intact in their 1957 form.<sup>15</sup> Thus, the regulation of competition in the internal market is characterised by an emphasis upon flexibility and diversity; the ability to experiment, to change the goals, the timetables and the methods used to create competition within different sectors of the internal market.

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<sup>12</sup> E. Szyszczak, 'Public services provision in competitive markets' (2001) 20 *Yearbook of European Law* 35–77.

<sup>13</sup> See Craig, *op. cit.*, n. 6 above. For further discussion, see E. Szyszczak, 'State intervention', in T. Tridimas and P. Nebbia (eds), *European Union Law for the 21st Century* vol. 2 (Oxford: Hart Publishing, 2004), pp. 217–38.

<sup>14</sup> The latter being available at <http://europa.eu.int/comm/competition/speeches>.

<sup>15</sup> OJ 2004 C310/1.

The liberalisation of a number of sectors in the internal market has used a new approach to governance. Originally in the first major sector to be liberalised, the telecommunications liberalisation programme, the goal was a structured liberalisation approach leading towards full competition. The early movements towards liberalisation reveal how a number of complementary tools were deployed by the Commission, relying upon experimentation. Larouche identifies at least four different kinds of regulatory models,<sup>16</sup> crafted around soft law exercises and political compromise. These experiments are repeated, but to a lesser extent, in other areas of liberalisation. The regulatory tools used were based upon Article 86(3) EC and the internal market legal base, Article 95 EC. Some forms of regulation were competition based; others were regulatory. However, the liberalisation process saw the use of new hybrid instruments utilising regulatory and competition principles within the same legal instrument.<sup>17</sup> Later liberalisation programmes in the utilities and postal sector adopted this hybrid approach, with regulation being particularly important in managing the provision of universal obligations and regulating access to networked industries.<sup>18</sup>

The new approach focuses attention on issues of market management. This, in turn, raises questions about competence. Such questions are not unfamiliar in the debates and litigation centred on the internal market. However, the intensity of the questioning of the reach of Community competence over a number of areas previously immune from market principles has increased. Recent litigation has explored the scope of the free movement and competition rules in relation to healthcare<sup>19</sup> and explored the boundaries between Community law and national autonomy in social security issues.<sup>20</sup> The use of

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<sup>16</sup> See Larouche, *op. cit.*, n. 2 above, Chapter 1.

<sup>17</sup> A discussion of this new approach can be found in P. Nihoul, 'Convergence in European communications: A case study on the relationship between regulation and competition' (1998/99) Issue 2/*Winter International Journal of Communications Law and Policy*, see <http://www.digital-law.net/IJCLP/2-1999index.html>.

<sup>18</sup> Directive 2002/22 of the European Parliament and of the Council on universal service and user's rights relating to electronic communications networks and services (Universal Service Directive), OJ 2002 L108/51.

<sup>19</sup> The case-law is summarised in European Commission, *Communication on the follow-up to the high level reflection process on patient mobility and healthcare developments in the European Union*, COM (2004) 301. See also *Communication on modernising social protection for the development of high quality, accessible and sustainable healthcare and long-term care: Support for the national strategies using the 'open method of co-ordination'*, COM (2004) 304.

<sup>20</sup> Joined Cases C-159/91 and C-160/91 *Poucet and Pistre* [1993] ECR I-666; Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I-5751; Case C-218/00 *Battistello* [2002] ECR I-691; Case C-174/97P *FFSA (Fédération française des sociétés d'assurances) and others v Commission* [1998] ECR II-229; and Case T-319/99 *Fenin v Commission* [2003] ECR II-357.

subsidiarity to control such a sensitive debate has been of limited importance, the Member States and the Courts emphasising the role of clear-cut boundaries between national autonomy and Community competence. The Court has preferred a broad approach, widening the reach of Community law but allowing the Member States to use the justifications and derogations within free movement and competition law to protect sensitive issues. This has blurred the line between Member State autonomy and Community competence.<sup>21</sup>

Gradually a template has emerged which begins to institutionalise the role of the new forms of economic governance and to explore sensitive areas of EU policy. This is seen where the Member States have sought to retain national competence but the logic of European integration demands at least convergence of policy. Such techniques are seen in the field of competition policy involving the State as an economic actor. The new techniques of governance are being used to supplement existing areas of Community competence without the resort to protracted negotiations on Treaty amendment.<sup>22</sup> There are arguments that the new forms of economic governance penetrate into national systems changing internal policy, and re-configuring political institutional frameworks.<sup>23</sup> This is reinforced by the fact that many of the claims for the effectiveness of the new forms of governance come from within, especially from the Commission.

The new forms of economic governance have gained acceptance through endorsement by the political elites in Europe. The technocratic participants, especially civil servants and experts, continue to dominate the process at the EU level, despite claims from the Lisbon Process that the citizen has a role in the new Europe. In competition policy, the Commission has created networks of regulators and experts to comment upon new policy proposals as well as opening up these issues to wider consultation, via the Europa website. The Commissioner for Competition has utilised conferences on competition law in Europe and abroad (in the United States, for example,) to explain Commission policy.<sup>24</sup> Such speeches are also used to drive a wider EU policy agenda, which creates a normative basis for Community action.

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<sup>21</sup> Szyszczak, *op. cit.*, n. 13 above.

<sup>22</sup> See E. Szyszczak, 'Social policy in the Post-Nice era', in A. Arnall and D. Wincott (eds), *Accountability and Legitimacy in the European Union* (Oxford: Oxford University Press, 2002), pp. 329–44. Here, the OMC is described as a 'pre-legal step'. The Complementary Competencies Working Group in the European Convention also recognised this role for the OMC, available at [http://european-convention.eu.int/doc\\_register.asp?lang=EN&Content=WGV](http://european-convention.eu.int/doc_register.asp?lang=EN&Content=WGV). As such, the new forms of economic governance can be viewed as feeding into conventional Community law-making processes.

<sup>23</sup> E. Szyszczak, 'The new paradigm for social policy: A virtuous circle?' (2001) vol. 38:5 *Common Market Law Review* 1125–70.

<sup>24</sup> See again, n. 14 above.

As with other areas of new governance, the Council and the Commission are the driving forces of the new method. To date, the claims for participatory democratic governance,<sup>25</sup> or the directly-deliberative polyarchy,<sup>26</sup> or indeed other forms of democratic experimentation based upon mutual learning and bottom-up processes to which the new forms of economic governance have laid claim to facilitating, have not emerged.<sup>27</sup> Yet the use of new forms of economic governance upsets the careful evolution of horizontal power within the EU. The European Parliament and the Committee of the Regions are sidelined, and the European Court of Justice (ECJ) is struggling to find a role for the rule of law in the process.

## THE EMERGENCE OF NEW ECONOMIC ACTORS

The growing maturity of the relationship between internal market and competition policy, alongside the use of new forms of economic governance, has had an impact upon the role of economic actors in the governance processes. This can be seen in three areas: enforcement, market participation and market structures.

### Enforcement

The success of the internal market programme posed threats to Member States that wanted to retain control over sensitive areas of the economy. Most Member States were reluctant to relinquish control to a more centralised, federalist EU structure, especially in such areas where national champions dominate (for example, in the utilities sector). However, markets began to outgrow the state. The increased regulation of the internal market, combined with the new forms of economic governance processes, evolved into a new form of co-regulation relying upon centralised and decentralised enforcement mechanisms. There has been a general shift towards encouraging local regulation and enforcement of competition law, despite concerns that this may lead

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<sup>25</sup> J. Scott and D. Trubeck, 'Mind the gap: Law and the new approaches to governance in the European Union' (2002) vol. 8:1 *European Law Journal* 1–18.

<sup>26</sup> O. Gersetenberg and C. Sable, 'Directly-deliberative polyarchy: An institutional ideal for Europe?', in C. Joerges and R. Dehousse (eds), *Good Governance in Europe's Integrated Market* (Oxford: Oxford University Press, 2002), pp. 289–341.

<sup>27</sup> Cf. the area of social inclusion where a wider range of actors has been admitted, alongside the establishment of a new body, the Social Protection Committee. The scope for the wider participation of civil society in the development of competition policy is barely recognised, even in relation to policy on services of general economic interest, beyond the formal structures established by the Commission.

to fragmentation of the internal market where regulators and enforcement mechanisms are inexperienced.<sup>28</sup> The Court has endorsed the decentralised model of enforcement in a recent ruling.<sup>29</sup> Here, the Court affirmed the duty of a national competition authority to disapply national law in conflict with Community competition law in accordance with the principle of primacy of Community law.

The most controversial aspect of the emergence of new economic actors is the role of private enforcement of competition law.<sup>30</sup> The Court encouraged the development of the internal market through the use of private litigation, relying upon the direct effect of the four freedoms in the national courts. Even after the ruling in *Keck*,<sup>31</sup> the Court has not discouraged the enforcement of what are seen as fundamental economic rights.<sup>32</sup> In competition law, the Commission has encouraged the role of private litigation at the national level.<sup>33</sup> A clear advantage of private litigation in the field of competition relates to the right to access a remedy. In relation to state aids and the regulation of state monopolies, the role of private litigants has increased often to gain control over the litigation process and to force the hand of the Commission. Clear examples of this strategy are seen in the private litigation in relation to the liberalisation of postal services.<sup>34</sup> However, for some commentators the

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<sup>28</sup> However, such fears can be misplaced. It should be recalled that the ECJ had no difficulty in shifting the enforcement of the EC Treaty-based competition rules onto national courts through the use of direct effect. The liberalisation processes of the 1990s also eschewed the use of a central EU regulator, relying instead upon local systems of regulation governed by Community law and principles.

<sup>29</sup> Case C-198/01 *Conorzio Industrie Fiammiferi (CIF) v Autorità garante della Concorrenza e del Mercato* [2003] ECR I-8055.

<sup>30</sup> W. Wils, 'Should private antitrust enforcement be encouraged in Europe?' (2003) vol. 26:3 *World Competition* 473–88.

<sup>31</sup> Joined Cases 267 to 268/91 *Criminal Proceedings Against Keck and Mithouard* [1993] ECR I-6097.

<sup>32</sup> The Court uses a number of different terms ranging from 'fundamental freedom' to 'foundations of the Community'. For a fuller discussion, see P. Oliver and W.H. Roth, 'The internal market and the four freedoms' (2004) vol. 41:2 *Common Market Law Review* 407–41.

<sup>33</sup> On the regulatory effects, see Notice on Co-operation between National Competition Authorities and the Commission, OJ 1997 C313/3; see also, B. Rodger and A. MacCulloch, 'Community competition law enforcement: The Commission, national authorities and private enforcement' (1998) 4 *Columbia Journal of European Law* 579–612.

<sup>34</sup> A frequent litigator is the United States' postal operator UPS, which has used a series of litigation tactics to open up the partially liberalised postal services sector in Europe, the prime target being litigation against the German postal services' incumbent, Deutsche Post: see Case T-182/98 *UPS Europe SA v Commission* [1999] ECR II-2857; Commission Decision 2001/354/EC of 20 March 2001, OJ L125/27; Case

role of such economic actors in the enforcement of competition law, especially where it relates to questions of national policy making, is questionable. The growing academic interest in widening *locus standi* to accommodate public interest litigation<sup>35</sup> has not been taken up, and the Court of First Instance has also been reluctant to entertain public interest litigation in relation to challenges to state aid.<sup>36</sup>

### Market Participation

The transfer of a number of state obligations to private parties has led to the use of Article 86 EC against private bodies granted a monopoly, or special or exclusive rights.<sup>37</sup> The impact of the liberalisation programmes has created new forms of market participants. In some instances, the former state monopoly is transformed into an economic actor, often expanding its hereditary power in newly liberalised markets. In other cases national markets are subject to competition from outside sources, leading to debates and litigation on how far the state can protect national markets from outside influences. Examples are seen in the state aid arena,<sup>38</sup> and the protracted battles between the Commission and a number of Member States over the use of golden shares in the privatisation processes.<sup>39</sup>

### Market Structures

These new participants are stakeholders in the integration process and have expectations of the kind of autonomy they should be allowed in relation to the market. However, such entities also fulfil roles previously occupied by the

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T-253/01, removed from the Register on 30 April 2003. The cross-subsidisation of the parcels' sector through universal service obligation resources was tackled as a state aid by the Commission in June 2002. The original complaint by UPS was made in 1994. See Press Release IP/02/890 'Deutsche Post must repay €72 million used to subsidise price undercutting in commercial parcel services', 19 June 2002.

<sup>35</sup> For discussion, see A. Cygan, 'Protecting the interests of civil society in Community decision-making: The limits of Article 230 EC' (2003) vol. 52:4 *International and Comparative Law Quarterly* 995–1012.

<sup>36</sup> Case T-121/03 *Greenpeace Ltd and Nexgen Group Ltd (trading as ECOTRIC-ITY) v Commission*, OJ 2003 C184/36, and Case T-124/03 *AES Drax Power Ltd v Commission*, OJ 2003 C135/37, both cases were removed from the Register on 21 October 2003.

<sup>37</sup> *Albany* (see n. 20 above).

<sup>38</sup> An example is the French postal services sector, where there is litigation on the use of alleged state aid: see Joined Cases C-83/01 P, C-93/01 P and C-94/01 P *Chronopost SA, La Poste v Commission* [2003] ECR I-6993.

<sup>39</sup> E. Szczyżczak, 'Golden shares and market governance' (2002) vol. 29:3 *Legal Issues of European Integration* 255–84.

state. The Courts have long recognised that private power should be subject to the same obligations and duties as previously placed upon public power<sup>40</sup> and this creates a paradox. If private power is encumbered with the same obligations and duties as the state, there may be disincentives to provide certain services on the market and markets will not develop under normal competitive principles.

Yet, despite these caveats, the evolution of new forms of economic power in the internal market has seen the development of new concepts in competition law, especially in relation to the regulation of power in the relevant market. Again, we see a new synergy emerging between regulatory ideas, backed by the Member States<sup>41</sup> and through the conventional case-law approach of the Commission and the European Courts. Examples of the case-law approach would be the emergence of concepts such as super dominance in relation to Article 82 EC,<sup>42</sup> ideas of joint or collective dominance,<sup>43</sup> or the development of the concept of discrimination by a dominant undertaking.<sup>44</sup> Ideas of special responsibility placed upon undertakings holding power in the market have also been used in a regulatory form, especially in relation to electronic communications.<sup>45</sup> The Framework Directive provides for *ex ante* regulation of dominant undertakings with significant market power.<sup>46</sup> In other

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<sup>40</sup> The Court recognised this parallel development in Case 322/81 *Nederlandsche Banden-Industrie Michelin v Commission* [1985] ECR 3461. The impact of the Court's approach is summed up by Amato: 'Market power, just because it is conceptually accepted, is thus loaded with the burdens and limits which, according to the general principles, more of public than of private law, bear upon whoever holds power' (G. Amato, *Antitrust and the Bounds of Power* (Oxford: Hart Publishing, 1997), p. 66). Examples would be the Commission's enforcement focus upon hard-core cartels and the recent Decision of the Commission against Microsoft (C (2004) 900 final, Commission Decision of 24 March 2004).

<sup>41</sup> Seen in the new package of regulation of electronic communications: see A.F. Bavasso, 'Electronic communications: A new paradigm for European regulation' (2004) vol. 41:1 *Common Market Law Review* 87–118; P. Nihoul and P. Rodford, *EU Electronic Communications Law* (Oxford: Oxford University Press, 2004).

<sup>42</sup> See, for example, the Opinion of Advocate-General Fennelly in Joined Cases C-395/96 P and C-396/96 P *Compagnie Maritime Transports SA v Commission* [2000] ECR I-1365, para. 136, where he argues that a dominant undertaking's special responsibility becomes greater where the undertaking 'enjoys a position of dominance approaching monopoly'.

<sup>43</sup> Case T-342/99 *Airtours v Commission* [2002] ECR II-2585.

<sup>44</sup> Case C-333/94 P *Tetra Pak International SA v Commission (Tetra Pak II)* [1996] ECR I-5951.

<sup>45</sup> Directive 2002/19 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive), OJ 2002 L108/7.

<sup>46</sup> Directive 2002/21 on a common regulatory framework for electronic communications networks and services (Framework Directive), OJ 2002 L108/33.

areas, most notably the attempts to introduce an essential facilities doctrine into European competition law, the Court has held back, not wishing to take the judicial arena into the realms of a regulatory agency.<sup>47</sup>

It is not only in the substantive nature of competition law that new regulatory ideas are emerging. The litigation of the 1990s increased awareness of the values inherent in free movement and competition law in relation to values of good governance.<sup>48</sup> A starting point is the case of *Höfner and Elser v Macrotron GmbH*.<sup>49</sup> Here, a public undertaking with exclusive rights in job placement was found to be abusing a dominant position where it could not meet demand for its services. Similarly, ideas of efficiency in meeting market expectations were used in the Commission's notice in relation to the liberalisation of the postal sector. A more recent example is seen in the prescriptive ruling of *Altmark*, setting out the pre-conditions to be met if an undertaking wishes to avoid the application of the state aid rules to the financing of services of general economic interest.<sup>50</sup> In setting out these conditions, the Court draws upon its own case-law and the soft law discourse generated by the Commission from the mid-1990s.<sup>51</sup>

The necessity of new competition concepts to handle the problems presented by the new forms of market structures, and new market participants, raises the question of how far, and for how long, can a general, generic competition law and competition principles exist; and how far down the road must the EU travel in developing sector specific principles of regulating competition law and policy?<sup>52</sup>

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<sup>47</sup> Case C-7/97 *Bronner v Mediaprint* [1998] ECR I-7791; in the more recent *IMS* case (Case C-418/01 *IMS Health GmbH & Co. OHG v NDC Health GmbH & Co. KG* (judgment of 29 April 2004, not yet reported), the Court does not use the term 'essential facilities' and sets tight conditions which must be satisfied before a firm in a dominant position is obliged to give access to information and structures protected by intellectual property law.

<sup>48</sup> E. Szyszczak, 'Governance' (2002) 3 *ERA Forum* 130–34; Szyszczak, op. cit., n. 39 above.

<sup>49</sup> Case C-41/90 [1991] ECR I-2010.

<sup>50</sup> See E. Szyszczak, 'Financing Services of General Economic Interest' (2004) vol. 67:6 *Modern Law Review* 982–92.

<sup>51</sup> See again, n. 5 above.

<sup>52</sup> There are claims that the telecommunications package is a new constitutional model for sector specific regulation, see both Bavasso, and Nihoul and Rodford, op. cit., n. 41 above. Historically each of the liberalisation programmes has addressed the specificities of the particular markets in a broad way. While there are some common themes to the liberalisation programmes, each has evolved differently.



## THE ECONOMIC CONSTITUTION AND POLITY BUILDING

The EC Treaty relies upon the interaction of competition law and the free movement rules to create the normative basis of the economic constitution. Article 4(1) EC provides the central, fundamental commitment of the Member States and the Community:

[f]or the purposes set out in Article 2, the activities of the Member States and the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein, the adoption of an economic policy which is based upon the close co-ordination of Member States' economic policies, on the internal market and on the definition of common objectives, and conducted in accordance with the principle of an open market economy with free competition.

This is repeated in Article 98 EC, which is contained in the Chapter VII entitled 'Economic and Monetary Policy':

Member States shall conduct their economic policies with a view to contributing to the achievement of the objectives of the Community, as defined in Article 2, and in the context of the broad guidelines referred to in Article 99(2). The Member States and the Community shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 4.

The Court has stated that Articles 4 and 98 EC establish a 'general principle whose application calls for complex economic assessments which are a matter for the legislature or the national administration'.<sup>53</sup> It was argued earlier that the BEPG have become the central tool of economic governance using new regulatory techniques, but at the same time the ECJ has supported the development of a flexible economic constitution by enhancing the role of the four freedoms and the competition rules. The competition and the free movement rules are seen by the Court as the basic layer of the economic constitution of Europe: further layers comprising economic and monetary union and the common commercial policy. For example, the Court and the Advocates General have used the language of fundamental rights in a number of internal market cases, especially in relation to the free movement of persons and the free movement of goods. However, when balancing the right to free trade against other fundamental rights protected in Community law, the Court has recognised that even as a constitutional principle, the right to free trade is not

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<sup>53</sup> Case C-9/99 *Échirolles Distribution SA v Association du Dauphiné and others* [2000] ECR I-8207, para. 25.

absolute.<sup>54</sup> The Court has also declared the hierarchical superiority of free competition as a constitutional norm:

... according to ... Article 3(1)(g) EC), Article 81 of the Treaty constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community and, in particular, for the functioning of the internal market. The importance of such a provision led the framers of the Treaty to provide expressly, in Article 85(2) of the Treaty, that any agreements or decisions prohibited pursuant to that article are to be automatically void.<sup>55</sup>

The Court has used also the principle of the effectiveness of Community law in order to emphasise the fundamental constitutional role of competition law. As we saw earlier, the attempts to decentralise the enforcement of Article 81 EC were not entirely successful. The Court used the ruling in *Courage v Crehan* to emphasise the fundamental nature of the direct effect of Community law, reiterating the ideas from *Eco Swiss*: ‘according to [Article 3(1)(g) EC], Article 85 of the Treaty constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community and, in particular, for the functioning of the internal market’.<sup>56</sup> These fundamental norms are then linked to provide an effective remedy obligation within the general principles of Community constitutional law.<sup>57</sup>

Following these rulings, the then President of the Court stressed the strategic role played by the internal market and free movement rules in the constitutional process in a key inaugural address to the 2002 FIDE conference:

I do hope that the central character of the basic economic provisions of the Treaty, the rules on free movement and competition, will be preserved in the future constitutional Treaty. One should not forget that the Union is based upon them, that they constitute the core and best established layer of the legal order. Indeed, they have a constitutional nature ... These constitutional economic provisions should not be overlooked and downgraded as something of secondary importance. Rather, they should be given pride of place within the new constitutional framework. This would secure the lasting value of the decades of case-law that gives them their present meaning.<sup>58</sup>

However, in the Constitutional Treaty, the competition and free movement rules remain separate policies linked by a general clause. This combination of

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<sup>54</sup> Case C-112/00 *Eugen Schmidberger v Austria* [2003] ECR I-5659.

<sup>55</sup> Case C-126/97 *Eco Swiss China Time Ltd v Benetton International NV* [1999] ECR I-3055, para. 36.

<sup>56</sup> Case C-453/99 *Courage v Crehan* [2001] ECR I-6297, para. 20.

<sup>57</sup> *Ibid.*, paras 21–24.

<sup>58</sup> Quoted in Oliver and Roth, *op. cit.*, n. 32 above, p. 410.

competition and free movement law to form the core of the economic constitution is a late development and, as the reluctance to link the substantive provisions in the new Constitutional Treaty reveals, a combination not receiving full political acceptance. The Court was given the opportunity to create a common economic core to the earlier Common Market through the interconnectedness of the competition and free movement rules seized upon by early litigants. In *Leclerc*, for example, the Court recognises the fundamental nature of both sets of provisions: ‘Articles 2 and 3 of the Treaty set out to establish a market characterised by the free movement of goods where the terms of competition are not distorted. That objective is secured *inter alia* by Article 28 et seq. prohibiting restrictions on intra-Community trade, to which reference was made during the proceedings before the Court, and by Article 81 et seq. on the rules of competition.’<sup>59</sup>

Yet, in subsequent litigation, the Court shied away from the combination of the free movement and competition rules to regulate the Member States. To have done otherwise would have exposed most regulatory action of the state to potential judicial scrutiny at the national and European levels. Instead, the Court chose to run with an expansionist view of Article 28 EC. One explanation for this preference of the free movement provision over the competition rules, and the reluctance fully to explore the inter-connection between the two sets of rules, is the ability of the Court to use the rule of reason approach from *Cassis* to create a balance between Community interests and Member State interests.<sup>60</sup> Another important factor is the availability of justifications for provisions which potentially harmed European integration but brought some counter-balancing values to the free trade ideal.<sup>61</sup> By taking this course, the Court has woven a series of values, recognised in the national laws of the Member States, as well as international and regional documents, particularly in relation to fundamental rights, into the fabric of the economic constitution which takes the principle of free trade and an open market economy based upon competition as its normative basis. By focusing upon Article 28 EC, the Court also preserved the central enforcement role of the Commission in competition law. This is an important point since the competition rules had limited derogations or justifications for anti-competitive conduct and relied upon the Commission and, more lately, the Courts to develop a set of non-market values into competition policy<sup>62</sup> and the later liberalisation policies.

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<sup>59</sup> Case 229/83 *Leclerc v Au blé vert* [1985] ECR 1, para. 9.

<sup>60</sup> Case 120/78 *Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649.

<sup>61</sup> For further discussion of the role of values in the internal market, see Weatherill and de Witte’s chapters in this book.

<sup>62</sup> See G. Monti, ‘Article 81 EC and public policy’ (2002) vol. 39:5 *Common*

## CONCLUSIONS

The Lisbon Process created a much repeated mantra, 'free trade is good', expressed more eloquently in the Lisbon Presidency Conclusions – at para. 5, that the EU has set itself 'the strategic goal of becoming the most competitive and dynamic, knowledge-based economy in the world, capable of sustainable economic growth, creating more and better jobs and greater social cohesion'.<sup>63</sup> The mantra now prefaces most policy documents and legislation at the Community level. There is a renewed emphasis upon productivity and efficiency, to be realised through the two main tools of integration, free trade and a competitive market. This chapter argues that, increasingly, tools of new economic governance are being deployed to regulate competition policy in the internal market, allowing for greater flexibility in policy making in the competition sphere and admitting competition as the legitimate twin of the free trade policy. However, the wide range of regulatory tools, often lacking enforcement mechanisms, can lead to a mish-mash of policies and conflicting ideas. While other factors play a role, the absence of centralising regulatory tools for the co-ordination and enforcement of the new forms of economic governance may play a part in the current failure of the Lisbon Process to deliver its goals.<sup>64</sup>

The two central policies of market liberalisation are balanced by a greater emphasis being placed upon other values in the integration process. Some of these policies have a Treaty base, others are found in policy documents, remaining aspirations rather than concrete policies. The Treaty of Amsterdam set out some of these countervailing values. There was an expansion of Articles 2 and 3 relating to the tasks and activities of the Community, the idea of mainstreaming equality between men and women and the environment through all Community policies. Article 16 EC, introduced at Amsterdam, shifts the focus of seeing services of general economic interest as a derogation from the free movement and competition principles to a positive role for the Community and the Member States, recognising the role of such services in the integration project. This project was taken further in Article 36 of the Charter of Fundamental Rights, which states that the EC institutions shall respect and recognise access to services of general economic interest as a fundamental right within the EU. However, the emphasis upon the *quality* of

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*Market Law Review* 1057–99. Cf. L.M. Soriano, 'How proportionate should anti-competitive state intervention be?' (2003) vol. 28:1 *European Law Review* 112–23, who argues that the Court takes a differentiated approach when applying the derogations to the free movement rules and Article 86(2) EC.

<sup>63</sup> See [http://europa.eu.int/comm/lisbon\\_strategy/intro\\_en.html](http://europa.eu.int/comm/lisbon_strategy/intro_en.html).

<sup>64</sup> European Commission, 'A new start for the Lisbon Strategy', available at [http://europa.eu.int/growthandjobs/index\\_en.htm](http://europa.eu.int/growthandjobs/index_en.htm).

such services is limited to the specific liberalisation packages using the idea of universal obligations.<sup>65</sup> The Commission acknowledges that there is a lack of consensus in the EU to create a normative framework for the regulation of services of general interest.<sup>66</sup> Thus, a question remains as to how far non-market values have secured a place in the integration project, and the more recent constitution-building project. In policy documents emphasis is placed upon increased efficiency and consumer gains,<sup>67</sup> with little reference to citizenship in the economic constitution that is emerging.

The use of a broader range of political actors, and the variety of tools to create and maintain the relationship between competition and internal market policy, brings flexibility at the expense of certainty and a concrete core of constitutional provisions when setting out the scope and content of such policies. In the Constitutional Treaty, a clear constitutional base for the centrality of competition and free trade is to be found,<sup>68</sup> as well as increased reference to the necessity of maintaining a competitive market.<sup>69</sup> Reference is also made to the duty to maintain consistency between other policies and activities throughout the EU policy-making process.<sup>70</sup> However, there is little guidance as to *how* competition and free trade will be balanced by other values in the integration process.

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<sup>65</sup> See the Commission's *White Paper on Services of General Interest*, COM (2004) 374 final, para. 3.3. Cf. the development of a sector specific approach to universal service obligations in the various liberalisation directives and, most recently, the detailed obligations set out in the electronic communications package, Directive 2002/22 (see n. 18 above).

<sup>66</sup> See the White Paper, *ibid.*, para. 4.1.

<sup>67</sup> European Commission, *A Methodological Note for the Horizontal Evaluation of Services of General Economic Interest*, COM (2002) 331 final; Commission Staff Working Paper, *Horizontal Evaluation of the Performance of Network Industries Providing Services of General Economic Interest 2004 Report*, SEC (2004) 866/1.

<sup>68</sup> See Article I-3 (the Union's objectives), para. 2: '[t]he Union shall offer its citizens an area of freedom, security and justice without internal frontiers, and an internal market where competition is free and undistorted'. See also, Article I-4 (fundamental freedoms and non-discrimination), para. 1: '[t]he free movement of persons, services, goods and capital, and freedom of establishment shall be guaranteed within and by the Union, in accordance with the Constitution'.

<sup>69</sup> For example, in Article III-132 (ex-Article 298 TEC).

<sup>70</sup> Article III-115 (new): '[t]he Union shall ensure consistency between the different policies and activities referred to in this Part, taking all of its objectives into account and in accordance with the principle of conferral of powers'. The revised Article 16 EC is included in this Chapter, Article III-122.

## 5. European Community media regulation in a converging environment

**Rachael Craufurd Smith<sup>1</sup>**

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### INTRODUCTION: REFLECTING ON REGULATION

This chapter explores the changing nature of internal market regulation from the perspective of the audiovisual sector and, more particularly, television broadcasting. It does this by examining how the Community initially sought to balance the respective interests of industry, consumers and Member States in the 1989 Television Without Frontiers Directive (the TWF Directive)<sup>2</sup> through a combination of harmonisation and mutual recognition provisions. This balance has now been brought into question by the current review of the TWF Directive, a process which highlights a number of important trends in Community rule-making. Though some of these developments are arguably subject specific, many are of interest well beyond the audiovisual sector and consequently find reflection in other contributions to this volume.

There are three main reasons why the TWF Directive is now being reviewed. First, there is a need to clarify and rationalise certain of the existing rules. The pace and evolution of Community law in this area has been driven principally by technological developments, though the internally fragmented nature of the Community institutions, in particular the European Commission, has also had an influence. Over time there has consequently built up a complex, overlapping and potentially confusing range of instruments. This is particularly apparent in the advertising field, with sector-specific measures for

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<sup>1</sup> This chapter was written while a Jean Monnet Fellow at the Robert Schuman Centre for Advanced Studies, European University Institute, Florence, and I would like to thank the Centre for their considerable support during my time at the Institute. My thanks also to Niamh Nic Shuibhne for her helpful comments on this chapter.

<sup>2</sup> Directive 89/552, OJ 1989 L298/23, amended by Directive 97/36, OJ 1997 L202/6. Unless specifically indicated to the contrary, references are to the amended Directive.

broadcast and on-demand services;<sup>3</sup> product-specific measures relating, for example, to tobacco;<sup>4</sup> and, finally, generally applicable measures, such as those designed to prevent misleading advertising.<sup>5</sup> There is, thus, a case for rationalisation and further consideration as to whether certain sector/product specific rules might not be replaced with general, 'horizontal', principles. This process of review and consolidation is a sign that the internal market has come of, or is beginning to show signs of, age.

Secondly, regulatory objectives need to be re-assessed in the light of changing social and cultural expectations. Rationalisation can be driven not only by the need to simplify and render a body of rules more coherent, but also by changing attitudes to the desirability of regulation itself, in some cases by a commitment to deregulation. Rationalisation may also lead to 'regulatory creep', in that the adoption of more general rules can pull within the scope of Community law additional sectors not previously covered. Technological developments have also influenced this reappraisal, in that certain fundamental distinctions employed by the Community in the past, notably that between 'on-demand' and 'broadcast services', now begin to look less convincing, given convergence among the various communications sectors.

Thirdly, the Community, and in particular the Commission, is now committed to the use of a wider range of regulatory techniques, in particular self-regulation and co-regulation, as well as to fostering European-wide networks of representative bodies to exchange information and develop guidelines, a process often referred to as the 'open method of co-ordination' (OMC).<sup>6</sup> There is uncertainty over the precise meaning of the terms 'self-regulation' and 'co-regulation' owing to a lack of consistency in their use. The Commission considers the term 'self-regulation' to relate to the 'large number of practices, common rules, codes of conduct and voluntary agreements which economic

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<sup>3</sup> The TWF Directive, n. 2 above; and Directive 2000/31 (the E-commerce Directive), OJ 2000 L178/16.

<sup>4</sup> Directive 2003/33, on the Approximation of the Laws, Regulations and Administrative Provisions of the Member States Relating to the Advertising and Sponsorship of Tobacco Products, OJ 2003 L152/16; and Directive 2001/37, concerning the Manufacture, Presentation and Sale of Tobacco Products, OJ 2001 L194/26.

<sup>5</sup> Directive 84/450, relating to the Approximation of Laws, Regulations and Administrative Provisions of the Member States concerning Misleading Advertising, OJ 1984 L250/17, as amended by Directive 97/55, concerning Comparative Advertising, OJ 1997 L290/18.

<sup>6</sup> The open method of co-ordination was specifically endorsed as a new mechanism for co-ordinating national policies at paras 37–40 of the Presidency Conclusions of the Lisbon European Council, 23/24 March 2000. For further discussion of the development of the open method of co-ordination see S. Regent, 'The open method of co-ordination: A new supranational form of governance' (2003) vol. 9:2 *European Law Journal* 190–214.

actors, social players, NGOs and organised groups establish themselves on a voluntary basis in order to regulate and organise their activities', and notes that '[u]nlike co-regulation, self-regulation does not involve a legislative act'.<sup>7</sup> Co-regulation occurs where industry and representative groups play a role in the realisation of policy objectives, either through setting standards, assisting with enforcement, or engaging in supportive ancillary measures. This activity takes place, however, within a legal framework, under which the legislator establishes key objectives, deadlines, and methods of implementation or enforcement. The legislator may also establish relevant sanctions.<sup>8</sup>

The scope for confusion here is apparent, in that co-regulatory schemes rely on industry and relevant private bodies to develop or flesh out standards, a process often termed 'self-regulation' even when carried out within a legislative framework. Two considerations may prove helpful when distinguishing self-regulatory from co-regulatory regimes.<sup>9</sup> The first is whether private participation is voluntary. In a purely self-regulatory context private actors remain free to decide whether or not they wish to participate, though in practice the option to remain outside any given scheme will often be commercially unattractive because of the potential impact on customer confidence. In contrast, co-regulatory schemes are designed to ensure compliance with overall objectives: companies or individuals do not have the same facility to ignore those objectives or the standards developed by private bodies to realise those objectives.<sup>10</sup> The second factor is the degree of public influence over the standard setting and

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<sup>7</sup> European Commission, *Action Plan: Simplifying and Improving the Regulatory Environment*, COM (2002) 278 final, p. 11.

<sup>8</sup> European Commission, *ibid.*, p. 13 and European Commission, *Fourth Report on the Application of the TWF Directive*, COM (2002) 778, p. 32. For further discussion see W. Shultz and T. Held, 'Regulated self-regulation as a form of modern government (interim report)' (2001), Working Paper no. 8 of the Hans Bredow Institut, Hamburg, in particular p. 6.

<sup>9</sup> C. Palzer, 'Self-monitoring v self-regulation v co-regulation', in S. Nikoltchev (ed.), *Co-regulation of the Media in Europe* (Strasbourg: European Audiovisual Observatory, 2003), pp. 29–31 at 31. See also the Mandelkern Group on Better Regulation, *Final Report*, 13 November 2001, available at <http://www.csl.gov.pt/docs/groupfinal.pdf>, particularly at pp. 15–17. The Report distinguishes a 'top-down' approach where private parties flesh out general rules already established in public Regulations and a 'bottom-up' approach, where non-compulsory industry standards are subsequently converted into mandatory rules by the public authority: see p. 17.

<sup>10</sup> Although, it may be possible under certain variants for a company to prove compliance with overall objectives using a different approach to that established by the standard setting body. This is illustrated by the Community 'New Approach' Directives, under which compliance with agreed standards results in a *presumption* of conformity but where alternative means of compliance remain open. See C. Barnard, *The Substantive Law of the EU: The Four Freedoms* (Oxford: Oxford University Press, 2004), pp. 520–25.



enforcement processes. Where co-regulation is employed in the context of, for example, a directive, the state and not the private sector remains ultimately responsible for the operation of the system. As a result the state is likely to be involved, often quite closely, in the decision-making process: for example, public officials may chair or be represented on the standard-setting body and any standards agreed may require formal approval by the administration.

Recourse to these techniques in the context of the audiovisual sector is particularly interesting because cultural differences among the Member States render any attempt to agree common standards in sensitive areas such as child protection extremely difficult. Indeed, harmonisation at the European level would arguably run counter to the Community's commitment to respect the cultural diversity of its Member States set out in Article 151 of the EC Treaty. It is not, however, impossible that a combination of Community supported self-regulatory initiatives and networking among interested bodies could ultimately lay the foundations for European standards in such areas.<sup>11</sup> These techniques could, consequently, indirectly erode those final barriers to the internal market where direct introduction of harmonising measures or mutual recognition principles would not be considered politically or legally acceptable. In this third context, too, technology plays its part, in that the potential for effective regulation of, for example, internet access over fixed lines or mobile phones is heavily dependent on technological capabilities.<sup>12</sup>

It will be apparent that a decision by the Community to adopt one regulatory technique rather than another can have far-reaching implications of both a substantive and constitutional nature: substantive, because the choice of regulatory system can markedly affect the nature of the adopted rules; constitutional, because that choice can also have important ramifications for institutional relations within the European Union (EU), and between the EU and its Member States. Though rather obvious when stated in this way, there is nevertheless a risk that these implications will receive insufficient attention, particularly if Community regulation is presented as a technocratic process of selecting the most suitable, or least intrusive, regulatory tool.<sup>13</sup>

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<sup>11</sup> C. Palzer, 'Horizontal rating of audiovisual content in Europe: An alternative to multi-level classification?' (2003) 10 *Iris plus* 1–8. Palzer explores the possibility of common European symbols to indicate content which could be cause for concern across all media. She is, however, doubtful whether Member States would be willing to accept European age ratings and a common approach to their application: see 6–8.

<sup>12</sup> For a discussion of the different capacities for regulatory control in the fixed and wireless internet sectors, see the report prepared for the Commission by the Programme in Comparative Media Law and Policy, Oxford (PCML), *Self-regulation of Digital Media Converging on the Internet: Industry Codes of Conduct and Sectoral Analysis*, April 2004, available at <http://pcmlp.socleg.ox.ac.uk> (see esp., pp. 67–9).

<sup>13</sup> That fundamental constitutional issues may, on occasion, be overlooked is

After an initial examination of the TWF Directive, this chapter focuses on these three aspects of the current review. It then considers the extent to which the Community has already moved to rely on co-regulatory and self-regulatory techniques and the OMC in the audiovisual context, and whether greater use could be made of these techniques in the future. The chapter concludes by considering the potential implications of any such development; first, for the substantive content of European broadcasting rules, and, secondly, for the respective regulatory roles of the Community institutions, Member States and interested parties.

## THE TWF DIRECTIVE AND HARMONISATION OF DOMESTIC TELEVISION CONTENT RULES

It is perhaps surprising to note that initial Community involvement in the audiovisual sector was targeted at promoting greater understanding among Europeans of European integration and diversity.<sup>14</sup> Democratic concerns were thus of central importance, though the EC Treaty contained no provisions dealing specifically with the audiovisual sector, or its role in society. The failure of the Commission's attempts to promote the development of specific pan-European television channels such as Eurikon and Europa<sup>15</sup> led the Commission to refocus its attention and consider instead the many domestic measures, ranging from advertising restrictions to rules on the portrayal of violence, which could impede the development of future cross-border television services. By the mid-1980s, cable and satellite services were beginning to develop and their potential for further growth was apparent. It was also around this time that the Court of Justice (ECJ) started to develop its case-law with regard to television broadcasting. In its 1974 *Sacchi* ruling, it concluded that television broadcasting could be characterised as a service within the terms of

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evidenced by the European Parliament's evident irritation at the Commission's 'unilateral' approach to developing guidelines on European governance: see the explanatory statement accompanying the EP Committee on Constitutional Affairs, *Report on the Conclusion of the Agreement between the European Parliament, the Council and the Commission on Better Law-Making* (A5-0313/2003 final), September 2003, para. 1.

<sup>14</sup> See, for example, D. Ward, *The European Union Democratic Deficit and the Public Sphere* (Amsterdam: IOS Press, 2001), pp. 46–53.

<sup>15</sup> These were European Broadcasting Union (EBU) initiatives, but were supported by the Commission and European Parliament. The services were unsuccessful owing to the then limited satellite capabilities, variable levels of support from public service broadcasters, and marked consumer apathy regarding the final product. For further details, see R. Collins, *Broadcasting and Audiovisual Policy in the European Single Market* (London: John Libbey, 1994), Chapter 3.

Article 56 (now Article 49 EC) of the EEC Treaty,<sup>16</sup> while the 1980 *Debauve* case confirmed that Community law did not prevent Member States applying non-discriminatory domestic regulations (in particular with regard to advertising) to foreign television services, provided those regulations could be shown to pursue a legitimate general interest and were proportionate.<sup>17</sup>

The consequent potential for fragmentation of the single market led the Commission to propose in its 1984 Green Paper that those domestic rules that could be justified in the general interest should be 'co-ordinated' under Articles 57(2) and 66 EEC (now Articles 47(2) and 55 EC).<sup>18</sup> The Green Paper was strongly contested by certain Member States who considered that the Community had no competence to intervene in domestic media matters,<sup>19</sup> but the single market basis on which the Commission's arguments were founded has proved to be a relatively secure and enduring foundation for Community action in this sector. It is clear, however, that the Commission considered that opening-up national borders to foreign services would be of more than solely economic benefit, and it expressly referred to the facilitation of freedom of expression and information, guaranteed by Article 10 of the European Convention on Human Rights (ECHR), the enhancement of understanding among European citizens (an objective which underpinned its earlier foray into the establishment of a European television channel), and the furthering of cultural exchanges.<sup>20</sup>

The 1989 TWF Directive, revised once in 1997, treads a thin line between recognising legitimate Member State sensitivities in the media field and dismantling significant impediments to the creation of a single television market. It does this using a number of stock internal market techniques. The TWF Directive responded to the *interests of industry* in the development of a single market in two main ways. First, it incorporated the principle of 'home state control'. Member States are required to ensure that broadcasters under their jurisdiction comply with the programme standards set out in the TWF Directive. With the exception of child protection measures, it is not open to the country of reception to carry out an additional compliance check on foreign broadcasts, nor, in the fields co-ordinated by the Directive, to impose more exacting standards.<sup>21</sup> Broadcasters thus know that, in the fields co-ordinated

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<sup>16</sup> Case 155/73 *Italy v Sacchi* [1974] ECR 409.

<sup>17</sup> Case 52/79 *Procureur du Roi v Marc JVC Debauve and others* [1980] ECR 833.

<sup>18</sup> European Commission, *Green Paper on the Establishment of the Common Market for Broadcasting, especially by Satellite and Cable*, COM (1984) 300 final.

<sup>19</sup> A view strongly rebutted by the Commission in its Green Paper, *ibid.*, pp. 6–7.

<sup>20</sup> European Commission, *op. cit.*, n. 18 above, pp. 24–36.

<sup>21</sup> Case C-11/95 *Commission v Belgium* [1996] ECR I-4115.

by the TWF Directive, they need only comply with one set of rules and administrative procedures, that of their country of establishment.

Secondly, the TWF Directive established common Community requirements only in those areas where Member State rules could be justified in the general interest and were most likely to cause real barriers to free movement. It was clear from the Green Paper that the Commission did not consider that Member States would be able to justify applying many of their television content requirements to foreign stations, and therefore considered general interest justifications to have a relatively limited scope. Thus, the Commission stated that:

[r]ules imposing general requirements on programmes do not fall under the reservation of general interest recognised by Community law . . . In the view of the Commission a provision which, like that of Articles 59 and 62, confers a fundamental right . . . would at the end of the day be worthless if at the same time it gave Member States a practically unconditional reservation, a virtually boundless freedom to impose restrictions.<sup>22</sup>

In areas not co-ordinated by the TWF Directive, therefore, broadcasters also have some (though not absolute) assurance that it is sufficient to comply with their familiar domestic regimes.<sup>23</sup> The 1989 TWF Directive established Community rules in four key areas: advertising, quotas for European and independent works, child protection/hate speech, and the right of reply. The 1997 revisions extended the advertising rules to cover tele-shopping and included a provision on access to events of major importance.

The *interests of the Member States* were accommodated in three main ways. First, Article 3 of the Directive confirmed that Member States remain free to impose stricter rules on domestic broadcasters in the areas covered by the TWF Directive. Member States thus retain their sovereignty and policy-making power over domestic broadcasters, despite the risk that their rules will be undermined by more lightly regulated services entering from abroad. This is illustrated by Swedish restrictions on television advertising aimed at children under 12, the impact of which has undoubtedly been diluted by foreign

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<sup>22</sup> European Commission, *op. cit.*, n. 18 above, p. 177.

<sup>23</sup> Though, as discussed in the text accompanying n. 27 below, it is possible that certain foreign restrictions (for example on election broadcasting or depictions of animal cruelty) might still be justified on general interest grounds, a matter which is complicated by uncertainty over which 'areas' have been fully co-ordinated in the TWF Directive: see further, R. Craufurd Smith, 'Sex and violence in the internal market: The impact of European Community law on television programme standards' (1998) vol. 3:2 *Contemporary Issues in Law* 135–54, and I. Katsirea, 'The transmission state principle: The end of the broadcasting sovereignty of Member States' (2003–2004) 6 *Cambridge Yearbook of European Legal Studies* 105–39.

satellite services containing just such advertising.<sup>24</sup> Though the Court of Justice has held that Community freedoms should not be used deliberately to evade domestic rules, and this principle is noted in paragraph 14 of the preamble to the amending 1997 Directive, it is not clear how far this principle can be relied on in the television broadcasting context.<sup>25</sup> Unlike the Council of Europe's Convention on Transfrontier Television, which pursues similar objectives to the TWF Directive, there is no formal provision in the body of the TWF Directive that requires advertisements specifically targeted at audiences in another Member State to conform to the advertising rules in *that* country.<sup>26</sup>

Secondly, the TWF Directive did not attempt to harmonise all areas, leaving Member States free to impose restrictions outside the domain of the Directive – provided they could be justified according to general Community law principles. Thus, sensitive rules relating to media ownership and election broadcasting were not touched by the Directive, nor were certain provisions relating to public order or morals where Community regulation could have had broader implications for the criminal law systems in the Member States.<sup>27</sup>

Thirdly, where co-ordination did take place, it afforded Member States varying degrees of flexibility in interpreting the Community rules. In certain areas, where a clear line could be drawn substantively and politically, the TWF Directive's provisions are specific, detailed, and relatively unambiguous. For example, the advertising time limits and prohibitions on the advertising of prescription drugs and tobacco leave States and industry limited, if any, room for manoeuvre.<sup>28</sup> In other contexts, however, the Directive sets out general

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<sup>24</sup> See Joined Cases C-34 to 36/95 *Konsumentombudsmannen (KO) v De Agostini (Svenska) Forlag AB and TV-Shop I Sverige AB* [1997] ECR I-3843. For an attempt to unpack some of the more Delphic pronouncements regarding the regulation of advertisers in this case, see Katsirea, *ibid.*; and, for discussion of the potentially deregulatory forces unleashed by the TWF Directive, see J. Harrison and L. Woods, 'Determining jurisdiction in the digital age' (1999) vol. 5:4 *European Public Law* 583–600.

<sup>25</sup> See Case C-23/93 *TV10 SA v Commissariaat voor de Media* [1994] ECR I-4795 and Case C-56/96 *VT4 v Vlaamse Gemeenschap* [1997] ECR I-3143, both discussed by Katsirea, *art. cit.*, n. 23 above. For details of the 1997 Directive, see n. 2 above.

<sup>26</sup> European Convention on Transfrontier Television, European Treaty Series No. 132, Article 16.

<sup>27</sup> For further discussion of the difficulty of harmonising domestic rules in the field of public order and morality see the Commission's *Green Paper*, n. 18 above, pp. 286–8.

<sup>28</sup> Though new advertising practices and techniques such as spot advertising during football matches and split screen advertising have raised a number of interpretative questions, as addressed by the Commission in its *Interpretative Communication on Certain Aspects of the Provisions on Televised Advertising in the 'Television Without Frontiers' Directive*, COM (2004) 1450.

objectives to be achieved, objectives framed at such a level of abstraction that social and cultural differences can relatively easily be accommodated.

Thus, Article 22 requires Member States to take ‘appropriate measures to ensure that television broadcasts by broadcasters under their jurisdiction do not include programmes which might seriously impair the physical, mental or moral development of minors, in particular those that involve pornography or gratuitous violence’. The provision applies also to programmes ‘which are likely to impair the physical, mental or moral development of minors’, except where measures are taken to ensure that minors will not normally hear or see such broadcasts, for example through encryption or late night transmission. No definition is provided as to what constitutes a ‘minor’, ‘pornography’ or ‘gratuitous violence’ (*Tom and Jerry* and/or *A Clockwork Orange*?) nor is there any explanation of the type of programmes that fall within the two main categories identified in the Article.

Although, ultimately, these provisions establish Community standards and are potentially subject to Court of Justice interpretation if a challenge were to be brought to domestic regulations under Articles 226 or 227 EC, or a reference made under Article 234 EC, in practical terms they afford Member States a continuing degree of discretion in these sensitive areas. This is particularly so in the context of the child protection provisions noted above, where the European Free Trade Area (EFTA) Court, in its *TV1000* opinion, interpreted Articles 2a(2) and 22 of the TWF Directive to allow both receiving and transmitting States to impose checks to ensure conformity with their own domestic standards.<sup>29</sup> Clearly, when one reaches this point, harmonisation is more apparent than real. Moreover, in relation to events of major importance, Article 3a of the Directive leaves Member States free to determine which, if any, events should be retained on free-to-air television: there is no attempt to establish a European list of major sporting events.

Nor is the Directive itself prescriptive as to the method of implementation, stating merely in Article 3 that ‘Member States shall, by appropriate means, ensure within the framework of their legislation, that television broadcasters under their jurisdiction effectively comply with the provisions of this Directive’. This is in line with Article 249 of the EC Treaty, which leaves national authorities considerable scope to determine, in the light of domestic legal and social conditions, how best to ensure the effective implementation of directives. It therefore differs from more recent measures in the audiovisual context, such as the E-commerce Directive, which specifically ‘encourages’ the ‘drawing up of codes of conduct at Community level, by trade, professional

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<sup>29</sup> Case E-7/97 *TV1000 Sverige AB v Norwegian Government* [1998] EFTA Court Reports 68.

and consumer associations or organisations' in order to contribute to the proper implementation of certain of that Directive's provisions.<sup>30</sup>

Does the lack of prescription in the TWF Directive leave Member States free to decide whether to implement the Directive by means of detailed legislative rules or to rely on co-regulation, or even self-regulation? The Court of Justice in *Commission v Germany* confirmed that Member States enjoy significant latitude in determining how best to implement directives.<sup>31</sup> They are not required to incorporate such measures 'formally and verbatim in express, specific legislation; a general legal context may, depending on the content of the directive, be adequate for the purpose, provided that it does indeed guarantee the full application of the directive in a sufficiently clear and precise manner so that, where the directive is intended to create rights for individuals, the persons concerned can ascertain the full extent of the rights and, where appropriate, rely on them before national courts'.<sup>32</sup>

The reference in Article 3 of the TWF Directive to a legislative framework would seem to exclude simple reliance on voluntary industry self-regulation, as opposed to co-regulation.<sup>33</sup> Indeed, self-regulation is generally problematic from an implementation perspective, in that not all industry members may be willing to co-operate in a self-regulatory scheme, and enforcement mechanisms are often weak. The fact that the requirements of a directive happen to be met in practice will not absolve States of their responsibility to put in place a legal framework designed to guarantee continuing compliance by all those affected now and in the future.<sup>34</sup>

In relation to co-regulation, the Court of Justice in *Commission v Germany* did not question the fact that the circular at issue had been adopted using what appears to be a form of co-regulation, involving representatives from the scientific community and interested parties. The circular was, however, inad-

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<sup>30</sup> The E-commerce Directive is considered further at the text accompanying nn. 36 and 52 below.

<sup>31</sup> Case C-361/88 *Commission v Germany* [1991] ECR I-2567.

<sup>32</sup> *Ibid.*, para. 15. For discussion, see P. Palzer, 'European provisions for the establishment of co-regulation frameworks', and T. McGonagle, 'The potential for practice of an intangible idea', both in S. Nikoltchev (ed.), *Co-regulation of the Media in Europe* (Strasbourg: European Audiovisual Observatory, 2003), pp. 3–13 at 6–7, and pp. 15–25 at 17–18 respectively.

<sup>33</sup> Case C-339/87 *Commission v Netherlands* [1990] ECR I-851, para. 22. At para. 25, the Court held that: '[i]n order to secure the full implementation of directives in law and not only in fact, Member States must establish a specific legal framework in the area in question'.

<sup>34</sup> See also Case 145/82 *Commission v Italy* [1983] ECR 711, which excluded, at para. 10, reliance solely on administrative practices which could be easily changed and lacked sufficient publicity, and Case 257/86 *Commission v Italy* [1988] ECR 3249, para. 13.

equate because it was less broad in scope than the parent directive and there was uncertainty as to whether or not it was legally binding under domestic law. In principle, therefore, co-regulation appears a legitimate mechanism by which to implement directives, but, where codes developed by private actors are relied on to meet specific Community requirements, *Commission v Germany* indicates that the standards must be sufficiently clear, must adequately reflect the Community objectives and have binding force. Moreover, individuals must be able to ascertain where to find such codes and their legal status should be readily apparent. Where co-regulation and industry standard-setting are employed in this way, practices more often associated with 'soft' law can be seen to infiltrate what appear to be classic examples of 'hard' Community legislation.<sup>35</sup>

Certain directives, rather than leaving it to Member States to determine how best to implement their provisions, may expressly promote or even require co-regulatory initiatives. Thus, as previously noted, the E-commerce Directive calls on the Member States and the Commission to 'encourage' the drawing up of codes of conduct 'designed to contribute to the proper implementation' of certain of its provisions.<sup>36</sup> Given the freedom which Article 249 EC expressly affords Member States to determine how best to implement a directive, it is questionable to what extent Community competence extends beyond 'encouraging' to actually mandating recourse to co-regulation. In the recent Interinstitutional Agreement on Better Law-Making (the Interinstitutional Agreement) the European Parliament, Council and Commission expressly recalled the definition of 'directive' in Article 249 EC and the principles of subsidiarity and proportionality.<sup>37</sup> The Commission

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<sup>35</sup> A point noted by D. Trubek and L. Trubek in 'Hard and soft law in the construction of Social Europe', a paper presented at the SALTSA, OSE, UW Workshop on *Opening the Open Method of Co-ordination*, at the European University Institute, Florence, July 2003, on file with author, p. 22. In relation to the regulation of the content of television advertising, many Member States already place considerable reliance on industry developed codes. The European Advertising Standards Alliance (EASA) supports a cross-border complaints system under which complaints are assessed according to the advertising rules in the country from which the advertising emanated: for details, see the EASA website at <http://www.easa-alliance.org>.

<sup>36</sup> See n. 30 above. It is interesting to note that the E-commerce Directive encourages the involvement of interested parties not only in order to realise the specific objectives set out in Articles 5–15 but also to further child protection, an area where Member States are authorised to *derogate* from the provisions of the Directive. Community support for co-regulation, and possibly here also self-regulation, thus reaches out into what might be considered residual areas of domestic competence.

<sup>37</sup> European Parliament, Council of the European Union and European Commission, *Interinstitutional Agreement on Better Law-Making Between the European Parliament*, OJ 2003 C321/1, para.13.



undertook to ensure that '[i]n its proposals for directives . . . a proper balance is struck between general principles and detailed provisions, in a manner that avoids excessive use of Community implementing measures'.<sup>38</sup> It is, however, possible to point to examples of directives, particularly those falling within the general category of 'new approach' directives, which leave Member States little latitude with regard to implementation. For example, the 1973 Directive on harmonisation of Member State laws relating to electrical equipment required the Member States to ensure that equipment complying with certain industry agreed harmonised standards would be regarded as also complying with the general safety requirements established by the Directive.<sup>39</sup>

Regarding Community oversight of Member State implementation, the Commission has used its powers of investigation, and ultimate reference to the Court of Justice, strategically to bring recalcitrant Member States into line and emphasise a number of the Directive's key principles.<sup>40</sup> The Directive does, however, make provision for more informal mechanisms of control. First, it imposes reporting requirements on both Member States and the Commission (Articles 4 and 26), so that Member States will be aware that their failings may be flagged up in public. Secondly, it establishes (Article 23a) a Contact Committee composed of 'representatives of the competent authorities of the Member States', chaired by the Commission. Although the Committee is advisory in nature, it can put pressure on particular wayward States and encourage greater uniformity in Member State practice across the EU.<sup>41</sup> Thirdly, the Directive affords the Commission supervisory powers in relation to certain Member State measures relating to the protection of minors and listed events provisions: in both instances, State measures must be referred to the Commission for approval.<sup>42</sup> In the child protection context, Community oversight is, however, limited, in that the Commission has stated that it does not intend to review moral assessments made by particular Member States, and will restrict itself to considering 'factual and legal considerations'.<sup>43</sup> Moreover, it appears that, at least in the child protection context, Commission

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<sup>38</sup> Ibid.

<sup>39</sup> Directive 73/23, on the harmonisation of the laws of Member States relating to electrical equipment designed for use within certain voltage limits, OJ 1973 L77/29; see Article 5.

<sup>40</sup> As in Case C-222/94 *Commission v United Kingdom* [1996] ECR I-4025 and Case C-11/95 *Commission v Belgium* [1996] ECR I-4115.

<sup>41</sup> See the discussion by C. O'Leary and D. Goldberg, 'Television without frontiers', in T. Daintith, *Implementing EC Law in the United Kingdom: Structures for Indirect Rule* (Chichester: Wiley, 1995), Chapter 8.

<sup>42</sup> Articles 2a and 3a(2).

<sup>43</sup> European Commission, *Second Report on the Application of Directive 89/552/EEC*, COM (1997) 523 final, para. 4.2.

rulings do not have sufficient legal effect to be the subject of review under Article 230 EC.<sup>44</sup> Despite these limitations, the Directive can be seen to establish a variety of formal and informal mechanisms designed to modify Member State behaviour, even in highly sensitive areas, thereby helping to ensure that the centrifugal forces which could so easily pull the Directive apart are kept in check.

The TWF Directive is, consequently, far from being a heavy-handed example of Community harmonisation; rather, it establishes a carefully modulated system for co-ordinating domestic rules. The Directive also illustrates some of the potential advantages and limitations, at least from a Community perspective, of reliance on the internal market freedoms as a basis for regulation. In terms of advantages, the general nature of the service provisions in the Treaty gave the Community purchase across a wide range of activities, even those considered to be of primarily cultural importance. This, coupled with the power to co-ordinate those areas where legitimate general interests could fragment the internal market, afforded the Community ample grounds on which to build a wide-ranging audiovisual policy – a policy developed in the absence of any specific objectives for the media in the EC Treaty.<sup>45</sup>

In terms of limitations, it is apparent that the very flexibility of the internal market provisions may undermine their cogency as a regulatory tool. Thus, even when a relatively strong case for intervention can be made out, the ‘indirect’ nature of internal market regulation may render Community measures suspect, as with the Commission’s controversial attempts to formulate Community limits to media ownership.<sup>46</sup> In other cases, the internal market rules, even given their capacity for flexible extension, may simply not accommodate certain forms of market intervention which the Member States wish to retain. Thus, prior to agreement of the TWF Directive, many Member States required national broadcasters to carry a proportion of domestic television content, a requirement motivated by both economic and cultural concerns. Such provisions were clearly directly discriminatory and could not then, and

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<sup>44</sup> See Case T-69/99 *Danish Satellite TV (DSTV) A/S v Commission* [2000] ECR II-4039. Contrast this with the position regarding Commission rulings under Article 3(a)(2) of the TWF Directive: Case T-33/01 *Infront WM AG v Commission*, judgment of 15 December 2005.

<sup>45</sup> The closest the EC Treaty now comes to this is in Article 151(2) EC, which authorises the Community to ‘encourage co-operation between Member States and, if necessary, supporting and supplementing their action in the following areas: . . . artistic and literary creation, including in the audiovisual sector’.

<sup>46</sup> On which see G. Doyle, ‘From “pluralism” to “ownership”’: Europe’s emergent policy on media concentrations navigates the doldrums’ (1997) 3 *Journal of Information Law and Technology* available at [http://elj.warwick.ac.uk/jilt/comms-reg/97\\_3doyl/](http://elj.warwick.ac.uk/jilt/comms-reg/97_3doyl/) and A. Harcourt, ‘EU media ownership regulation: Conflict over the definition of alternatives’ (1998) vol. 36:3 *Journal of Common Market Studies* 369–89.

cannot now, be justified under Community law.<sup>47</sup> In their place, the TWF Directive established a system of European quotas that enabled the pre-existing state policies to live on in practice, if not in name, but which are hard to justify on free movement grounds given the illegal nature of the pre-existing domestic measures.<sup>48</sup>

## REVIEW OF THE TWF DIRECTIVE

The TWF Directive is generally considered to have stood up well to the changes in the broadcasting sector since its adoption. As indicated in the introduction to this chapter, however, the Commission has embarked on a wide-ranging review of its provisions, with inevitable reappraisal not only of regulatory techniques but also regulatory objectives. These aspects, together with the desirability of using this opportunity to clarify and rationalise the existing body of rules, are considered in turn below.

### Clarifying and Rationalising the Existing Body of Community Rules

In a number of communications dating from 2001, in particular those concerned with *Simplifying and Improving the Regulatory Environment*, the Commission put forward proposals designed to enhance the clarity and coherence of Community law.<sup>49</sup> These were followed by a more detailed programme for simplification, consolidation and codification of existing rules in the Commission's 2003 *Communication on Updating and Simplifying the*

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<sup>47</sup> The only circumstance in which such rules might be maintained would be if 'nationality' related solely to content and not place of production, nationality of producers or key workers etc. In contrast, it is arguable that the pre-existing *language* requirements adopted by countries such as Spain and France were legitimate as indistinctly applicable measures, justifiable on cultural grounds. For a specific discussion of these points see I. Katsirea, 'Why the European broadcasting quota should be abolished' (2003) vol. 28:2 *European Law Review* 190–209; and, more generally, in relation to the underlying principles, N. Nic Shuibhne, 'Labels, locals and the free movement of goods' in R. Craufurd Smith (ed.), *Culture and European Union Law* (Oxford: Oxford University Press, 2004), pp. 81–111.

<sup>48</sup> For a discussion of the legality of the quotas, see B. de Witte, 'The European content requirements in the EC Directive: Five years after', in E.M. Barendt (ed.), *The Yearbook of Media and Entertainment Law* (Oxford: Oxford University Press, 1995), pp. 101–27.

<sup>49</sup> European Commission, *Communication on Simplifying and Improving the Regulatory Environment*, COM (2001) 726, and the subsequent Communication setting out an Action Plan, op. cit., n. 7 above.

*Community Acquis*.<sup>50</sup> The audiovisual sector was not, however, listed as an area for priority consideration in the 2003 work programme and there remains a strong case for careful review of the existing provisions.

Technology has been a key determinant of the timing and nature of Community intervention in the audiovisual sector. The introduction of cable and satellite services was an important catalyst for the TWF Directive, while expanding internet access later led to the adoption of the E-commerce Directive. This intermittent evolution has resulted in the development of complex and fragmented rules in areas such as advertising.<sup>51</sup> It has been suggested by Jan Kabel that many, though not all, of the sector-specific advertising provisions now contained in the TWF and E-commerce Directives could be transposed into general rules applicable across all sectors.<sup>52</sup> The advertising rules in the TWF Directive are, however, considerably more wide-ranging than those in the E-commerce Directive, the latter being designed essentially to ensure that commercial communications on the internet are clearly identifiable and, in certain contexts, unambiguous.<sup>53</sup> Such a move could consequently extend Community advertising rules for the broadcasting sector, for example, those relating to the protection of human dignity, editorial independence from sponsors, product placement and alcohol advertising, to other advertising media such as the press and the internet.<sup>54</sup>

Convergence among the telecommunications, information technology and television broadcasting sectors, facilitated by the development of digital technology, also brings into question the relatively autonomous regimes under which these sectors have traditionally operated. Member States have tended to regulate the internet relatively lightly, in part because they have not wanted to stifle a developing industry, but also because of the strong 'freedom of expression' ethic with which the internet is associated.<sup>55</sup> In addition, there are significant practical difficulties posed by any attempt to regulate services relayed

<sup>50</sup> COM (2003) 71.

<sup>51</sup> Anyone wishing for a concrete example may like to grapple with the Court of Justice's ruling in the *De Agostini* case, see n. 24 above.

<sup>52</sup> J. Kabel, 'Swings on the horizontal: The search for consistency in European advertising law' (2003) 8 *Iris plus* 2–8. Rules which could not be dealt with in this way include those on isolated spot advertising and the insertion of advertisements during programmes.

<sup>53</sup> Compare Articles 10–20 of the TWF Directive with Article 6 of the E-commerce Directive.

<sup>54</sup> Though the impact of such a step would arguably be diluted by the fact that many of the advertising rules in the TWF Directive are already built into self-regulatory codes operated by the advertising industries in the Member States.

<sup>55</sup> The influence of this ethic is well illustrated by the United States Supreme Court case of *Reno v ACLU* (1997) 117 S.Ct 2329, 138 L Ed 2d 874.

over international networks. This is reflected in the E-commerce Directive, which relates to information society services defined as services provided electronically and at the individual request of the recipient.<sup>56</sup> The main concerns of the Directive are to ensure that consumers have adequate information about the information society services they are accessing, to regulate the liability of service providers and to encourage the development of self-regulatory systems involving all interested parties. Unlike the TWF Directive, the E-commerce Directive does not attempt to co-ordinate the substantive content of programmes or advertisements that form part of information society services. As a result, Member States remain competent to restrict, albeit on limited public policy, public health, public security and consumer protection grounds, services coming from another Member State.<sup>57</sup> Domestic restrictions of this type are, however, subject to a system of notification to, and approval by, the Commission. The E-commerce Directive seeks, on the one hand, to keep a check on Member State intervention in the market while, on the other, to promote consumer information and the development of self-regulatory systems.

The Community has thus established two quite distinct regulatory regimes: one under the earlier TWF Directive for 'broadcasting' services, comprising television programmes transmitted for general reception by the public; the other under the later E-commerce Directive, for 'information society services'. With the development of video-on-demand, interactive television and webcasting, this basis for distinguishing regulatory obligations is beginning to look increasingly strained.<sup>58</sup> It is consequently necessary to consider whether some of the standards adopted in the television broadcasting sector – right of reply, advertising standards etc. – should be transported across to the internet sector, thereby creating a more general 'audiovisual content' directive.<sup>59</sup> Alternatively, whether certain of the lighter touch regulatory techniques employed in the internet sector might profitably be exported in the other direc-

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<sup>56</sup> See Article 2 of the E-commerce Directive, n. 3 above.

<sup>57</sup> Article 3(4); this list does not appear to extend to other justifications, such as media pluralism, considered by the Court of Justice to be legitimate where a Member State measure is indistinctly applicable and not directly discriminatory.

<sup>58</sup> For an interesting discussion of the various ways in which consumers may use audiovisual services in the future, see A. Andersen, *Outlook of the Development of Technologies and Markets for the European Audiovisual Sector Up to 2010* (2002), available at [http://ec.europa.eu/comm/avpolicy/info\\_centre/library/studies/index\\_en.htm](http://ec.europa.eu/comm/avpolicy/info_centre/library/studies/index_en.htm).

<sup>59</sup> The recent Commission *Proposal for a Recommendation of the EP and Council on the protection of minors and human dignity and the right of reply in relation to the competitiveness of the European audiovisual and information services industry* recommends that Member States introduce domestic measures to ensure a right of reply 'across all media': see COM (2004) 341 final, I(1).

tion, to the field of television broadcasting.<sup>60</sup> Indeed, the Commission expressly noted in its 2003 *Communication on Updating and Simplifying the Community Acquis* that one possible indicator of the need for simplification or consolidation was the inappropriate nature of an existing regulatory regime, in that 'softer' regulatory alternatives might more appropriately be employed in that area.<sup>61</sup> It thus seems likely that future Community regulation of audiovisual content will have two distinct aspects. On the one hand, directives or, more probably, non-binding measures such as recommendations, will be used to expand the reach of certain regulatory objectives from broadcasting to other sectors. On the other, these measures will rely more heavily than has been the case in relation to broadcasting on self-regulation or co-regulation to bring industry on board.<sup>62</sup>

### Reappraising the TWF Directive's Underlying Regulatory Objectives

The TWF Directive pursues a wide variety of objectives. Apart from facilitating cross-border broadcasting and promoting the European audiovisual industry, it seeks to protect the integrity of artistic works; to protect consumers; to prevent harm to children, discrimination and racial or religious hatred; as well as to promote fair and balanced reporting through the right of reply and sponsorship restrictions. In its 2003 *Communication on the Future of European Regulatory Audiovisual Policy*, the Commission concluded that technological and market developments did not call into question such regulatory objectives as cultural diversity, the right to information, the protection of minors and consumer protection.<sup>63</sup> It was rather the 'means by which these objectives can be achieved in a changed environment' which was at issue.<sup>64</sup> If this is so, then there is arguably little more to say under this heading. Nevertheless, the line between ends and means can be extremely fine, and a shift in means may also be indicative of a wider change, even if quite subtle, in objectives. It is also

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<sup>60</sup> See, for example, the discussion in R. Craufurd Smith, 'European Community audiovisual policy and review of the Television Without Frontiers Directive' (2003) *European Current Law* xi–xvi, in particular at xiv. The EU's cross-media approach to child protection issues is considered in more detail in the following section.

<sup>61</sup> *Op. cit.*, n. 50 above, p. 8.

<sup>62</sup> The Commission proposal for a recommendation that the right of reply be extended across all media clearly points in this direction: see n. 59 above. In the short term, the Commission has sought to clarify how the provisions of the TWF Directive apply to new advertising practices and techniques, such as split screen and interactive advertising (see n. 28 above).

<sup>63</sup> European Commission, *Communication on the Future of European Regulatory Audiovisual Policy*, COM (2003) 784 final, p. 24.

<sup>64</sup> *Ibid.*

clear that certain industry actors consider the level of protection afforded particular interests in the TWF Directive to be unduly high.

Two examples can be given by way of illustration, one relating to broadcasting controls on the basis of taste and decency, the other to advertising time limits. In both instances the traditional ‘paternalistic’ model of broadcasting regulation is brought into question. To date, the regulation of television broadcasting has largely been carried out by the State, or State appointed regulators, on behalf of the viewer. Increasingly, however, regulatory decisions can be devolved to the ultimate consumer, in that filtering and rating techniques create the potential for individuals to determine the kind of programmes they do, or do not, wish to watch. In consequence, we can see the demise of ‘community broadcasting standards’, with questions of taste and decency now widely considered to be matters for private, not public, determination.<sup>65</sup> Industry co-operation, particularly in relation to the standardisation and transmission of relevant consumer information, thus complements regulation being carried out at the lowest possible level, that of the individual.<sup>66</sup>

Of more direct relevance to reform of the TWF Directive is the issue of advertising time limits. Articles 10 and 11 of the TWF Directive, as amended, establish detailed provisions specifying the amount of advertising that can be broadcast and where this can be placed in relation to television programmes. The Association of Commercial Television (ACT), in its response to the Commission’s *Communication on the Future of European Regulatory Audiovisual Policy*, argued that standard setting in this area should now be left to market forces.<sup>67</sup> If consumers felt that there was too much advertising on a particular channel then they could select another service, possibly a subscription service carrying no, or limited, advertising.<sup>68</sup> The ACT concluded that ‘neither the regulator nor the broadcaster will be empowered to decide what

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<sup>65</sup> For a helpful discussion of the nebulous border between the public and private domains in the context of self-regulation, see A. McHarg, ‘The constitutional dimension of self-regulation’, a paper presented at the Workshop on Self-Regulation (II), 14–15 November 2003, at the European University Institute, Florence, on file with author.

<sup>66</sup> It may be noted that taste and decency issues were not harmonised in the TWF Directive, and it remains an interesting question to what extent the Member States have the competence to restrict the transmission of foreign broadcasts on this basis: see R. Craufurd Smith, n. 23 above, p. 149.

<sup>67</sup> ACT, written submission to the Commission on Review of the TWF Directive, 2003, available at [http://ec.europa.eu/comm/avpolicy/reg/tvwf/modernisation/consultation\\_2003/contributions/index\\_en.htm](http://ec.europa.eu/comm/avpolicy/reg/tvwf/modernisation/consultation_2003/contributions/index_en.htm).

<sup>68</sup> The successful Home Box Office (HBO) channel in the United States, which does not take advertising, is often referred to in this context.

amount of advertising is “excessive”, rather that the individual consumer will do so’.<sup>69</sup>

Similar arguments were deployed by the broadcaster RTL in a recent challenge to State regulations implementing the TWF Directive in Germany.<sup>70</sup> In a preliminary reference to the Court of Justice, RTL argued that restrictions on the number of advertising breaks inserted in made-for-television films contravened not only its freedom of communication but also the consumers’ freedom of choice. Consumer choice, RTL argued, acted as an effective regulatory mechanism, so that public intervention should be limited to ensuring that the potential viewer could obtain adequate information about a broadcaster’s advertising policies, through details transmitted just before the start of a programme or in published programme guides. RTL drew a direct parallel with the Court of Justice’s case-law in the field of the free movement of goods. In these cases, national content requirements for certain food and drinks had been held disproportionate on the basis that consumers could be adequately protected by the provision of information on the product label.<sup>71</sup> The parallel with the goods cases seems less ambitious when one considers that there has also been a move to prefer information requirements over content restrictions in the field of services, for example, in the E-commerce Directive discussed above, and in Commission proposals for a regulation concerning sales promotions in the internal market.<sup>72</sup>

Ultimately, the Court of Justice concluded that the legislator’s decision to protect the consumer from excessive advertising by specific timing restrictions was a legitimate regulatory choice, but it is clear that in the rather different context of review of the TWF Directive this question is open for reappraisal. Though it may indeed be possible to draw relevant distinctions between the consumption of, say, pasta on the one hand, and television programmes on the other, questions of coherence across the body of internal market law are clearly raised. More importantly for present purposes, it is far from clear that a system which prohibits specific programmes or advertisements differs only as to regulatory means, from one which provides individuals with sufficient information to determine whether or not to watch those same programmes or advertisements.

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<sup>69</sup> ACT submission, n. 67 above, p. 15.

<sup>70</sup> Case C-245/01 *RTL Television GmbH v Niedersächsische Landesmedienanstalt für privaten Rundfunk* [2003] ECR I-12489.

<sup>71</sup> As in Case 178/84 *Commission v Germany (German Beer)* [1987] ECR 1227 and Case 407/85 *Drei Glocken GmbH and Krützing v USL Centro-Süd and Provincia Autonoma di Bolzano* [1988] ECR 4233.

<sup>72</sup> European Commission, *Proposal for a Regulation Concerning Sales Promotions in the Internal Market*, COM (2002) 585 final.



## Reform of the TWF Directive and Community Governance

Review of the TWF Directive was anticipated in the 1999 Commission *Communication on Principles and Guidelines for the Community's Audiovisual Policy in the Digital Age*, which re-affirmed five general principles for regulatory action: that regulation should establish clearly defined policy objectives, be the minimum necessary to meet those objectives, enhance legal certainty in a dynamic market, aim to be technologically neutral, and be enforced as closely as possible to the activities being regulated.<sup>73</sup> The 1999 Communication stressed the importance of proportionality and indicated that there was potential for greater reliance on self-regulation, an approach considered to reflect the principle of subsidiarity. The Commission noted, however, that self-regulation should not lead to the fragmentation of the internal market and, presumably with this in mind, indicated support for the development of codes of conduct *at Community level*. Subsidiarity in this context thus appears more concerned with EU/industry (or interest group) relations than EU/Member State relations.

The ideas in the 1999 Communication were taken up in the *Fourth Report on the Application of the TWF Directive* in 2002, in which the Commission stated that it would consider whether Community measures continued to be necessary to protect the objectives underpinning the TWF Directive, and what the most appropriate regulatory measures might be for achieving these objectives in the future.<sup>74</sup> The Commission expressly envisaged co-regulation and did not exclude the use in certain contexts of self-regulation.

The shift in regulatory emphasis evident in the Commission's *Fourth Report* is, of course, not unique to the media sector. Rather, it constitutes a specific reflection of the Commission's more general commitment to the deployment of a wider variety of regulatory tools.<sup>75</sup> A call for the re-assessment of regulatory techniques was made at the Edinburgh European Council in December 1992, which ultimately led to the Commission's 2001 *White Paper on European Governance* (White Paper).<sup>76</sup> This, in turn, was followed by the report of the Mandelkern Group on Better Regulation,<sup>77</sup> and the Commission communications setting out an *Action Plan on Simplifying*

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<sup>73</sup> COM (1999) 657 final, pp. 9–10.

<sup>74</sup> European Commission, *op. cit.*, n. 8 above, pp. 31–3.

<sup>75</sup> For a recent example of the Commission's willingness to integrate a variety of regulatory techniques, see its *Proposal for a Directive on Services in the Internal Market*, COM (2004) 2 final.

<sup>76</sup> COM (2001) 428 final.

<sup>77</sup> *Final Report*, n. 9 above.

and *Improving the Regulatory Environment*<sup>78</sup> and on *European Governance: Better Lawmaking*.<sup>79</sup> More recently, the Commission has developed guidelines on consultation during the policy formation process and an integrated approach to assessing the potential economic, environmental and social impact of proposed legislative measures.<sup>80</sup>

The White Paper grounded its review on a perceived lack of public confidence in the ability of the Community to deliver policy objectives and a concern that the Community was both 'remote and too intrusive'.<sup>81</sup> The paper was equally conscious of the regulatory challenges which globalisation poses for both Member States and the Community, necessitating effective action below and above the level of the nation state. It was apparent that the Community had been slow to acknowledge, at a systemic level, the implications of the many different regulatory practices which were already embedded within the Community system, and that there was scope to learn more from the diverse approaches to policy implementation adopted by the Member States. Reappraisal was also required in light of the extensive academic literature questioning the continuing efficacy of traditional command and control forms of regulation.<sup>82</sup>

The White Paper called for more coherence, transparency and accountability in the policy-making process. In particular, it envisaged greater recourse to 'less heavy handed' framework directives, with legislation 'limited to essential elements (basic rights and obligations, conditions to implement them)', leaving the executive to fill in the technical detail via implementing 'secondary' rules.<sup>83</sup> The White Paper and subsequent Commission documents suggested that use might be made here of self-regulation and co-regulation, supported by effective networks operating at European level.

Rapid development in the communications sector, not merely from a technical perspective, makes this a particularly promising area for the application

<sup>78</sup> Op. cit., n. 7 above.

<sup>79</sup> COM (2002) 275 final.

<sup>80</sup> European Commission, *Towards a Reinforced Culture of Consultation and Dialogue: General Principles and Minimum Standards for Consultation of Interested Parties by the Commission*, COM (2002) 704 final; *Communication on Impact Assessment*, COM (2002) 276 final; and Commission Staff Working Paper, *Impact Assessment: Next Steps in Supporting Competitiveness and Sustainable Development*, SEC (2004) 1377.

<sup>81</sup> European Commission, op. cit., n. 76 above, p. 3.

<sup>82</sup> On which see, in particular, J. Black, 'Decentring regulation: Understanding the role of regulation and self-regulation in a "post-regulatory" world' (2001) 54 *Current Legal Problems* 103–46, and 'Enrolling actors in regulatory systems: Examples from UK financial services regulation' (2003) *Public Law* 63–91.

<sup>83</sup> European Commission, op. cit., n. 76 above, p. 20.

of alternative regulatory techniques. In a Working Paper published in 1999, Cass Sunstein argued, in the United States (US) context, for greater reliance on (a) mandatory disclosure requirements concerning public interest content, (b) economic incentives, such as ‘play or pay’ schemes, to encourage public interest programming, and (c) voluntary codes of conduct.<sup>84</sup> The sheer quantity of information now being conveyed across state borders, and the potentially damaging nature of at least some of that content (relating, for example, to terrorist activities, child pornography or violent sexual material) renders enforcement of domestic standards increasingly problematic. It may also prove considerably more difficult to determine the source of information transmitted over the Internet than traditional broadcast content. As a result, co-ordination and co-operation at the European level – with the additional leverage this may give at the international level – is seen by Member States as one possible response to the challenges of globalisation. Co-option of industry, interest groups and consumers into the processes of standard-setting, monitoring and enforcement are essential if public policy objectives are to have any chance of being realised.

It is also apparent that as the scale of cross-border communication increases, so persisting variations in domestic standards are likely to become more problematic. For example, the very different rating systems and standards employed by the Member States for films, videos, and DVDs have, to date, imposed only limited costs on the European audiovisual industry because European films and television programmes tend to have a restricted European circulation. Instead, this variation has proved most problematic for the US film distributors who do distribute on a pan-European basis. Though cultural and linguistic barriers will undoubtedly remain, it is quite possible that what has, to date, been a minor inconvenience for the Americans could become a more substantial impediment for European industry in the future.<sup>85</sup>

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<sup>84</sup> C.R. Sunstein, ‘Public broadcasting and the public interest: Notes towards a “Third Way”’ (1999) Chicago Law and Economics Working Paper, no. 65, available at <http://www.law.uchicago.edu/Lawecon/workingpapers.html>.

<sup>85</sup> A recent study carried out for the Commission concluded that there was currently no great pressure from either industry or consumers for greater homogeneity in ratings. The consultants did, however, conclude that ‘the combination of globalisation and convergence trends will, over time, create extremely strong pressures for a more homogenous system of content rating than exists at present’. See Olsberg/SPI, KEA European Affairs in association with KPMG, *Empirical Study on the Practice of the Rating of Films Distributed in Cinemas, Television, DVD, and Videocassettes in the EU and EEA Member States*, May 2003, available at [http://ec.europa.eu/comm/avpolicy/info\\_centre/library/studies/index\\_en.htm](http://ec.europa.eu/comm/avpolicy/info_centre/library/studies/index_en.htm), in particular, pp. 16–17.

## THE PRESENT PRACTICE OF CO-REGULATION AND SELF-REGULATION IN THE AUDIOVISUAL SECTOR

It is relatively easy to point to examples of co-regulatory and self-regulatory practices already in operation in the media sectors of the Member States. The press, for free speech reasons, has generally been subject to self-regulation, illustrating that regulation at a distance may be considered more compatible with constitutional guarantees or human rights. There are also examples from the broadcasting sector of relatively ‘hands-off’ regulatory systems, particularly in the public service sector. Thus, the UK public service broadcaster, the British Broadcasting Corporation (BBC), has, from its inception, operated under a co-regulatory regime, which affords it considerable autonomy in establishing its own operating standards.

Similar examples can be given from outside the EU, with perhaps the most developed system being that established in Australia under the 1992 Broadcasting Services Act.<sup>86</sup> In two areas, in relation to programmes for children and Australian content, the independent regulator, the Australian Broadcasting Authority (ABA), is required to set standards – possibly because it was felt that the industry could not here be trusted to establish adequate requirements, or because of political sensitivities. In other cases, however, it is left to industry itself to establish suitable codes that are then registered by the ABA. Once registered, the industry must comply with the codes and considerable reliance is placed on individual complaints to bring shortcomings to light. Codes have been established in this way on child protection issues, advertising time limits, accuracy and fairness in news reporting, misleading programmes, sponsorship and complaints – that is, on a number of issues which are currently subject, within Europe, to specific regulation under the TWF Directive.<sup>87</sup>

At the EU level, significant steps have already been taken to support self-regulation and co-regulation in the audiovisual sector, as well as the creation of networks of representative organisations. It is possible to point to a number of developments to illustrate the various ways in which the EU is engaging with, and in some cases driving, these processes. First, there are examples of self-regulation taking place with limited, if any, EU intervention.<sup>88</sup> A good example of this is the Pan-European Game Information System (PEGI), which establishes a uniform rating system for interactive games. The system, established

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<sup>86</sup> For discussion, see Schultz and Held, *op. cit.*, n. 8 above.

<sup>87</sup> *Ibid.*

<sup>88</sup> See the discussion by M.L. Lule, ‘Self-regulation and co-regulation: A broadcasting perspective’, in S. Nikoletchev (ed.), *op. cit.*, n. 9 above, pp. 87–92 at 90, and Palzer, *art. cit.*, n. 11 above, at 4.

by industry after extensive consultation, uses both age ratings and content descriptors. Though currently an autonomous system, the line between games and other audiovisual content may be narrowing, with sequences from films such as *Matrix Reloaded* and *Lord of the Rings* designed for use in games, and increasing potential for interactive elements to be incorporated into otherwise standard television programmes. This has prompted Carmen Palzer to ask ‘why the *Star Wars* computer game can be granted the same rating across Europe while the corresponding film can not’.<sup>89</sup> The PEGI rating system is, thus, just one more element to be taken into account in trying to establish a more coherent and uniform rating system at the European level.

Secondly, it is possible to point to areas where the Community institutions, in particular the Commission, have been highly active in promoting industry standard-setting, networking and ancillary measures within a more or less exacting Community framework. One example, already mentioned, is that of E-commerce. The E-commerce Directive requires Member States and the Commission to ‘encourage’ the drawing up of codes of conduct *at Community level* in relation to specific areas covered in the Directive, including advertising by regulated professions.<sup>90</sup> Though this clearly entails the general diffusion of standards across the EU in these areas, it also allows some scope for experimentation and deliberation in fleshing out the nature of these standards.<sup>91</sup> The Directive also promotes the development of codes of conduct in relation to the protection of minors and human dignity, though here cultural differences may explain the absence of any reference to their adoption ‘at the Community level’.<sup>92</sup>

The provisions of the E-commerce Directive on child protection are in fact one aspect of a much more ambitious Community programme.<sup>93</sup> In this

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<sup>89</sup> Palzer, art. cit., n. 11 above, at 3. Agreement of the PEGI system was facilitated by the fact that many Member States had yet to introduce measures in this area.

<sup>90</sup> See Articles 16(1)(a) and 8(2).

<sup>91</sup> For an interesting discussion of both ‘top-down’ and ‘bottom-up’ aspects of the open method of co-ordination, see Trubek and Trubek, op. cit., n. 35 above, pp. 20–21.

<sup>92</sup> Article 16(1)(c), see also n. 36 above.

<sup>93</sup> See, for example, European Commission, *Communication on Illegal and Harmful Content on the Internet*, COM (1996) 487; European Commission, *Green Paper on the Protection of Minors and Human Dignity in Audiovisual and Information Services*, COM (1996) 483; Council of the European Union, *Recommendation on the Development of the Competitiveness of the European Audiovisual and Information Services Industry by Promoting National Frameworks Aimed at Achieving a Comparative and Effective Level of Protection of Minors and Human Dignity* (98/560), OJ 1998 L270/48; European Parliament and Council Decision (2761/1999) adopting a *Multiannual Action Plan on Promoting Safer Use of the Internet and New Online Technologies*, OJ 1999 L33/1; and European Commission, *Proposal for an EP and*

context, the Community has adopted both cross-platform and sector-specific approaches, addressing concerns arising in the 'on demand' and broadcasting sectors. In particular, the Community has promoted the development of 'hotlines' within the Member States to which individuals can refer audiovisual content that appears to be illegal or harmful, in particular child pornography. Depending on which body runs the hotline, the information is then passed on to the police, relevant internet service provider (ISP) or broadcaster, as appropriate. The Commission has encouraged co-ordination among hotlines at the European level to facilitate the exchange of information and good practice, by supporting INHOPE – an association of internet hotlines which now has an international membership.<sup>94</sup> The object of self-regulation here is not so much the development of European standards, though the Commission considers that the 1998 Recommendation promotes a 'comparable' level of protection, but to aid the effective enforcement of domestic child protection standards in the context of a complex and diffuse industry.

In relation to content that is legal for adults but could prove harmful to children, the Community has promoted the development of content descriptors and supported research into filtering technologies.<sup>95</sup> It has additionally sought to assist parents in controlling what their children watch by encouraging the dissemination of information about available filtering and rating systems.<sup>96</sup> Further steps have been taken to encourage schools to help children think about the possible risks involved in internet use and to encourage safe access to facilities such as chat rooms.<sup>97</sup> The emphasis here has been on individual empowerment and access to information.

## THE POTENTIAL FOR FURTHER RELIANCE ON SELF-REGULATION AND CO-REGULATION IN THE AUDIOVISUAL SECTOR

It is apparent that initiatives involving self-regulation or co-regulation are already widespread within the audiovisual sector; a key question is whether

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*Council Decision on Establishing a Multiannual Community Programme on Promoting Safer Use of the Internet and New Online Technologies*, COM (2004) 91 final.

<sup>94</sup> For further details, see the Commission information society website at [http://ec.europa.eu/information\\_society/activities/sip/index\\_en.htm](http://ec.europa.eu/information_society/activities/sip/index_en.htm).

<sup>95</sup> See the documents detailed in n. 93 above.

<sup>96</sup> Ibid.

<sup>97</sup> Ibid.

the Community can, and should, encourage further steps in this direction. The answer to this will depend not only on whether such systems offer greater efficiency, flexibility or legitimacy, issues considered in more detail in the section below, but also whether they are likely to affect the substantive outcome of the regulatory process. If they do result in different substantive outcomes, it will be necessary to consider whether these outcomes are likely to be more or less in tune with the underlying regulatory objective.

It is possible to imagine at least two contexts in which reliance on self-regulatory and co-regulatory techniques could be developed further. First, the Community might encourage additional industry co-ordination in those general interest areas where divergent approaches in the Member States create potential, even if not currently pressing, barriers to trade. As indicated above, a key area here could be that of content ratings, where Member States employ a variety of institutional arrangements and standards. Practice also varies within certain Member States as to how the different media platforms are regulated. This is potentially confusing, not only for industry, but also for consumers, and the response in the Netherlands has been the development of the Kijkwijzer system, a central computerised system for rating television and cinema films, videos, and DVDs.<sup>98</sup> The Community itself is actively supporting networking among rating organisations with a view to the possible acceptance of common indicative symbols or pictograms, which alert the consumer as to the existence of sensitive content (fear/violence/drugs/sex/language). Although there is no suggestion that the Community wishes to curtail the capacity of Member States to impose their own age ratings alongside these pictograms, and any such proposal would be highly contentious given Member State sensitivity regarding domestic standards, it is not inconceivable that this process of co-ordination could lead to greater coherence in rating use not only across different platforms, but also, ultimately, across EU Member States.

This raises the question of whether it is appropriate for the Community to use soft law techniques to achieve indirectly a result that it is precluded from pursuing directly. In its April 2004 *Proposal for a Recommendation on the Protection of Minors, Human Dignity and the Right of Reply*, the Commission explicitly stated that '[g]iven that the harmonisation of laws of the Member States is excluded from industrial and cultural policies, the Community is bound to use non-binding instruments, such as recommendations, to fulfil the

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<sup>98</sup> Palzer, *op. cit.*, n. 11 above, pp. 3–4. The Kijkwijzer system was developed and is run by the Netherlands Institute for the Classification of Audiovisual Media (NICAM), an independent body made up of representatives of the television, computer game, film and video/DVD industries.

tasks and obligations enshrined in the Treaty'.<sup>99</sup> In the body of the Proposal, the Commission then goes on to recommend the development of measures for the benefit of minors through, *inter alia*, 'a "bottom-up" harmonisation through co-operation between self-regulatory and co-regulatory bodies in the Member States'.<sup>100</sup> This example illustrates the extent to which the Community is able to work indirectly, through co-ordination and funding, to facilitate a particular regulatory outcome. Of course, it is one thing to say that the Community cannot harmonise directly a particular area, another to say that it cannot take measures to encourage further co-ordination. There is the risk, however, that such initiatives will receive insufficient scrutiny by the Community legislative organs and the Community dimension may be obscured. It is interesting to note that, in this instance, the Commission expressly notes that it has framed the recommendation to come from both the European Parliament and Council, while the earlier 1989 Recommendation concerning the protection of minors was a purely Council measure.<sup>101</sup>

A second area for reappraisal in the TWF Directive is the detailed advertising requirements. We have already noted that some industry members are calling for greater use of self-regulatory techniques in this field, or even reliance simply on the market. The situation here is rather different from that of child protection, in that the TWF Directive does establish a number of uniform rules to be applied across the Member States. In consequence, there is the risk that a change in regulatory approach could lead to the reappearance of diverse domestic standards, relating, for example, to the number of advertising minutes per hour, which the TWF Directive explicitly sought to minimise. The Commission is aware of this possibility and has stated that the use of self-regulatory or co-regulatory techniques should not lead to a re-fragmentation of the internal market.<sup>102</sup> In practice, however, this could be avoided by adopting a system of home-State control and mutual recognition of domestic codes of conduct,<sup>103</sup> and/or the co-ordination of standards at the European level, largely carried out by industry, following the approach in Article 16 of the E-commerce Directive. To adopt the former would be to cut away the protection of minimum harmonisation and leave Member States even more exposed to

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<sup>99</sup> European Commission, *op. cit.*, n. 59 above, p. 3. The Commission proposes Article 157 EC as the legal basis for this recommendation.

<sup>100</sup> *Ibid.*, p. 7.

<sup>101</sup> *Ibid.*, p. 3 and see also Council of the European Union, *Recommendation 98/560*, *op. cit.*, n. 93 above.

<sup>102</sup> European Commission, *op. cit.*, n. 63 above, p. 23.

<sup>103</sup> This could be underpinned by a cross-border complaints system along the lines developed by the EASA. The EASA system assists individuals in referring complaints about advertising originating from another Member State to the relevant disciplinary body in that State. For details, see n. 35 above.



the vagaries of regulatory competition; to adopt the latter would be largely to take Member States out of the regulatory framework.

Both approaches could clearly have a significant impact on the nature of advertising regulations in the Member States, but it is far from clear what form this is likely to take. On the one hand, given the extensive reliance that already exists on industry codes in the advertising field, their impact could be relatively slight. One should, however, bear in mind that industry and independent regulators work with different constraints and different chains of accountability. In some areas one might anticipate that greater reliance on industry to set standards could lead to a marked element of deregulation, in particular in relation to constraints on the amount and timing of television advertising. It might also lead to a reappraisal of the restriction in the TWF Directive on product placement, a practice which is well established in non-broadcasting sectors such as cinema.<sup>104</sup>

In other areas, particularly in the content field, industry may prefer to play safe and adopt relatively restrictive rules to ensure that consumers are not alienated. Interests in free speech and alternative forms of expression may thus be downplayed by the regulatory body when competing commercial interests are at stake. Thus, Gunnel Arrback, from the Swedish National Film Classification Board, notes that when the Netherlands changed its classification system from a government agency, concerned solely to protect children from harm, to self-regulation within the industry, 'the age limits became generally and noticeably higher. I do not think the reason for this to be that Dutch children suddenly became so much more sensitive to material in movies. Rather there were suddenly other considerations.'<sup>105</sup> Similarly, the PEGI rating system for interactive games, a self-regulatory initiative, adopted relatively high standards for the depiction of violence.<sup>106</sup> Nevertheless, the United Kingdom (UK), has recently been examining labelling requirements for video games in the light of a number of violent incidents, both at home and abroad, involving children.<sup>107</sup>

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<sup>104</sup> For further discussion of the responses to the European Commission's *Fourth Report on the Application of the TWF Directive*, n. 8 above, see European Commission, *Communication on The Future of European Regulatory Audiovisual Policy*, COM (2003) 784, in particular p. 19.

<sup>105</sup> G. Arrback (Swedish National Film Classification Board), 'Protecting whom from what?', speech at the International Film Classification Conference, Australia, September 2003, pp. 3–4, available at <http://www.oflc.gov.au/resource.html?resource=259&filename=259.pdf>.

<sup>106</sup> Palzer, *op. cit.*, n. 11 above at 5.

<sup>107</sup> Press Association, 'Action on Computer Game Violence', *The Guardian*, 11 December 2004. Though contested, access to violent computer games has been linked, *inter alia*, to the killing of Stefan Pakeerah in Leicester, February 2004, and to the mass shooting by Robert Steinhäuser of students and teachers in a school in Erfurt, Germany, in April 2002.

The above discussion illustrates that there is indeed scope for greater recourse to self-regulatory or co-regulatory techniques in the media sector. Indeed, these techniques can offer particular advantages in the context of rapid technological and industrial change. More importantly, the discussion also illustrates that regulatory techniques can have a significant impact on the nature and intensity of the standards set: one is not dealing here with mere technocratic options. Given the policy implications which lurk behind any decision as to the composition of a standard setting body and the terms on which it operates, it is important that any shift in regulatory strategy be carefully articulated by the Commission and overseen, at Community level, by the legislative institutions, the European Parliament and the Council.

## WHAT ARE THE IMPLICATIONS OF GREATER RELIANCE ON SELF-REGULATION OR CO-REGULATION FOR THE COMMUNITY INSTITUTIONS IN TERMS OF THEIR LEGISLATIVE AND EXECUTIVE FUNCTIONS?

Greater reliance on self- or co-regulation will have considerable implications for the Community institutions and necessitates important modifications to their mode of operation. On the one hand, given that a key rationale for greater reliance on framework directives is that European standards can be framed in more general terms, less of the Commission's time should be spent drafting (and the Council and Parliament reviewing) highly detailed legislation. This will also be the case where non-binding measures, such as recommendations, are used to 'encourage' greater recourse to self-regulation in order to realise broadly drawn objectives. On the other hand, considerable attention will need to be given to the issue of which regulatory approach will in fact be most suitable and to ensuring, where co-regulation is endorsed, that representative and transparent systems are in place for standard-setting, that implementation is effective, and that the whole process is properly monitored. To date, Community guidance on this issue has been rather patchy, but a number of principles have been established by the Commission in relation to the use of co-regulation, which are briefly noted below.<sup>108</sup>

First, co-regulation should be based on a legislative act. The legislature must identify the key objectives to be pursued, implementation and monitoring methods, and any sanctions. This provides some reassurance for the Council and the Parliament as to their involvement in the operation of co-regulatory procedures,

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<sup>108</sup> European Commission, *op. cit.*, n. 7 above, pp. 11–13 and European Commission, *op. cit.*, n. 76 above, pp. 20–21.

though the exact degree of Parliament influence will depend on whether the basic act is enacted using the co-decision or consultation procedures. Recourse to co-regulation has been an extremely sensitive issue for the European Parliament, which saw itself increasingly side-lined from the process of standard setting and with limited scope for oversight over implementation. That this is not merely a hypothetical concern is underlined by the fact that the distinction between ‘essential elements’ and ‘technical details’, which demarcates for the Commission those matters to be specified in primary legislation and those to be determined during implementation, is likely to be far from clear-cut.

The recent *Interinstitutional Agreement on Better Law-Making* goes some way to addressing these issues by providing that legislation should expressly indicate the extent of co-regulation that is envisaged.<sup>109</sup> It goes on to provide that the competent legislative authority should also establish measures to be taken in the event of non-compliance by one or more party or if the agreement fails.<sup>110</sup> In this context, the legislative authority *may* require the Commission to keep the legislature informed of follow-up measures or include a revision clause under which the Commission is to report on progress at the end of a specified period and, ‘where necessary, propose an amendment to the legislative act or any other appropriate legislative measure’.<sup>111</sup> The European Parliament has indicated that it will not accept the adoption of legislation incorporating a co-regulatory element where these verification and call-back provisions are not incorporated.<sup>112</sup> The *Interinstitutional Agreement on Better Law-Making* also requires that draft agreements relating to practical arrangements be forwarded by the Commission to the legislative authority and checked for compliance with Community law and the basic legislative act by the Commission. During the passage of a basic legal act, the European Parliament or Council may also request that there be included a provision specifying that, after submission of such a draft agreement, either institution should have a period of 2 months in which to propose amendments to the draft, object to its entry into force or ask the Commission to propose a legislative act.<sup>113</sup> These measures should enhance the legislature’s influence over the way in which standard setting is taken forward within a co-regulatory scheme.

The level of protection this affords the European Parliament does, of

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<sup>109</sup> European Parliament, Council and Commission, *op. cit.*, n. 37 above, para. 21.

<sup>110</sup> *Ibid.*

<sup>111</sup> *op. cit.*, n. 109.

<sup>112</sup> European Parliament, *op. cit.*, n. 13 above.

<sup>113</sup> European Parliament, Council of the European Union and European Commission, *op. cit.*, n. 37 above, para. 20.

course, depend on whether the Commission decides to propose a legislative act, entailing co-regulation, or, alternatively, decides to support self-regulation. As we have seen, it is possible for the Community to promote self-regulation through soft law recommendations, which ‘encourage’ industry, on a voluntary basis, to develop standards in a given area.<sup>114</sup> In certain cases, the concerns underlying these measures could instead have been addressed through directives introduced on established internal market lines, calling on Member States to ensure co-regulatory schemes are put in place to realise a particular objective. Though the European Parliament may, in fact, be closely involved in soft law initiatives such as recommendations, it has no guarantee that this will be the case.<sup>115</sup> The Commission has, however, undertaken to notify the European Parliament and Council of any self-regulatory practices which it regards as contributing to the Community’s objectives and to consider a request by either institution to adopt a legislative act in that area.<sup>116</sup>

Secondly, co-regulation should not be used where fundamental rights or major political choices are called into question, nor where rules need to apply in a uniform way in every Member State. The first of these limitations is clearly problematic in the media sector where fundamental rights, in particular freedom of expression and information, are often at stake.<sup>117</sup> In nearly every case, it is possible to frame key issues in terms of human rights, as one can see from the *RTL* case discussed above, yet the audiovisual sector is a field where the Commission clearly envisages greater recourse to co-regulation.<sup>118</sup> Underlying this limitation is the conviction that it should not be left to private bodies to determine the scope of regulations which could curtail fundamental rights. Indeed, such a situation could contravene constitutional guarantees in a number of Member States. Article 5 of the Basic Law of the Federal Republic of Germany, 1949, for example, requires any limitation on freedom of expression to be established by a general statute or in specific statutory provisions for the protection of youth and personal honour.<sup>119</sup> A similar provision can be

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<sup>114</sup> For an example, see the discussion of the Commission’s *Proposal for a Recommendation on the Protection of Minors, Human Dignity and the Right of Reply* at the text accompanying n. 99 above.

<sup>115</sup> See the text accompanying n. 101 above and the discussion accompanying n. 39.

<sup>116</sup> European Parliament, Council of the European Union and European Commission, *op. cit.*, n. 37, para. 23.

<sup>117</sup> Clarification is also required regarding the second limitation mentioned by the Commission under this heading, namely when ‘major’ political choices are at stake.

<sup>118</sup> See n. 70 above, in which *RTL* argued that the TWF Directive restricted its freedom of communication under Article 10 ECHR.

<sup>119</sup> For further discussion see T. McGonagle, *op. cit.*, n. 32 above, at 18, and W. Schultz, U. Jürgens, T. Held and S. Dreyer, ‘Regulation of Broadcasting and Internet

found in Article 52 of the Charter of Fundamental Rights of the European Union, which states that: '[a]ny limitation on the exercise of the rights and freedoms recognised by this Charter must be provided for by law and respect the essence of those rights and freedoms'.<sup>120</sup> This article was carried over into Title II of the Treaty Establishing a Constitution for Europe, though the prospects of the Treaty being implemented are now greatly diminished, given the outcome of the French and Dutch referenda.<sup>121</sup>

Tarlach McGonagle has suggested that these constraints do not entirely rule out recourse to co-regulation, but rather impose significant constraints on its mode of operation.<sup>122</sup> What is important is that the interposition of private, as opposed to public, actors in the standard-setting and enforcement stages does not lead to the creation of a 'black hole' in the operation of human rights protection. It is clear that Member States are required to comply with human rights when implementing and interpreting directives or derogating from Community freedoms.<sup>123</sup> Human Rights delimit the scope of a directive's provisions and, in consequence, also establish parameters for those authorised to flesh out their terms in more detail. Moreover, Member States cannot avoid liability for improper implementation of a directive under Article 226 EC on the basis that the failure lies with a public agency or constitutionally independent institution,<sup>124</sup> nor can they rely on the failure of a private body to which they have entrusted the task of implementation.<sup>125</sup> This suggests that Member States must take effective measures to ensure, when they rely on private standard setting bodies to flesh out general European Community requirements, that those bodies comply with human rights standards, both procedurally and substantively. If not, they risk Commission investigation and potential refer-

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Services in Germany' (2002), Working Paper no. 13 of the Hans Bredow Institute, Hamburg, pp. 6–7. Article 19(4) of the German Basic Law also provides that where a person's rights are violated by the actions of a public authority they are entitled to have recourse to a court of law.

<sup>120</sup> OJ 2000 C364/1.

<sup>121</sup> OJ 2004 C310/1, Article II-112.

<sup>122</sup> Op. cit., n. 32 above.

<sup>123</sup> Case 5/88 *Wachauf v Bundesamt für Ernährung und Forstwirtschaft* [1989] ECR 2609, para. 19; see also, the discussion in P. Craig and G. de Búrca, *EU Law, Text, Cases and Materials* (Oxford: Oxford University Press, 2003), pp. 339–45.

<sup>124</sup> Case 77/69 *Commission v Belgium* [1970] ECR 237, para. 15.

<sup>125</sup> See Case 246/80 *Broekmeulen v Huisarts Registratie Commissie* [1981] ECR 2311, para. 17, and the discussion by E. Steyger, 'European Community law and the self-regulatory capacity of society' (2003) vol. 31:2 *Journal of Common Market Studies*, 171–90 at 176. In *Commission v Germany*, n. 31 above, Germany was held to have infringed Community law in part because the circular, on which representatives from the scientific and economic sectors had participated, did not fully reflect the requirements set out in the governing Directive.

ence to the ECJ under Article 226 EC. It is also possible that an individual adversely affected by the actions of a private body entrusted with fleshing out and implementing a directive might seek damages from the state under the principle established in the *Francovich* case.<sup>126</sup>

What is less clear is whether there is any basis for a direct challenge to the decisions of the private standard setting bodies themselves. Catherine Barnard has noted, in relation to the standard setting bodies recognised under the Community new approach to technical harmonisation, that they are 'not bound by the duty to give reasons in Article 253 or other principles of good government, nor are they subject to review by the Court of Justice'.<sup>127</sup> Undoubtedly, domestic bodies of the kind at issue here do not fall within the scope of Article 230 EC, but their decisions may be subject to appeal or review at the domestic level. The scope of judicial review, and in particular the ability of courts to review decisions for compliance with human rights will depend on the constitutional arrangements within each Member State, a subject which it is only possible to touch on briefly here.

Within the UK, section 3 of the Human Rights Act 1998 requires primary and secondary legislation to be read and given effect to wherever possible in conformity with the Convention rights specified in the Human Rights Act. Moreover, section 6 renders it unlawful for any person whose functions are of a public nature to act incompatibly with a Convention right. It is clear from English cases such as *Datafin* that in certain contexts private standard setting and enforcement bodies may be regarded as performing a public function.<sup>128</sup> Of particular interest is the fact that in *Datafin*, the Panel on Takeovers and Mergers (the 'Panel'), a body composed of representatives from the financial services industries, was not exercising powers granted by statute. Government intervention in this area was, however, premised on the existence of the Panel

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<sup>126</sup> Cases C-6 and 9/90, *Francovich and Bonifaci v Italy* [1991] ECR I-5357. E. Steyger, at *ibid.*, 187, concludes that Member States could be liable in damages for the failure of private bodies to whom they have entrusted the elaboration and implementation of general norms set out in directives. One problem which could arise in this context stems from the fact that the damages awarded under *Francovich* are for injury to rights granted to individuals by a directive. The fundamental right relied on by a claimant may not be one of the rights specifically conferred by the principal directive, and may be used in an attempt to cut down the scope of those rights which have been so conferred. Thus, a Community directive requiring the introduction of measures to protect children from harmful advertising could be applied with excessive rigour by a private implementing body, thereby infringing the advertisers' freedom of expression. The objective of the directive is not here to grant rights to advertisers, rather to curtail them.

<sup>127</sup> Barnard, *op. cit.*, n. 10 above, p. 525.

<sup>128</sup> *R. v Panel on Takeovers and Mergers ex parte Datafin plc and Another*, [1987] QB 815, [1987] 2 WLR 699.

and, but for its existence, specific legislation would almost certainly have been enacted. In addition, the Panel exercised immense *de facto* power over the UK financial market and any finding that a company had breached its code could lead to severe penalties by the Department of Trade and Industry or Stock Exchange, bodies which do operate under statutory powers. The Panel was thus operating within a statutory framework, much as one could envisage a standard setting and enforcement body to operate in the context of national legislation implementing a framework directive. The application of a broad 'functional' test in English law to determine whether a body is amenable to judicial review has brought within the scope of review a number of media regulatory bodies and, drawing on this jurisprudence, the government has indicated that it considers 'private' regulators such as the British Board of Film Classification and the Press Complaints Commission to be public authorities within the meaning of section 6(3) of the Human Rights Act.<sup>129</sup>

Finally, it may be possible for the private standard setting body to seek guidance from the ECJ as to the proper interpretation of the governing Community legislation using the preliminary reference procedure set out in Article 234 EC. Though the lengthy time-lag between reference and answer may make this a relatively unattractive option, cases such as *Broekmeulen* do indicate that private regulatory bodies entrusted with the task of implementing Community law and acting 'under a degree of governmental supervision' may have the opportunity of making a preliminary reference.<sup>130</sup> Where the decisions of such a body are final then it will be under an obligation to make such a reference. In this way the human rights constraints which are built into the operation of secondary Community law, and which consequently establish parameters to the competence of private implementing bodies, may be tested.

Given concerns that fundamental rights may be insufficiently protected within co-regulatory schemes it is worth considering whether any steps could

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<sup>129</sup> See R. Reed and J. Murdoch, *A Guide to Human Rights Law in Scotland* (London: Lexis Nexis Butterworths, 2001), pp. 35–8, and R. Clayton and H. Tomlinson, *The Law of Human Rights* (Oxford: Oxford University Press, 2000), pp. 192–9.

<sup>130</sup> *Broekmeulen*, op. cit., n. 125, para. 17. The ECJ has laid down relatively exacting criteria for establishing which bodies are courts or tribunals within Article 234 EC. The Court considers whether the body is established by law, is permanent, has compulsory jurisdiction, adopts *inter partes* procedures, applies rules of law and is independent. In addition, the decisions of such bodies must be of a judicial, as opposed to administrative, nature. The question of independence and whether there is a clear separation between the investigative and decision-making arms of a professional body are consequently of considerable importance. See, for discussion of these criteria, Joined Cases C-110/98 to C-147/98 *Gabalfrisa and Others v Agencia Estatal de Administración Tributaria (AEAT)* [2000] ECR I-1577, para. 33, and Case C-134/97 *Victoria Film* [1998] ECR I-7023, para. 14.

be taken to improve the situation. First, the impact of any proposed co-regulatory measure on human rights should be built into the initial impact assessment, alongside economic and environmental considerations.<sup>131</sup> Secondly, those fundamental rights (most likely to be at issue) should be specified in the basic legislative act, with a specific obligation imposed on those designated to set standards to ensure conformity with them. The *Interinstitutional Agreement on Better Law-Making*, as noted above, requires the Commission to check that any draft agreements relating to practical arrangements comply with ‘Community law’, which could be said to encompass respect for fundamental rights, and to refer these agreements to the legislative authority.<sup>132</sup> Finally, where private actors are involved in the application and enforcement of co-regulatory agreements, provision should be made, depending on the circumstances, for a right of appeal or review to a court of law.

If, however, one takes at face value the stipulation that co-regulation should not be used where fundamental rights are at stake, then there is little scope for co-regulation in the audiovisual context and these concerns are largely hypothetical. However, if co-regulation is excluded it remains possible that the Community will turn to promote self-regulatory initiatives, about which there are also serious questions concerning the degree of protection afforded fundamental rights.<sup>133</sup> Thus, the PCML has argued that, in the field of digital media, any policy on self-regulation ‘must take into account a broader view of the sustainability, effectiveness and impact on free speech of self-regulatory codes and institutions’.<sup>134</sup> They express particular concern that the free speech implications of the use of programme filters, and the commercial ranking of sites, pages and content types, have not been sufficiently addressed. Similarly, the present system of reliance on industry-supported hotlines to monitor complaints relating to child protection, and on ISPs to ‘take down’ material

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<sup>131</sup> The Commission has now indicated that it will audit all major legislative initiatives to ensure that human rights dimensions are considered at an early stage of the planning process: see the speech 05/34 of Franco Frattini, Commissioner for Justice, Freedom and Security, given on 25 January 2005 in Brussels at the opening of the public hearing on a fundamental rights agency, available under press releases at <http://europa.eu/rapid/searchAction.do>.

<sup>132</sup> European Parliament, Council of the European Union and European Commission, *op. cit.*, n. 37 above, para. 20.

<sup>133</sup> It may be noted that the ECJ does not have competence to review recommendations under Article 230 of the EC Treaty, so that were the European Parliament or a Member State to have concerns over the human rights implications of a Commission or Council recommendation they would not be able to use this provision. For a helpful discussion of the role of rights in the context of new governance, albeit with a focus on the OMC, see G. de Búrca, ‘The constitutional challenge of new governance in the European Union (2003) vol. 28:6 *European Law Review* 814–39 at 833–34.

<sup>134</sup> PCML, *op. cit.*, n. 12 above, p. 8.



identified as harmful by those hotlines, may lead to the enforcement of freedom of expression being 'privatised'.<sup>135</sup> Within such a system there is a real risk that free speech interests may be sacrificed for commercial convenience.

Under the *Interinstitutional Agreement on Better Law-Making*, the Commission undertakes to 'scrutinise self-regulation practices in order to verify that they comply with the provisions of the EC Treaty'.<sup>136</sup> It would be helpful if the scope of this provision could be clarified, in that it is open to question whether it imposes on the Commission a duty to review self-regulatory arrangements for general conformity with fundamental rights.<sup>137</sup> More specifically, however, the Commission is required to comment on the representative nature of the self-regulatory body and to consider putting forward a proposal for a legislative act at the request of the Council or European Parliament where they consider the existing provisions to be unsatisfactory.<sup>138</sup>

The third requirement is that those entrusted with responsibility to define and implement measures must have sufficient experience gained in the field and be 'representative, organised and responsible'.<sup>139</sup> Membership of any standard setting body is clearly crucial, as is the balance of power within it. Where interests are particularly polarised, or industry does not consider the overarching objectives to be in its own interest, then reliance on co-regulation is unlikely to be successful.<sup>140</sup> Practices across the Member States have varied considerably in the media field with, for example, advertising standards (with the exception of those for television) being determined in the UK by the industry alone, while in other Member States consumer and relevant interest groups have been allowed greater representation. The Community has considerable scope to influence the degree and nature of representation on standard-setting, enforcement and monitoring bodies. In certain instances, those with a legitimate interest do not have the resources to participate effectively and the Community can play an important role in identifying and remedying these deficits. The E-commerce Directive, for example, encourages the involvement of consumer groups in the drafting and implementation of codes which could affect their interests, as well as consultation of groups representing the visually-

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<sup>135</sup> *Ibid.*, p. 11.

<sup>136</sup> *Op. cit.*, n. 37 above, para. 22.

<sup>137</sup> The EC Treaty does not, for example, contain an express provision relating to fundamental rights such as Article 6 of the Treaty on European Union and it is worth remembering that, in any event, one is here dealing with self-regulatory initiatives.

<sup>138</sup> *Op. cit.*, n. 37 above, para. 23.

<sup>139</sup> European Commission, *op. cit.*, n. 7 above, p. 13.

<sup>140</sup> As illustrated by the reluctance of industry to endorse technical standards which facilitate interoperability: see P. Laven, 'Technical standards' in S. Nikoltchev (ed.), *op. cit.*, n. 9 above, pp. 49–53 at 49.

impaired and disabled.<sup>141</sup> In the Australian context, the ABA promotes co-operation among a number of relatively focused yet unrelated interest groups, for example, those representing women and the disabled, to ensure more effective representation.

It will be important to ensure that standard setting, in practice, matches up to this inclusive agenda. Major representatives from industry inevitably have the technical and financial resources to come to the negotiating table with well-developed, focused agendas; whereas smaller industry operators, consumers and other interest groups can find themselves pushed into responding reactively, with limited capacity to carry out independent research to support their position. From this perspective, the Commission's decision to rely primarily on ISPs and industry players in developing a European code of conduct for ISPs is a matter of some concern. The Commission has indicated that '[i]ndustry should take the initiative in drafting the Code but other interested parties including user/consumer/child welfare representatives and regulators would need to be consulted before it is finalised'.<sup>142</sup> To allow such parties the opportunity to influence a scheme only 'before it is finalised' marginalises their input, yet seeks to capitalise on the legitimacy which their involvement can bring to the standard setting process.

Finally, the Commission has stressed the importance of transparency and public access to both the main act and implementing provisions. In the White Paper, it established that 'the rules agreed must be sufficiently visible so that people are aware of the rules that apply and the rights they enjoy'.<sup>143</sup>

## CONCLUSIONS

This chapter has suggested that there is more continuity in the media regulatory environment than recent Commission papers might lead one to believe. Co-regulation and self-regulation have been in operation in the audiovisual sector for a considerable time, both at domestic and European levels. What we are seeing now, however, is an intensification of their use, particularly in relation to on-demand and internet services, where regulation is politically contentious, and implementation and enforcement are particularly problematic. Greater reliance on these techniques calls for the development of sophisticated guidelines for

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<sup>141</sup> See Article 16(2) of the E-commerce Directive, n. 3 above.

<sup>142</sup> See European Commission, *Towards a European Code of Conduct for Internet Service Providers*, available at [http://europa.eu.int/information\\_society/activities/sip/news\\_events/project\\_news/index\\_en.htm](http://europa.eu.int/information_society/activities/sip/news_events/project_news/index_en.htm).

<sup>143</sup> European Commission, *White Paper on European Governance* op. cit., n. 76 above, p. 21.

assessing their potential advantages and limitations, whether at the standard-setting or enforcement stages. In particular, their potential impact on well-established national standards needs to be acknowledged. For this reason, studies such as those carried out by the Hans Bredow Institut in Hamburg and the PCML in Oxford, which argue for the introduction of a detailed auditing procedure in relation to self-regulatory codes, are particularly important.<sup>144</sup>

Similarly, the guidelines identified by the Commission itself in the preceding section are important but require greater clarification and development. In particular, one should be wary of the assumption that co-regulatory or self-regulatory systems are necessarily more flexible or efficient, though they often transfer costs from central government to the industry itself and thus, indirectly, to the ultimate consumer. Such techniques *may* indeed be better able to respond to technical or market developments; *may* render information-gathering more effective; and *may* increase the likelihood that industry will accept adopted standards leading, in turn, to higher levels of compliance – but these benefits are not inevitable. The history of press regulation in the UK, to take one example, serves as a salutary reminder that self-regulatory systems may prove severely limited.<sup>145</sup> Moreover, where industry dominates the standard-setting, monitoring and enforcement processes, there is the inevitable risk that important public interests will be marginalised or ignored.

In other instances, reliance on self-regulation or co-regulation for implementation purposes may prove to be little more than a form of ‘symbolic’ regulation. In the internet context, for example, because it is difficult to track down the ultimate originator of media content, ISPs and parents have been targeted for child protection purposes. Gatekeepers may not, however, feel sufficiently committed to specified regulatory objectives for the system to operate effectively: ISPs tend to have little interest in effectively encouraging the take-up of filtering mechanisms, while parents may be ignorant, indifferent or even opposed to their use.<sup>146</sup> These observations highlight the importance of appropriate criteria, not only for evaluating the respective merits of different regulatory systems (a regulatory audit system that is not biased in favour of soft regulation), but also of guidelines designed to ensure that where co-regulatory or self-regulatory systems are supported by the Community they

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<sup>144</sup> See above nn. 8 and 12 respectively.

<sup>145</sup> See T. Prosser, ‘Self-regulation, politics and law: The example of the media’, paper presented at the Workshop on Self-Regulation (II), 14–15 November 2003, at the European University Institute, Florence, on file with author.

<sup>146</sup> Both aspects are illustrated by Australian attempts to protect children online through the Broadcasting Services Amendment (Online Services) Act 1999, discussed by P. Chen, ‘Lust, greed, sloth: The performance and potential of internet co-regulation in Australia’ (2002) vol. 11:2 *Griffith Law Review* 465–96.

are effective, representative and transparent.<sup>147</sup> Above all, given the way in which regulatory techniques can shape the realisation of policy objectives, it is imperative that both the European Parliament and Council are actively involved in determining whether co-regulatory or self-regulatory techniques should be employed, and in evaluating the impact of these regulatory choices once adopted.

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<sup>147</sup> In this regard, see the recommendations put forward by PCML, *op. cit.*, n. 12 above, in particular pp. 11–12.

## 6. The legal framework for financial services and the Internet

**Michel Van Huffel<sup>1</sup>**

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### INTRODUCTION

The European Commission presented its Financial Services Action Plan (FSAP) on 11 May 1999.<sup>2</sup> This FSAP aimed at integrating financial markets and identified in this respect a series of measures to be undertaken to achieve these policy objectives. It concerned both the gross market and the retail market, and one of its core actions was – and remains – the development of open and secure markets for retail financial services.<sup>3</sup> The FSAP was due to be completed by 2004,<sup>4</sup> and was followed, in December 2005, by a White Paper on Financial Services Policy for the period 2005–10.<sup>5</sup>

The legal framework for financial services (which has been substantially amended, revised and completed since 1999, under the auspices of the FSAP) has been profoundly influenced by the emergence of the Internet and by the

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<sup>1</sup> Legal Secretary, European Court of Justice. The views expressed are personal, and should not be attributed to any institution, member of an institution or administrative service with which the author is, or has been, associated. The author wishes to thank Ms Kundan Patel for her reading and comments.

<sup>2</sup> Communication of the Commission, *Implementing the Framework for Financial Markets: Action Plan*, COM (1999) 232; see M. Merlin, ‘Le plan d’action sur les services financiers’ (2002) vol. 2002/4 *Revue du Droit de l’Union européenne* 687–709 and D. Kurek, ‘The EU’s Financial Services Action Plan’ (2004) vol. 43:1 *Monetary Review* 83–91.

<sup>3</sup> See J.F. Mogg, ‘Looking ahead to the next century: EU priorities for financial services’ (1999) *European Banking and Financial Law Journal – Euredia* 9–21.

<sup>4</sup> European Commission, *Turning the corner: Preparing the Challenge of the Next Phase of European Capital Market Integration*, Tenth Progress Report, available at [http://europa.eu.int/comm/internal\\_market/en/finances/actionplan/progress10\\_en.pdf](http://europa.eu.int/comm/internal_market/en/finances/actionplan/progress10_en.pdf), 2 June 2004.

<sup>5</sup> COM (2005) 629 final. The White Paper presents the Commission strategy for further integration of EU financial markets, focusing primarily on implementing existing rules agreed under the FSAP and on co-operation, rather than proposing new laws. It also explores ways of improving cross-border access to retail financial services and asset management.

legal pattern developed to regulate the electronic commerce of these services.<sup>6</sup> Directive 2000/31 on E-commerce was presented in 1998 and adopted in 2000.<sup>7</sup> It dramatically impacted on the EC *acquis* in financial law, as well as consumer law and private international law, in such a manner that some of its consequences remain a source of controversy in the legal doctrine. The purpose of this chapter is not to give a detailed analysis of the existing – and future – legal provisions applicable to the selling of financial services over the Internet. The scope of such an analysis would be too broad, in consideration of the multiplication of legal texts applicable in this domain. Instead, attention here will be concentrated on the ‘internal market clause’, which is the core element of the E-commerce Directive, and on its effects on financial law, consumer law and private international law. Moreover, it is not only the cornerstone of the E-commerce Directive, but a central element of a new regulatory approach pursued by the Commission, which aims at sweeping away inconsistencies and divergences resulting from national legal regimes that constitute hurdles to the smooth functioning of the internal market.

In that respect, it is arguable that it constitutes a new form of (de-)regulation of the market, which deserves to be analysed in comparison with, on the one hand, the mutual recognition principle as developed by the Court of Justice (ECJ) in the field of services, and, on the other hand, the classical harmonisation techniques used in consumer law (harmonisation based on a minimal clause) and in financial law (largely inspired by the minimal harmonisation approach). After having analysed the concept of the Internal Market Clause (IMC) and its effects on private international law, some of its consequences on EC financial law will then be illustrated. We will see also how consumer protection rules on distance marketing of financial services have

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<sup>6</sup> ‘New technology is already having a profound impact on the financial services industry. It is revolutionising the operation of, and access to, wholesale markets; it is transforming cross-border service provision; and acting as a catalyst for the creation of new financial services and new business models, often triggering new alliances involving telecommunications, information technology, retail, and financial services providers. An environment conducive to the development of both the European Union’s (EU) financial services industry and the information society is of vital importance for the EU’s future competitiveness. The Commission recently issued a Communication outlining its strategy to respond to the Lisbon Council’s call for urgent action to harness the benefits of e-commerce. The Lisbon Council also set the completion of the Internal Market for Financial Services as a priority, in particular by implementing the Financial Services Action Plan.’ Communication from the Commission, *E-commerce and Financial Services*, COM (2001) 66 final, p. 3.

<sup>7</sup> OJ 2000 L178/1.

been reshuffled in order to accommodate the E-commerce Directive. Finally, the new evolution of the concept of harmonisation, which seems to emerge from these considerations, will be examined.

## THE E-COMMERCE DIRECTIVE: INTERNAL MARKET CLAUSE VERSUS MUTUAL RECOGNITION

### **Free Provision of Services and Mutual Recognition**

Article 49 EC states that '[r]estrictions on freedom to provide services within the Community shall be prohibited in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended'. In accordance with this Article, an economic operator lawfully providing a service in a Member State must be able freely to provide the same service in the other Member States. In order to allow a better functioning of the EC Treaty, legislative measures have been progressively taken which are based on the mutual recognition principle. This regulation process has been particularly important in the field of financial services. The concept is simple: where a provider or a service has been subject to an authorisation and/or a control in its own Member State, this authorisation/control will be recognised in the other Member States. To facilitate the application of this principle, rules pertaining to the authorisation/control scheme are harmonised at Community level, with the authorisation granted in one country giving the right to circulate freely in the other Member States.

However, the free provision of services may be subject to a rule of reason, the conditions of which are strictly defined by the Court. In its *Säger* judgment, the Court decided that:

[h]aving regard to the particular characteristics of certain provisions of services, specific requirements imposed on the provider, which result from the application of rules governing those types of activities, cannot be regarded as incompatible with the Treaty. However, as a fundamental principle of the Treaty, the freedom to provide services may be limited only by rules which are justified by imperative reasons relating to the public interest and which apply to all persons or undertakings pursuing an activity in the State of destination, in so far as that interest is not protected by the rules to which the person providing the services is subject in the Member State in which he is established. In particular, those requirements must be objectively necessary in order to ensure compliance with professional rules and to guarantee the protection of the recipient of services and they must not exceed what is necessary to attain those objectives.<sup>8</sup>

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<sup>8</sup> Case C-76/90 *Säger v Dennemeyer* [1991] ECR I-4221, para. 15.

In the light of the jurisprudence of the Court, '[t]he overriding reasons relating to the public interest which the Court has already recognised include professional rules intended to protect recipients of the service . . . protection of intellectual property . . . the protection of workers . . . consumer protection . . . the conservation of the national historic and artistic heritage . . . turning to account the archaeological, historical and artistic heritage of a country and the widest possible dissemination of knowledge of the artistic and cultural heritage of a country . . .'.<sup>9</sup> In the banking field, the Commission adopted an interpretative communication in 1997, which illustrated how the rule of reason may be applied.<sup>10</sup> It should also be recalled that the application of the *Keck* doctrine to the free provision of services remains unsettled.<sup>11</sup> It is proposed here that this doctrine might be applicable, in particular with regard to financial services; this point is addressed again below.<sup>12</sup>

### The Country of Origin Principle: The Internal Market Clause

The IMC is the key element of the E-commerce Directive. The Directive harmonises some issues (some information requirements, commercial

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<sup>9</sup> Case C-288/89 *Stichting Collectieve Antennevoorziening Gouda and others v Commissariaat voor de Media* [1991] ECR I-4007, para. 14 (with references to relevant case-law).

<sup>10</sup> European Commission, *Freedom to Provide Services and the Interest of the General Good in the Second Banking Directive*, SEC (1997) 1193. Nonetheless, this Communication gave rise to some controversy: see notably, L. Roeges, 'Quelques réflexions critiques sur le cadre légal pour la libre prestation de services bancaires et financiers' (2000) *European Banking and Financial Law Review – Euredia* 149–56; M. Tison, 'Lecture critique de la communication interprétative' (1998) 3 *Revue de la Banque* 162–73; J.F. Lerouge, 'La libre prestation des services bancaires virtuels' (1999) 59 *Journal des Tribunaux de Droit Européen* 111–14; and B. Taevernier and A.S. Pijke, 'La communication interprétative et ses enseignements pour l'interprétation de la DSI' (1999) 59 *Revue de la Banque* 152–61.

<sup>11</sup> Joined Cases 267 and 268/91 *Criminal Proceedings against Keck and Mithouard* [1993] ECR I-6097. See B.J. Drijber, 'Les communications commerciales au carrefour de la dérégulation et de la réglementation' (2002) vol. 38:5–6 *Cahiers de Droit Européen* 529–610; W.H. Roth, 'The European Court of Justice's case-law on freedom to provide services: Is *Keck* relevant?', in M. Andenas and W.H. Roth (eds), *Services and Free Movement in EU Law* (Oxford: Oxford University Press, 2002), pp. 1–24; and J.L. da Cruz Vilaça, 'On the application of *Keck* in the field of free provision of services', in Andenas and Roth (eds), *ibid.*, pp. 25–40. See also, the discussion on Case C-442/02 *CaixaBank* (n. 87 below, and accompanying text; see, in particular, paras 70–76 of the Opinion of Advocate-General Tizzano).

<sup>12</sup> For instance, it might be argued that the *Keck* doctrine could be applied to the prohibition to sell bound services in the case of a mortgage credit sold together with a life insurance or with other non-connected banking services (credit card, etc.).



communications, some aspects of the liability of the providers), but bases the free movement of information society services on a 'prohibition of restriction clause' i.e. the IMC. As far as contracts are concerned, it operates more or less similarly by requiring from the Member States the adaptation of their contract law in view of the prohibition of requirements impeding electronic contracts, without setting up a full set of harmonised rules applicable to electronic contracts.

The mechanism of the IMC is twofold: it lays down a positive rule on the one hand (compliance with legal requirements of the country of origin) and a negative rule on the other (prohibition of restriction by the country of destination). However, the internal market rule can only be understood by having regard to the definition of the co-ordinated field of the Directive.

### **The co-ordinated field**

Article 1(2) states that:

[t]his Directive approximates, to the extent necessary for the achievement of the objective set out in paragraph 1, certain national provisions on information society services relating to the internal market, the establishment of service providers, commercial communications, electronic contracts, the liability of intermediaries, codes of conduct, out-of-court dispute settlements, court actions and co-operation between Member States.

This would normally be the co-ordinated field of the Directive. However, this is not the case for the E-commerce Directive, which defines it under Article 2(h) as 'requirements laid down in Member States' legal systems applicable to information society service providers or information society services, regardless of whether they are of a general nature or specifically designed for them'. This provision goes on as follows:

- (i) The co-ordinated field concerns requirements with which the service provider has to comply in respect of:
  - the taking up of the activity of an information society service, such as requirements concerning qualifications, authorisation or notification,
  - the pursuit of the activity of an information society service, such as requirements concerning the behaviour of the service provider, requirements regarding the quality or content of the service including those applicable to advertising and contracts, or requirements concerning the liability of the service provider;
- (ii) The co-ordinated field does not cover requirements such as:
  - requirements applicable to goods as such,
  - requirements applicable to the delivery of goods,
  - requirements applicable to services not provided by electronic means.

It should be noticed that the purpose of Article 1(2) remains, therefore, unclear. One could even argue that it is in contradiction with Article 2(h), since

the limitation of the scope of harmonisation defined under Article 1(2) does not correspond to the purposely unlimited scope of the co-ordinated field of the Directive.

It has to be underlined that national requirements are covered regardless of whether they are of a general nature or specifically designed for information society services. This implies that any kind of requirements, provided they are applicable to the service or the provider, may be scrutinised under the filters and prohibitions imposed by the E-commerce Directive. However, on the contrary, due to the circumscribed – even if very broad – scope of the Directive, the same rule will not be subject to the same analysis or to the same restrictions when it will be applied in a ‘non E-commerce’ mode. This might cause problems when the service is not *only* provided through E-commerce, but is ‘multi-modal’. This is particularly true for financial services.

### **The country of origin principle**

Article 3(1)–(2) provide that:

1. Each Member State shall ensure that the information society services provided by a service provider established on its territory comply with the national provisions applicable in the Member State in question which fall within the co-ordinated field.
2. Member States may not, for reasons falling within the co-ordinated field, restrict the freedom to provide information society services from another Member State.

*Home country control* With this provision, the European Commission sought to enshrine the principle of ‘home country control’ for information society services.<sup>13</sup> However, ‘it has not been proved that the Community legislature laid down the principle of home State supervision in the sphere of banking law with the intention of systematically subordinating all other rules in that sphere to that principle . . . [I]t is not a principle laid down by the Treaty.’<sup>14</sup> As underlined by Wilderspin and Lewis, in the field of free provision of services, the country of origin rules are used as a ‘benchmark’ if, for instance, the country of destination wants to apply disproportionate restrictions or requests authorisation similar to that which has already been granted in the country of origin. However, even in that case, country of origin rules are not applied as such. It is the compliance with these rules which absolves the provider from the obligation to act in accordance with the rules of the country where he provides services or sells goods. Therefore, the country of origin rule

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<sup>13</sup> See point III. 6 of the Explanatory Memorandum of the proposal, COM (1998) 586 final.

<sup>14</sup> Case C-233/94 *Germany v Parliament and Council* [1997] ECR I-2405, para. 64. It must be underlined that this case concerned the Deposit-guarantee schemes Directive (Directive 94/19, OJ 1994 L135/5).

simply consists in a *datum*, which has to be taken into account by the country of destination.<sup>15</sup> So it would be more accurate to say that this Directive does not enforce a principle which pre-exists in Community law, but that secondary law, in the field of E-commerce,<sup>16</sup> establishes such a principle.<sup>17</sup>

It should also be noticed that the Directive diverges radically from the 'classical' approach of home country control, pursued notably in EC financial law. For instance, the Banking Directive<sup>18</sup> bases the free provision of services on an authorisation granted by the home country authorities and this procedure gives a 'passport' to the credit institution, enabling it to provide services in other countries after having notified its intention to do so. In the case of the E-commerce Directive, however, the prior authorisation mechanism is prohibited; Article 4(1) states that:

Member States shall ensure that the taking up and pursuit of the activity of an information society service provider may not be made subject to prior authorisation or any other requirement having equivalent effect. 2. Paragraph 1 shall be without prejudice to authorisation schemes which are not specifically and exclusively targeted at information society services.

It is true that, for financial services, existing prior authorisation schemes are safeguarded. However, in all other cases, it is difficult to see how Member States will be able to ensure that their providers comply with national requirements applicable to them (especially in consideration of the very broad definition of the co-ordinated field) if they cannot set up an *ex ante* control mechanism.

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<sup>15</sup> See M. Wilderspin and X. Lewis, 'Les relations entre le droit communautaire et les règles de conflits de lois des Etats membres' (2002) vol. 91:1 *Revue Critique de Droit International Privé* 1–37; 289–313, at 295.

<sup>16</sup> It should be noted that this concept exists in some other directives, but without such an extent of 'civil' law: see, for instance, the Television without Frontiers Directive (Directive 89/552, OJ 1989 L298/23, amended by Directive 97/36, OJ 1997 L202/60).

<sup>17</sup> Nonetheless, having succeeded in establishing a bridgehead in this Directive, it is likely that the Commission will be inclined to claim that there is – now – a country of origin principle in EC law; see, for instance, the Commission proposal on services, COM (2004) 2 final: '[i]n order to eliminate the obstacles to the free movement of services, the proposal provides for the application of the country of origin principle, according to which a service provider is subject only to the law of the country in which he is established and Member States may not restrict services from a provider established in another Member State. This principle is accompanied by derogations which are either general or temporary or which may be applied on a case-by-case basis.' Note also, however, the amended proposal: COM (2006) 160 final.

<sup>18</sup> Directive 2006/48 relating to the taking up and pursuit of the business of credit institutions, OJ 2006 L177/1.

*New liability of the country of origin?* The Directive requires that each Member State shall ensure that services will comply with national provisions applicable in that Member State which falls within the co-ordinated field. Recital 22 states that:

information society services should be supervised at the source of the activity in order to ensure an effective protection of public interest objectives; to that end, it is necessary that the competent authority provides such protection not only for the citizens of its own country, but for all Community citizens; in order to improve mutual trust between Member States, it is essential to state clearly this responsibility on the part of the Member State where the services originate.

Moreover, Article 19(1) states that ‘Member States shall have adequate means of supervision and investigation necessary to implement this directive effectively’. This seems to imply that Member States cannot just limit themselves to subject providers and services to the law of the country of origin, but that they have to ensure that providers and services *comply* with these rules. Does this mean that the Directive creates a new type of Member State liability, generating responsibility for damages caused to individuals by providers or services that do not comply with nationally applicable provisions? Would this imply that Member States have to set up control mechanisms in order to ‘ensure that service providers established on its territory comply with the national provisions applicable in the Member State in question which fall within the co-ordinated field’ i.e. more or less any kind of rules pertaining to civil or public law? If this was the case, E-commerce would be treated less favourably than any other kind of distribution system for which such a control does not exist. The question remains open.<sup>19</sup>

*Purely internal situations* The provisions of the Treaty relating to the freedom to provide services, and the rules adopted for their implementation, are not applicable to situations which do not present any link to any of the situations envisaged by Community law.<sup>20</sup> It is, therefore, doubtful that the Community has competence to regulate such ‘purely internal situations’. Consequently, the question whether the Community is competent to take measures requiring a Member State to ‘ensure that the information society services provided by a service provider established on its territory comply

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<sup>19</sup> See M. Van Huffel and L. Rolin-Jacquemyns, ‘L’impact de la directive commerce électronique sur la réglementation européenne des services financiers’ (2001–02) 1 *European Banking and Financial Law Review – Euredia* 45–123.

<sup>20</sup> See Case C-60/00 *Carpenter v Secretary of State for the Home Department* [2002] ECR I-6279.

with the national provisions applicable in the Member State in question' is debatable, especially where these provisions do not originate from EC law.

### **Derogations from the Internal Market Clause**

Article 3(3)–(4) provides for two categories of derogations from the IMC: general and case-by-case.

#### **A general category of derogations**

Article 3(3) states that 'paragraphs 1 and 2 shall not apply to the fields referred to in the Annex'. As far as financial services are concerned, the following 'fields' have to be pointed out: the emission of electronic money by institutions in respect of which Member States have applied one of the derogations provided for in Article 8(1) of Directive 2000/46 (the 'electronic money' directive), Article 44(2) of the UCITS Directive (Directive 85/611 on provisions relating to undertakings for collective investment in transferable securities), Article 30 and Title IV of Directive 92/49 (the third non-life assurance Directive), Title IV of Directive 92/96 (the third life assurance Directive),<sup>21</sup> Articles 7 and 8 of Directive 88/357 (the second non-life assurance Directive), Article 4 of Directive 90/619 (the second life assurance Directive),<sup>22,23</sup> and two categories which are probably the most controversial: 'the freedom of the parties to choose the law applicable to their contract' and 'contractual obligations concerning consumer contacts'. Concerning this last exception, recital 56 states that 'as regards the derogation contained in this Directive regarding contractual obligations concerning contracts concluded by consumers, those obligations should be interpreted as including information on the essential elements of the content of the contract, including consumer rights, which have a determining influence on the decision to contract'.

To what extent prior information requirements fall under the IMC remains controversial<sup>24</sup> and will probably be interpreted in different ways by the Member States. This was also one of the more critical issues during the negotiations on the Distance Marketing of Financial Services Directive,<sup>25</sup> and is analysed more deeply below. It should be emphasised that this regime of exceptions does not lead to an automatic application of the rules of the country of destination. On the contrary, it will lead to the application of the

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<sup>21</sup> This Directive has been 'recast' by Directive 2002/83, OJ 2002 L1/345.

<sup>22</sup> *Ibid.*

<sup>23</sup> Respectively, OJ 2000 L275/39, OJ 1985 L375/3, OJ 1992 L228/1, OJ 1992 L360/2, OJ 1988 L172/1 and OJ 1990 L330/50.

<sup>24</sup> See Van Huffel and Rolin-Jacquemyns, *op. cit.*, above n. 19, pp. 45 et seq.

<sup>25</sup> Directive 2002/65, OJ 2002 L271/16.

'normal' regime provided for by the Treaty: free circulation is guaranteed, but rules justified by the general good might be applicable provided that the conditions posed by the Court as to their admissibility – less restrictive than the requirements of the Directive – are satisfied.

### Case-by-case exceptions

The case-by-case system of exceptions, regulated by paragraphs 4 to 6, has a completely different purpose; it concerns the admissibility of specific (i.e. individual) measures to be taken against a service in particular. Paragraph 4 defines the requirements with which the measures should comply:

Member States may take measures to derogate from paragraph 2 in respect of a given information society service if the following conditions are fulfilled:

- (a) the measures shall be:
  - (i) necessary for one of the following reasons:
    - public policy, in particular the prevention, investigation, detection and prosecution of criminal offences, including the protection of minors and the fight against any incitement to hatred on grounds of race, sex, religion or nationality, and violations of human dignity concerning individual persons,
    - the protection of public health,
    - public security, including the safeguarding of national security and defence,
    - the protection of consumers, including investors;
  - (ii) taken against a given information society service which prejudices the objectives referred to in point (i) or which presents a serious and grave risk of prejudice to those objectives;
  - (iii) proportionate to those objectives.

The lack of clarity of this provision has been highlighted in the *Joint Practical Guide for Persons involved in the Drafting of Legislation within the Community Institutions* of the European Parliament, the Council and the Commission.<sup>26</sup> The complexity of the regime necessitated an interpretative communication from the Commission, attempting to clarify the application of these provisions to financial services.<sup>27</sup> However, the communication remains largely theoretical and probably does not give the analysis expected by the market and national authorities in charge of the application of banking and financial law.<sup>28</sup>

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<sup>26</sup> Drafted by the three Legal Services of these institutions and available at [http://europa.eu.int/eur-lex/en/about/techleg/guide/index\\_en.htm](http://europa.eu.int/eur-lex/en/about/techleg/guide/index_en.htm).

<sup>27</sup> Communication from the Commission, *Application to Financial Services of Article 3(4) to 3(6) of the Electronic Commerce Directive*, COM (2003) 259.

<sup>28</sup> See Communication from the Commission, *E-commerce and Financial Services*, COM (2001) 66 final: 'To assist Member States and service providers and to ensure compliance with the directive, the Commission intends to identify certain types of legal provisions in respect of which Member States may wish to use the derogation. The Commission will consult Member States and interested parties

Paragraphs 4(b), 5 and 6 lay down the procedure to be followed by a Member State to be allowed to take a measure complying with the requirements of paragraph 4(a):

4. Member States may take measures to derogate from paragraph 2 in respect of a given information society service if the following conditions are fulfilled:

[ . . . ]

(b) before taking the measures in question and without prejudice to court proceedings, including preliminary proceedings and acts carried out in the framework of a criminal investigation, the Member State has:

- asked the Member State referred to in paragraph 1 to take measures and the latter did not take such measures, or they were inadequate;
- notified the Commission and the Member State referred to in paragraph 1 of its intention to take such measures.

5. Member States may, in the case of urgency, derogate from the conditions stipulated in paragraph 4(b). Where this is the case, the measures shall be notified in the shortest possible time to the Commission and to the Member State referred to in paragraph 1, indicating the reasons for which the Member State considers that there is urgency.

6. Without prejudice to the Member State's possibility of proceeding with the measures in question, the Commission shall examine the compatibility of the notified measures with Community law in the shortest possible time; where it comes to the conclusion that the measure is incompatible with Community law, the Commission shall ask the Member State in question to refrain from taking any proposed measures or urgently to put an end to the measures in question.

Two problems should be highlighted. First, to what extent are courts bound by this 'administrative authorisation regime' put in place by – and under the auspices of – the Commission? Paragraph 4(b) applies 'without prejudice to court proceedings, including preliminary proceedings and acts carried out in the framework of a criminal investigation'. This could be interpreted as derogation for courts, which would not be obliged to follow this procedure. Nonetheless, 'without prejudice to' does not exactly have the same meaning as 'with the exception of'. The ambiguity is reinforced by recital 25 of the Directive which states that 'national courts, including civil courts, dealing with private law disputes can take measures to derogate from the freedom to provide information society services *in conformity with conditions established in this directive*' (emphasis added). Crabit considers that the purpose of this sentence is to avoid paralysis of the judicial procedures by these notifications.

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during the course of 2001. The objective of this consultation is to analyse the divergences in the level of protection between certain national provisions which Member States might wish to continue to impose on incoming services, and to facilitate the examination of such provisions with respect to their proportionality under Article 3 (paragraphs 4–6).'

Therefore, the two conditions provided for in point (b) do not apply if they cannot be fulfilled in the course of a judicial procedure. However, he considers that it does not mean that they are inapplicable to judicial procedures.<sup>29</sup>

Instead of clarifying the problem, the Commission contributed to the blurring of the picture by adopting divergent attitudes in consecutive documents. In a working document for the Financial Services Policy Group, which was endorsed by the ECOFIN Council in May 2001, the Commission was of the opinion that ‘the measures [Member States] could take (injunctions, *court proceedings*) would have to satisfy the conditions of Article 3(4) (consumer protection, *prior notification to the Commission and to country [of origin]*, and proportionality’.<sup>30</sup> In 2003, however, the Commission, in its Communication on the ‘guidance’ addressed to Member States regarding the application of Article 3(4)–(6) to financial services, said exactly the contrary: ‘it should be pointed out that the dialogue with the Member State in which the provider is established and notification of the Commission are matters for the State’s central administration *and not, for example, the courts*’.<sup>31</sup> It is, therefore, difficult to foresee what the definitive attitude of the Commission will be.

In any case, the fact that the decision of the national court could be subordinated to an appraisal of its content by the Commission sounds rather strange. In the light of jurisprudence from the European Court of Human Rights (ECHR), the fact that a court is bound by a preliminary ruling does not affect its independence. If the preliminary ruling is given by an administrative or legislative body, Article 6 ECHR will be complied with if the parties have the possibility of introducing an action before a court against this ruling.<sup>32</sup> In this case, recourse would exist against the decision of the Commission. However, it should be noted that the procedure laid down in Article 3 does not lead to a ‘preliminary ruling decision’ from the Commission, but to either a green light or a prohibition of the measure. It is

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<sup>29</sup> E. Crabit, ‘La directive sur le commerce électronique: Le projet “Méditerranée”’ (2000) 4 *Revue de Droit de l’Union Européenne* 749–833 at 791: ‘La formule “sans préjudice de la procédure judiciaire” vise à éviter que ces notifications ne paralysent le déroulement des procédures judiciaires. Ainsi, les deux conditions de notification prévues au paragraphe (b) ne s’appliquent pas dans le cas où elles ne pourraient pas être respectées dans le cadre d’une procédure judiciaire. Toutefois, cela ne signifie pas que ces procédures ne sont pas applicables aux procédures judiciaires.’

<sup>30</sup> Annex to the Report on E-commerce and Financial Services to the Financial Services Policy Group, available at [http://europa.eu.int/comm/internal\\_market/finservices-retail/docs/onlineservices/fspg\\_en.pdf](http://europa.eu.int/comm/internal_market/finservices-retail/docs/onlineservices/fspg_en.pdf) (3 August 2001; emphasis added).

<sup>31</sup> Op. cit., n. 23 above, point 2.1.6 (emphasis added).

<sup>32</sup> See J. Velu and R. Ergec, *La convention européenne des droits de l’homme. Extrait du Répertoire pratique du droit belge*, vol. VII (Brussels: Bruylant, 1990), at 454; see also *Applic. 11761/85 Obermeier v Austria* [1990] ECHR 15.



therefore questionable whether the procedure would be compatible with the ECHR. Moreover, considering the principle of independence of the courts vis-à-vis Member States and, in particular, the executive, it is quite difficult to see how a Member State could require a court to refrain from taking a decision without violating this principle. A process of co-operation between national courts and the Commission might have been more appropriate and more fruitful.

Secondly, the Commission considers that it will adopt a formal decision, which might be challenged by the Member State in proceedings for annulment. This means that instead of bringing an action against a Member State if the latter does not fulfil its obligations under Community law – when it takes a measure which might not be in conformity with the Directive – the Commission takes a decision which will have to be challenged by the Member State before the ECJ. The action for failure to fulfil obligations aims at enabling the Court to determine whether a Member State has fulfilled its obligations under Community law. The nature of this procedure is largely an objective one.<sup>33</sup> Also, in fact, the procedure laid down in Article 3 has the same purpose. However, instead of having a pre-litigation procedure (leading to a reasoned opinion from the Commission) and a litigation procedure (leading to a decision from the ECJ), the decision itself will be taken by the Commission. However, it will not be possible, in that case, to examine the general rule that is the legal basis for the individual measure.<sup>34</sup> By shifting the nature of the ‘normal’ procedure, and by exempting the Commission from the burdens of Article 226 EC,<sup>35</sup> the question may be raised as to whether the procedure set out in the Directive is compatible with the EC Treaty. Finally, the burdensome nature of the administrative control procedure put in place by the Commission for individual measures must be questioned with regard to the jurisprudence of

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<sup>33</sup> See J.V. Louis, G. Vandersanden and D. Waelbroeck, *Commentaire Mégret: Le droit de la CE (CEE)*, vol. 10, 2nd edn (Brussels: Éd. de l’Université de Bruxelles, 1993), p. 57 (translation by the present author): ‘[t]he procedure for a declaration of a failure on the part of a State to fulfil an obligation itself affords a means of determining the exact nature of the obligations of the Member States in case of differences of interpretation’. See also, Case 7/71 *Commission v France* [1971] ECR 1003.

<sup>34</sup> Case C-347/87 *Trieveneta Zuccheri and others v Commission* [1990] ECR I-1083, para. 16: ‘[t]he Court has consistently held . . . that, except in an action for a declaration of a failure to fulfil obligations, it is not for the Court to rule on the compatibility of a national provision with Community law. That competence belongs to the national courts, if necessary, after obtaining from the Court, by way of a reference for a preliminary ruling, such clarification as may be necessary on the scope and interpretation of Community law’.

<sup>35</sup> On this question, see Case C-287/03 *Commission v Belgium* [2005] ECR I-3761, where the Commission’s action was dismissed because it had failed to prove that Belgium had failed to fulfil its obligations under Article 49 EC.

the ECJ more generally, which considers frequently that the national courts are better placed than the Court itself to judge the proportionality of a national rule,<sup>36</sup> as well as the decentralisation process organised by the Commission for the application of competition law matters.

### Meaning of the Internal Market Clause

The very broad definition of the co-ordinated field, read in parallel with the IMC, is the tool used by the Directive to reverse the usual logic of harmonisation; it is no longer positive harmonisation, defining new common rules, but essentially a negative integration, affecting national rules pertaining to the co-ordinated field in respect of cross-border transactions. The purpose of the IMC is twofold: an extended application of the mutual recognition principle and the application of the law of the country of origin. As regards the first objective, Article 3 does not generate a completely new approach to mutual recognition. In fact, it largely corresponds to the classical theory but with, on the one hand, a limitation of the overriding reasons relating to the public interest recognised by the ECJ and, on the other hand, a control procedure managed by the Commission. It is probably, in fact, a Commission response to the jurisprudence of the Court, which has perhaps been perceived as too generous with regard to national rules derogating from the free provision of services. The second objective, which is more controversial, is analysed further below.

### The Internal Market Clause in the Commission Proposal for a Directive on Services

In January 2004, the Commission presented a proposal for a directive on services in the internal market.<sup>37</sup> Despite the fact that it is not specified in the recitals or in the provisions, the proposal does encompass information society services.<sup>38</sup> Nonetheless, the directive will not apply to financial services. Curiously, the exclusion is formulated by reference to the definition of financial services in Directive 2002/65 (distance marketing of financial services) which concerns only services sold to consumers. However, the exclusion is broader, since the services excluded are financial services as defined in Article 2(b) of Directive 2002/65 (i.e. 'any service of a banking, credit, insurance, personal pension, investment or payment nature') and not services *referred to* in Article 2(b). The proposal is based on a 'country of origin principle' laid

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<sup>36</sup> See, for example, Case C-405/98 *Konsumentombudsmannen (KO) v Gourmet International Products* [2001] ECR I-1795, para. 33.

<sup>37</sup> COM (2004) 2 final.

<sup>38</sup> *Ibid.*, explanatory memorandum, p. 19.

down in Articles 16–19. It must be stressed that the wording of these articles is not similar to the wording of the E-commerce Directive on a number of issues. The way this proposal will be applied to information society services remains, therefore, unclear.

Moreover, as regards financial services, the situation will be paradoxical: they are covered by the E-commerce Directive, and the IMC applies with some limited exceptions; but in multi-modal situations (advertising over the Internet, telephone call for information, letter for the conclusion of the contract), the phases which do not fall within the scope of the E-commerce Directive will not be subject to an IMC. This will, without any doubt, increase the complexity of the legal regime applicable to financial services.

## PRIVATE INTERNATIONAL LAW

### Mutual Recognition and Conflict of Laws Rule

What is the impact of the mutual recognition theory on conflict of laws rules? Several positions have been defended.<sup>39</sup> According to Basedow, the mutual recognition principle contains a concealed conflict of law rule which would impose the application of the country of origin law on the host Member State. However, in his view, if the host state law is more liberal (i.e. less restrictive) than the law of the country of origin, EC law would not oppose the application of the law of the country of destination. In fact, it would boil down to a principle of the most favourable law for the supplier (*favor offerentis*).<sup>40</sup> Radicati di Brozolo argues that the application of a law different from the law of the country of origin should be analysed as a restriction on the free circulation of the service; a true internal market would, therefore, suppose the application of the law of the country of origin.<sup>41</sup> However, this result is not always ensured by the functioning of the conflicts rules because they do not systematically seek to apply country of origin law to *intra*-EC situations. Finally,

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<sup>39</sup> For an analysis of these positions, see M. Van Huffel, 'Le droit bancaire Européen et le droit international privé à la croisée des chemins' (2004) 179–81 *Gazette du Palais* 1–14; Wilderspin and Lewis, op. cit., above n. 15; and J. Wouters, 'Conflict of laws and the single market for financial services' (1997) *Maastricht Journal of European and Comparative Law* vol. 4:2, 161–208; and vol. 4:3, 284–309.

<sup>40</sup> J. Basedow, 'Der kollisionsrechtliche gehalt der produktfreiheiten im europäischen binnenmarkt: Favor offerentis' (1995) *Rebels Zeitschrift für Ausländisches und Internationales Privatrecht* 1–55.

<sup>41</sup> L. Radicati di Brozolo, 'L'influence sur les conflits de lois des principes de droit communautaire en matière de liberté de circulation' (1993) *Revue Critique de Droit International Privé* 401–24.

following Von Wilmsowsky, 'contractual freedom forms part of Community constitutional law and . . . the freedom to choose applicable law is safeguarded by the Treaty's free movement provision. Both substantive law limitations on contractual freedom and conflict-of-law interferences with the freedom to choose the applicable law by means of objecting factors must . . . be justified by imperative reasons to the public interest.'<sup>42</sup>

At the other end of the spectrum, authors like Tebbens and Kohler have taken the view that free movement provisions are indifferent (neutral) vis-à-vis national conflict rules: the incompatibility with Community law does not result from a conflicts rule which renders the law of the host state applicable but because the substantive rule applicable puts a disproportionate burden on free movement.<sup>43</sup> This interpretation is shared here. The substantive rule needs to be analysed in the light of the criteria defined by the ECJ, and the law of the country of destination might remain applicable if it satisfies the tests. While this debate has, in the past, been essentially an academic one, the E-commerce Directive has now shifted it onto the legislative field.

### **The E-commerce Directive and Private International Law**

Article 1(4) states that '[t]his directive does not establish additional rules on private international law nor does it deal with the jurisdiction of Courts'. In conformity with the Annex, Articles 3(1) and (2) do not apply to 'the freedom of the parties to choose the law applicable to their contract' and to 'contractual obligations concerning consumer contracts'. Recital 23 adds that the Directive 'neither aims to establish additional rules on private international law relating to conflicts of law nor does it deal with the jurisdiction of Courts; provisions of the applicable law designated by rules of private international law must not restrict the freedom to provide information society services as established in this directive'. The explanatory memorandum of the Commission proposal had stated that the IMC 'does not seek to substitute either the 1980 Rome Convention on applicable law for contractual obligations or the 1968 Brussels Convention on Judicial Competence, which continue to apply. Nor does the

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<sup>42</sup> P. Von Wilmsowsky, *Rebels Zeitschrift für Ausländisches und Internationales Privatrecht*, 1995, pp. 736 et seq.; see Wouters, op. cit., above n. 39.

<sup>43</sup> See H. Duintjer Tebbens, 'Les conflits de lois en matière de publicité déloyale à l'épreuve du droit communautaire' (1994) *Revue Critique de Droit International Privé* 451–81; C. Kohler, *Travaux du Comité français de droit international privé*, 1993–94, pp. 71 et seq., and Wouters, op. cit., above n. 39, p. 289. See also, A. Bernel, *Le Principe d'Équivalence ou de 'Reconnaissance Mutuelle' en Droit Communautaire* (Zürich: Schulthess Polygraphischer Verlag; Collection de droit européen, 1996), pp. 116–18.

directive prejudice ongoing work on judicial competence in the context of the revision of the Brussels Convention.<sup>44</sup>

Notwithstanding the clarity of these provisions, extensive interpretations of the IMC have been put forward giving to Article 3 an influence on the determination of the applicable law. It has been claimed, for example, that Article 3 seeks to determine the territorial field of application of the rules to be respected by information society providers and the submission of the provider to the law of his country of origin without considering the geographical distribution of its activity. Article 3 does not apply only where there is a conflict of laws, therefore, but lays down a '*règle d'application générale*' providing for the application of the law of his country of origin by the provider, irrespective of the cross-border (or otherwise) nature of the activity.<sup>45</sup> This seems to refer partly – but it is not that clear – to the notion of '*loi de police*' or '*loi d'application immédiate*'. Rather curiously, however, the same author also suggests that the judge will have three options: he may apply the substantive rules of the country of origin, provided that it does not lead to any restriction, within the meaning of Article 3; he may continue to apply the conflict of laws rules (applicable in his country) in order to determine the applicable law, and decline to apply it if it constitutes a restriction within the meaning of Article 3; or he may decline his jurisdiction, considering that, in conformity with Article 3, the jurisdiction belongs to the judge of the country of origin.<sup>46</sup> Crabit even suggests that the fact that the provider might have to defend himself before the court of another country might be considered as a restriction.

However, this system of (unequal) options seems incompatible with this idea of '*loi d'application immédiate*'. Moreover, the first option implies that Article 3 contains a conflict of law rule, which would be incompatible with the wording of Article 1(4). The third option would be in contradiction with Regulation 44/2001,<sup>47</sup> limiting restrictively the cases where a judge may decline competence and excluding, in principle, the theory of the *forum non conveniens*. The second option might be more acceptable (and is discussed further below), provided that it would not imply a systematic rejection of the law of the country of destination. However, it seems that this theory considers that the designation of this law is in itself a restriction. This is not the usual effect of the mutual recognition principle. It is true that it would be the effect of a '*loi d'application immédiate*' but in that case, it is not necessary to use

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<sup>44</sup> COM (1998) 586 final, p. 22.

<sup>45</sup> Crabit, op. cit., above n. 29, pp. 798–9.

<sup>46</sup> Ibid.

<sup>47</sup> Regulation 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ 2001 L12/1.

conflicts rules to determine the applicable law. However, Crabit suggests that these conflicts rules should be applied, and that this would be an argument in favour of a non-systematic rejection of the law of the country of destination.

Following a second theory developed by Fallon and Meeusen, it has to be taken into consideration that the method based on the '*loi d'application immédiate*' takes place, nowadays, within the methods used in private international law. Following these authors, the reference to the absence of rules of private international law in Article 1(4) has to be understood as a reference to the traditional rules of applicability. However, it would not exclude that the Directive would contain a set of rules affecting the conflict of laws. From the country of origin, Article 3 would require a rule determining the international scope of its own substantive rules, like a '*loi d'application immédiate*'. From the country of destination, it would require a mechanism enabling the eviction of the law designated by the national rule of applicability, which would consist in a mutual recognition objection ('*exception de reconnaissance mutuelle*'). Such a mechanism would intervene when the conflict of laws rule in the country of origin is formulated, and when the conflict of laws rule has to be applied in the country of destination.<sup>48</sup>

Once again, however, this theory appears flawed, for three reasons. First, it gives to Article 1(4) a meaning which does not reflect its wording – and seems even in contradiction with it. Secondly, the concept of a '*loi d'application immédiate*' is closely connected with the idea of a (public) interest to be protected. Normally, such a rule contains, on the one hand, an obligation for the judge to apply that rule, even if another law would be applicable in conformity with private international law rules, *and*, on the other hand, a substantive rule, i.e. a clear and positive obligation to be applied. This is not the case with the IMC, which would only prohibit the application of a law which would not be that of the country of origin, without prescribing any formal, precise and positive obligation. Moreover, since the free provision of services has always been considered as the principle and some public interests have been recognised as exceptions to that principle, it seems difficult to argue that, due to its nature of '*loi d'application immédiate*', the interest to be protected by that rule would be the free provision principle itself. Finally, it is difficult to see where the true difference between the '*exception de reconnaissance mutuelle*' and the classical (i.e. neutral) interpretation of mutual recognition actually lies.

An application of the IMC which would be similar to the neutral interpretation given to mutual recognition is thus called for here: conflicts rules (and

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<sup>48</sup> M. Fallon and J. Meeusen, 'Le commerce électronique, la directive 2000/31/CE et le droit international privé' (2002) *Revue Critique de Droit International Privé* 435–90.

notably the Rome Convention) are applied, a law is designated and, in the light of the filters provided for by Articles 3(1) and (2), the rules which do not satisfy the requirements of the filters (and only these) are moved aside. In respect of the two categories exempted by the annex ('the freedom of the parties to choose the law applicable to their contract' and 'contractual obligations concerning consumer contacts'), the filters of Article 3 do not apply but the law which is designated is scrutinised under the filters of the 'classical' theory of mutual recognition, which are less restrictive due to the broader scope of interests that are accepted in accordance with the jurisprudence of the Court.<sup>49</sup> This interpretation also gives a logical meaning to Article 1(4).

### **New Elements of Uncertainty**

If it is still possible to reconcile the E-commerce Directive and its IMC with a classic interpretation of the link between EC law and private international law, some new elements of uncertainty have been put forward by two recent proposals.

#### **The proposal for a Directive on services**

Article 16(1) of the Commission proposal provides that Member States:

shall ensure that providers are subject only to the national provisions of their Member State of origin which fall within the co-ordinated field. Paragraph 1 shall cover national provisions relating to access to and the exercise of a service activity, in particular those requirements governing the behaviour of the provider, the quality or content of the service, advertising, contracts and the provider's liability.

Articles 17(20) and (21) provide that Article 16 shall not apply to 'the freedom of parties to choose the law applicable to their contract' or to 'contracts for the provision of services concluded by consumers to the extent that the provisions governing them are not completely harmonised at Community level'. This wording is close to that of the E-commerce Directive. However, the proposal does not contain a rule along the lines of Article 1(4). In fact, the intention of the Commission is to strengthen the effect on private international law of the IMC: '[i]n order to eliminate the obstacles to the free movement of services, the proposal provides for the application of the country of origin principle, according to which a service provider is subject only to the law of the country in which he is established and Member States may not restrict services from a

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<sup>49</sup> See M. Van Huffel, *op. cit.*, above n. 39, and Wilderspin and Lewis, *op. cit.*, above n. 15. This chapter was completed before the Commission published its amended proposal: see again n. 17 above.

provider established in another Member State. This principle is accompanied by derogations which are either general, or temporary or which may be applied on a case-by-case basis.<sup>50</sup>

However, even in the absence of a provision like Article 1(4), it might be argued that it is (and it is only) an interpretation of the IMC which remains without prejudice to an application of the classical relationship between the country of origin principle and private international law.<sup>51</sup> More pertinent is the question of the absence of any ‘exclusion of convoy’. In the Rome Convention, Article 15 states that ‘the application of the law of any country specified by this Convention means the application of the rules of law in force in that country other than its rules of private international law’. This is not the case in the services proposal, and it might, therefore, be argued that the law of the country of origin which is designated by the draft directive includes the private international law of that country. It remains to be seen whether the solution proposed by the Commission is more sound than those of the Rome Convention regarding contractual obligations. Under Articles 3 and 4 of the Rome Convention, parties may choose the law applicable to their contract and ‘to the extent that the law applicable to the contract has not been chosen in accordance with Article 3, the contract shall be governed by the law of the country with which it is most closely connected’ (Article 4(1)). Article 4(2) specifies that:

[s]ubject to the provisions of paragraph 5 of this Article, it shall be presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or, in the case of a body corporate or unincorporate, its central administration. However, if the contract is entered into in the course of that party’s trade or profession, that country shall be the country in which the principal place of business is situated or, where under the terms of the contract the performance is to be effected through a place of business other than the principal place of business, the country in which that other place of business is situated.

This wording is probably more precise and better adapted to complex contracts than a clause devoid of nuance referring only to ‘the law of the country of origin’.

### **The proposal for a regulation on the law applicable to non-contractual obligations (Rome II)**

Article 23 of the proposed regulation on the law applicable to non-contractual

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<sup>50</sup> COM (2004) 2 final, p. 9.

<sup>51</sup> However, it could also be argued that in this case, we are faced with a clear intention, at least, from the Commission.



obligations (Rome II)<sup>52</sup> addresses the issue of the relationship with other provisions of Community law:

1. This Regulation shall not prejudice the application of provisions contained in the Treaties establishing the European Communities or in acts of the institutions of the European Communities which:
  - in relation to particular matters, lay down choice-of-law rules relating to non-contractual obligations; or
  - lay down rules which apply irrespective of the national law governing the non-contractual obligation in question by virtue of this Regulation; or
  - prevent application of a provision or provisions of the law of the forum or of the law designated by this Regulation.
2. This Regulation shall not prejudice the application of Community instruments which, in relation to particular matters and in areas co-ordinated by such instruments, subject the supply of services or goods to the laws of the Member State where the service-provider is established and, in the area co-ordinated, allow restrictions on freedom to provide services or goods originating in another Member State only in limited circumstances.

Paragraph 2 seeks to articulate conflicts rules and internal market provisions, reinforcing the enigmatic character of these provisions. If the effect on the designation of the applicable law were indubitable, the provisions of paragraph 1 would have been sufficient. However, this is not the case and so it is difficult to discern the effects of provisions such as those referred to in paragraph 2 on private international law.

## THE E-COMMERCE DIRECTIVE AND FINANCIAL SERVICES

The effects of the E-commerce Directive on financial services have to be illustrated with regard to their inclusion in the scope of the Directive, the concept of passport which underpins the Directive, the way that home country control of financial directives is affected by the country of origin principle and, finally, looking at the applicable law.

### **The Scope *Ratione Materiae* of the Directive**

The E-commerce Directive seeks to contribute to the proper functioning of the internal market by ensuring the free movement of information society services

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<sup>52</sup> COM (2003) 427 final, 22 July 2003. See C. Nourissat and E. Treppoz, ‘Quelques observations sur l’avant-projet de proposition de règlement du Conseil sur la loi applicable aux obligations non contractuelles “Rome II”’ (2003) vol. 130:1 *Journal du Droit International* 7–38.

between Member States.<sup>53</sup> These services are defined as ‘services within the meaning of Article 1(2) of Directive 98/34/EC as amended by Directive 98/48/EC’.<sup>54</sup> Article 1(2) of Directive 98/34 defines the concept of ‘service’ as:

any Information Society service, that is to say, any service normally provided for remuneration, at a distance, by electronic means and at the individual request of a recipient of services. For the purposes of this definition:

- ‘at a distance’ means that the service is provided without the parties being simultaneously present,
- ‘by electronic means’ means that the service is sent initially and received at its destination by means of electronic equipment for the processing (including digital compression) and storage of data, and entirely transmitted, conveyed and received by wire, by radio, by optical means or by other electromagnetic means,
- ‘at the individual request of a recipient of services’ means that the service is provided through the transmission of data on individual request.

Article 1(5) states that ‘this directive shall not apply to rules relating to matters which are covered by Community legislation in the field of financial services, as listed non-exhaustively in Annex VI to this Directive’.<sup>55</sup> Nevertheless, despite this exclusion, financial services *are* covered by the E-commerce Directive, since the reference to the scope of Directive 98/48 does not include a reference to the services that are excluded from it. This kind of definition, based on the non-inclusion of an exclusion, is not very satisfactory in terms of legal certainty.

The other problematic issue is the requirement that the service has to be provided ‘at the individual request of a recipient of services’. Recital 18 states that ‘television broadcasting . . . and radio broadcasting are not information society services because they are not provided at individual request. In contrast, services which are transmitted point-to-point, such as video-on-demand or the provision of commercial communications by electronic mail

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<sup>53</sup> See Article 1(1).

<sup>54</sup> Article 2(1); see also, Directive 98/34 laying down a procedure for the provision of information in the field of technical standards and regulations, OJ 1998 L204/37, as amended by Directive 98/48, OJ 1998 L217/18.

<sup>55</sup> This list reads as follows: ‘Investment services; Insurance and reinsurance operations; Banking services; Operations relating to pension funds; Services relating to dealings in futures or options. Such services include in particular: (a) investment services referred to in the Annex to Directive 93/22/EEC; services of collective investment undertakings; (b) services covered by the activities subject to mutual recognition referred to in the Annex to Directive 89/646/EEC; (c) operations covered by the insurance and reinsurance activities referred to in: Article 1 of Directive 73/239/EEC, the Annex to Directive 79/267/EEC, Directive 64/225/EEC, Directives 92/49/EEC and 92/96/EEC.’

are information society services'.<sup>56</sup> However, if it is true that it is necessary to avoid the confusion between a 'point-to-multi-point' activity and a 'point-to-point' activity, which supposes the individualisation of the service, it is also necessary to avoid the confusion between a 'point-to-point' activity and the concept of 'the individual request' of a recipient of services, which implies *in terminis* a request, *even* if the transmission occurs from point-to-point. Therefore, it is questionable whether unsolicited commercial communications, despite the fact that they are allowed under the regime of Article 7 of the Directive, constitute information society services, considering the fact that there is no request by definition if they are unsolicited.

### Some Consequences for the 'Passport' Principle

The legal framework in the field of financial services is more or less always built on the same pattern: provided that some requirements are fulfilled, a provider (credit institution, UCITS, investment firm) receives an authorisation to provide certain services, under the control of its country of origin, and is able, on the basis of this 'passport', to benefit from freedom of establishment or to provide services in other Member States. If the provider does not fulfil the conditions to obtain such a passport – for instance if a banking institution cannot be recognised as a credit institution because it does not receive deposits or other repayable funds from the public or does not grant credits for its own account – he will, nevertheless, benefit from the provisions of the Treaty, but will have to respect requirements imposed by the other Member States which are justified.

It seems to be arguable that Article 3, combined with Article 4, creates a kind of new European passport for activities which do not benefit from a passport under financial secondary law and which fall, therefore, under the regime of free provision established by the EC Treaty. A credit intermediary, for instance, who does not benefit from a single passport under the Banking Directive, will, nevertheless, benefit from the passport created by the E-commerce Directive. He will be able to provide credit intermediation services over the Internet, provided that he fulfils all the conditions laid down by the law of the country where he is established. If this home country does not require any agreement, no prior authorisation will be possible by virtue of Article 4(1); if the home country foresees a prior authorisation for the domestic activity, Article 3(1)–(2) will enable the intermediary to provide services in another country on the basis of the mutual recognition of this national authorisation. In that case, regulated financial actors will be discriminated against

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<sup>56</sup> See also point 3 of Annex V of Directive 98/48.

because they will have to fulfil the strict conditions of the regime imposed upon them by secondary law, whether they operate on-line or off-line.

### **Some Consequences for Home Country Control Provided for by Financial Directives**

#### **Consequences for the free provision of services: notification procedures**

A notification procedure, regarding the free provision of services, is foreseen by several financial directives when a banking institution, a UCITS or an investment firm wishes to operate for the first time on the territory of another Member State. This procedure imposes a duty on the authority of the country of origin to inform the authority of the host Member State. For example, Article 28 of Directive 2006/48 provides that:

1. Any credit institution wishing to exercise the freedom to provide services by carrying on its activities within the territory of another Member State for the first time shall notify the competent authorities of the home Member State, of the activities on the list in Annex I which it intends to carry on.
2. The competent authorities of the home Member State shall, within one month of receipt of the notification mentioned in paragraph 1, send that notification to the competent authorities of the host Member State.<sup>57</sup>

However, the word ‘territory’ is subject to different interpretations, in particular as regards services which are provided electronically. In its interpretative communication of 1997, the Commission considered that ‘in order to determine where an activity was carried on, the place of provision of what may be termed the “characteristic performance” of the service, i.e. the essential supply for which payment is due must be determined’.<sup>58</sup> Therefore, the Commission takes the view that ‘the provision of distance banking services, for example through the Internet, should not, in the Commission’s view, require prior notification, since the supplier cannot be deemed to be pursuing its activities in the customer’s territory’.<sup>59</sup> This interpretation has been criticised.<sup>60</sup> Article 4 of the E-commerce Directive, which excludes a prior authorisation procedure for information society services, states, nevertheless, that this prohibition is ‘without prejudice to authorisation schemes which are not specifically and exclusively targeted at information society services’.

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<sup>57</sup> Directive 2006/48, see n. 18 above.

<sup>58</sup> European Commission, *op. cit.*, above n. 10, p. 6.

<sup>59</sup> *Ibid.*

<sup>60</sup> Roeges, *op. cit.*, above n. 10; Tison, *op. cit.*, above n. 10; Taevernier and Pijke, *op. cit.*, above n. 10.

However, if authorisation schemes are clearly specified, notification procedures are not. Yet they are covered by the definition of the co-ordinated field of this Directive. Notification requirements are therefore subject to the IMC.

Nonetheless, paragraph 1 of Article 3 states that legal requirements *applicable in the home country* have to be satisfied. Paragraph 2 exempts services and providers which do comply with paragraph 1 from any other restriction *that could be imposed by the host state*. In the case of the notification procedure, the notification is a ‘domestic’ obligation: the provider has to notify its own authority that services will be provided in another Member State. It is not a ‘restriction’ imposed by the host Member State. The fact that there is no need to notify in the case of electronic services seems, therefore, to remain based on this interpretation of the provision of a service in another Member State and, consequently the controversy is not necessarily dispelled by the E-commerce Directive.

### **Consequences on the freedom of establishment**

Three problems should be distinguished here. If a credit institution is established in country A, has a branch in country B and if that branch offers financial services in country C, what will be the applicable law? The cumulative effect of the setting up of a branch and of the free provision of services is not a new one.<sup>61</sup> In its 2001 Communication, the Commission considered that:

[a]lthough, the E-commerce Directive places responsibility for the enforcement of rules with the public authorities in the country of establishment of the information society service provider, for branches, this does not affect transfers of responsibilities between Member States which are dealt with by existing financial services legislation. So, the existing transfers of competence from host to home country (for example, of licensing, prudential control, deposit guarantee, and supervision of branches) remain entirely valid. Consequently, as a result of previous express transfers made by the EU sectoral directives, prudential control of branches remains with the ‘home country’ in the meaning of these sectoral directives.<sup>62</sup>

However, the question of the applicable law is not solved. Considering, on the one hand the definition of an established service provider in Article 2 of the E-commerce Directive (‘a service provider who effectively pursues an economic activity using a fixed establishment for an indefinite period’) and, on the other hand, the wording of Article 3(1) (‘each Member State shall ensure that the information society services provided by a service provider *established on its*

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<sup>61</sup> See B. Sousi-Roubi, *Droit bancaire européen* (Paris: Dalloz, 1994), pp. 136–7.

<sup>62</sup> European Commission, *op. cit.*, above n. 4, p. 18.

*territory* comply with the national provisions applicable in the Member State in question which fall within the co-ordinated field<sup>63</sup>), it seems that the authority within the country where the credit institution is established (home country in the meaning of the Banking Directive) shall be responsible for the control of the respect of the rules pertaining to the co-ordinated field applicable in the country where the branch is located (home country in the meaning of the E-commerce Directive). It goes without saying that, in such a case, the role of these authorities will be singularly complicated.

The second problem concerns the activities of branches of credit institutions originating from a third country. These branches do not benefit from the freedom to circulate organised by secondary law. In other words, they have to receive an authorisation in each Member State where they want to operate.<sup>64</sup> However, they will be considered as an ‘established service provider’ within the meaning of the E-commerce Directive. Moreover, as discussed above, the localisation of these E-commerce services shall be deemed to be in the country where they are physically located. This means that they will be able to offer these E-commerce services in other Member States without having any authorisation from these Member States, which they could not do so in the off-line world.

Finally, the need to share competence between the competent authorities of the home Member State and the host Member State has been recently recognised in secondary law. In Directive 2004/39 on markets in financial instruments,<sup>65</sup> by way of derogation from the principle of home country authorisation, supervision and enforcement of obligations in respect of the operation of branches, the competent authority of the host Member State assumes responsibility for enforcing certain obligations specified in this Directive in relation to business conducted through a branch within the territory where the branch is located, since that authority is closest to the branch, and is better placed to detect and intervene in respect of infringements of rules governing the operations of the branch.<sup>66</sup> The way this approach has to – and can – be applied in the E-commerce mode (particularly if the selling method of investments services occurs is a multi-modal one: advertisement on the Internet, phone call for further information, conclusion of the contract by letter) remains unclear.

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<sup>63</sup> Emphasis added.

<sup>64</sup> See Sousi-Roubi, *op. cit.*, n. 61 above, p. 104.

<sup>65</sup> OJ 2004 L145/1.

<sup>66</sup> See recital 32 and notably Article 62.

### Some Consequences for the Applicable Law: General Good Provisions and Advertising Requirements

Article 31 of the Banking Directive states that

Articles 29 and 30 shall not affect the power of host Member States to take appropriate measures to prevent or to punish irregularities committed within their territories which are contrary to the legal rules they have adopted in the interest of the general good. This shall include the possibility of preventing offending institutions from initiating any further transactions within their territories.

Similarly, Article 44(1) of the UCITS Directive states that ‘a UCITS which markets its units in another Member State must comply with the laws, regulations and administrative provisions in force in that State which do not fall within the field governed by this directive’. In the E-commerce world, the possibility to apply these general good provisions from the host Member States will be extremely reduced.

It should be noted that Article 44(2) of the UCITS Directive, which states that ‘any UCITS may advertise its units in the Member State in which they are marketed. It must comply the provisions governing advertising in that State’ falls *outside* the scope of Article 3 of the E-commerce Directive, in conformity with the exclusions of the annex to the latter. However, a similar provision in the Banking Directive, namely Article 37, does not receive the same treatment, since it is not specified in the annex to the E-commerce Directive. The reasoning behind this difference in treatment remains unclear.

### RETAIL FINANCIAL SERVICES OVER THE INTERNET: THE DISTANCE MARKETING DIRECTIVE<sup>67</sup>

In order to enhance consumer confidence in new financial markets and new marketing techniques, and to develop cross-border provision of financial services, the Commission presented a proposal for a Directive on the Distance Marketing of Financial Services in October 1998.<sup>68</sup> Proposed in conjunction with the E-commerce Directive, it was only adopted, after long and difficult

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<sup>67</sup> Directive 2002/65, n. 25 above; see M. Van Huffel, ‘La directive 2002/65/CE du 23 septembre 2002 concernant la commercialisation à distance des services financiers auprès des consommateurs’ (2003) *European banking and financial law review – Euredia* 345–94.

<sup>68</sup> Proposal for a Directive of the European Parliament and the Council concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, COM (1998) 468 final.

negotiations, in September 2002, two years after the latter. The Directive applies to distance contracts, i.e. any contract concerning financial services concluded between a supplier and a consumer under an organised distance sales or service-provision scheme run by the supplier, who, for the purpose of that contract, makes exclusive use of one or more means of distance communication up to and including the time at which the contract is concluded.<sup>69</sup> Means of distance communication refers to any means which, without the simultaneous physical presence of the supplier and the consumer, may be used for the distance marketing of a service between those parties, and notably the Internet. It should be noted that this Directive covers multi-modal selling schemes, provided that they are distance means of communication.

The Directive provides for different tools in order to enhance the situation of the consumer i.e.:

- a substantial range of information has to be communicated to the consumer prior to the conclusion of the contract;
- contractual conditions and these elements of information are subject to written confirmation (on paper or in another durable medium);
- for 14 days (30 days for life insurance and personal pensions operations) the consumer has the right to withdraw from the contract (this right does not apply for some financial services and in particular investment services);
- the consumer has to pay for the service which has been performed before the withdrawal;
- inertia selling is prohibited;
- limits are imposed on the use of unsolicited communications.

The Directive does not contain a minimal clause, which traditionally allows Member States, in consumer protection directives, to maintain or adopt more stringent provisions in order to protect consumers. This has been a source of difficulty regarding the compatibility of the provisions of this Directive with the *acquis* in the field of protection of consumers as to financial services, notably because of the impact of the E-commerce Directive on all of these rules. As a matter of fact, some services were already largely regulated, such as life insurance (information requirements, right of withdrawal, and so on). However, some were subject to very limited harmonised requirements (non-life insurance, for instance) and some were not regulated at EU level at all, despite the fact that they were subject to comprehensive legislation at national level (mortgage credit, banking services). Moreover, the harmonisation techniques

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<sup>69</sup> See Article 2(a).



were not always the same: for example, the Consumer Credit Directive had a minimal clause, the UCITS Directive had a provision on the respect of the general good provisions of the host state, and the Cross-Border Transfers Directive was a ‘fully harmonised’ directive, leaving no room to Member States to go beyond the level playing field laid down by EU law. This means that the host Member State could, in the vast majority of cases, impose respect of its national rules on a provider originating from another Member State (provided that these rules were in conformity with the jurisprudence of the ECJ).

However, the E-commerce Directive had disrupted the equilibrium by requiring respect of the home country principle, prohibiting the host state from applying its legislation – with some exceptions, and notably the ‘contractual obligations concerning consumer contacts’ derogation.<sup>70</sup> However, the interpretation to be given to this derogation and especially to its extent was anything but clear. Therefore, the Council, supported by the Parliament, introduced some provisions aiming at ensuring a smooth functioning of these different sets of rules and preventing an unwanted dismantling of consumer protection in a field where it was deemed particularly important.

#### **Prior Information and the Need for an Articulation Clause: Article 4**

One of the key issues associated with distance marketing of financial services is the information to be given to the consumer. The initial Commission proposal did not raise this question directly. It considered three different elements: the existence of some scattered elements of information in the *acquis*; the need to get information in any circumstances, whether the contract was being concluded at a distance or face-to-face; and the fact that a financial service is a bundle of contractual obligations which forms a contract. It was therefore suggested by the Commission to communicate the contract to the consumer prior to its conclusion and to give him a few days to make a decision (period of reflection). This approach was rejected by both the Council and the Parliament, pronouncing themselves in favour of a list of prior information. The problem was, therefore, to articulate the content of this list (mainly targeted at information relative to the marketing technique) with, for some services, detailed and harmonised lists of information related to the service itself (such as life insurance), and for other services, either very short and non-

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<sup>70</sup> To be read in the light of recital 56, which states that: ‘as regards the derogation contained in this Directive regarding contractual obligations concerning contracts concluded by consumers, those obligations should be interpreted as including information on the essential elements of the content of the contract, including consumer rights, which have a determining influence on the decision to contract’.

exhaustive lists (such as non-life insurance), or no requirements at EC level but very detailed information required at national level (mortgage credit, for instance). Moreover, even where harmonised, the requirements were often minimal, thus allowing Member States to impose additional elements.

A very detailed list of information elements was eventually put together (28 requirements laid down in Article 3) and, to preserve this piecemeal, sector specific *acquis*, an articulation clause was provided for in Article 4. This Article states that:

1. Where there are provisions in the Community legislation governing financial services which contain prior information requirements additional to those listed in Article 3(1), these requirements shall continue to apply.
2. Pending further harmonisation, Member States may maintain or introduce more stringent provisions on prior information requirements when the provisions are in conformity with Community law.

Paragraphs 3 and 4 provide for a communication procedure to the Commission, aiming notably at more transparency of these additional requirements. 'Pending further harmonisation' provides the context: the Commission – supported by the Council and the Parliament – should propose full harmonisation of requirements pertaining to the services as such. It means that the 'full harmonisation' approach pursued in the Distance Marketing Directive is supposed to become the standard approach, at least in the field of financial services. It remains to be seen whether the Commission really wants (and is able) so to do.<sup>71</sup> It is also interesting to note that the full harmonisation approach is slightly undermined since paragraph 2 of that provision is in fact a minimal clause, even if it is subject to a (reinforced) control procedure by the Commission.

### **The Law Applicable to Prior Information**

What is the applicable law in respect of prior information? And what is the influence of the E-commerce Directive, the IMC, its derogations (and recital 23) on that question? Opinions on that issue are split. Should it be the law of the country of origin of the provider – even if the contract was subject to another law by virtue of the Rome Convention? That idea was not completely absent in the debate. Nonetheless, it is reasonable to consider that, with the exception of non-targeted advertising, the law applicable to information requirements should be the same as the law applicable to contractual obligations. Otherwise, the risk

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<sup>71</sup> See, for example, the proposed revision of the consumer credit directive: COM (2002) 443 final.

of discrepancies between the information given on the contract and the reality of the contract would be serious. Moreover, a completely diverging mechanism for E-commerce would have been inapplicable in the case of multi-modal transactions, if, for instance, the means of communication changed during the pre-contractual phase.

The Directive reflects this reasoning. Article 3(1) provides for information to be given to the consumer on ‘the Member State or States whose laws are taken by the supplier as a basis for the establishment of relations with the consumer prior to the conclusion of the distance contract’. Moreover, Article 3(4) states that: ‘information on contractual obligations, to be communicated to the consumer during the pre-contractual phase, shall be in conformity with the contractual obligations which would result from the law presumed to be applicable to the distance contract if the latter were concluded’. The wording of this provision is not really satisfactory, because it sheds some doubt on the way the Rome Convention is applied.<sup>72</sup>

### **Applicability of More Stringent Rules During the Implementation Period**

Finally, Article 16 aims at ensuring the smoothness of the transition period before the date of implementation as regards the applicability of more stringent rules in the country of destination if the latter has already implemented the Directive. However, the wording of this provision is – once again – not satisfactory, since it could be read as ensuring the applicability of these rules even after the date of the implementation period. It could be seen as a way to recognise (for the first time) the horizontal direct effect of the provisions of this Directive.

## **FROM HARMONISATION TO COMPETITION BETWEEN LEGAL ORDERS: AN EVOLVING CONCEPT**

The way in which the ECJ advanced, in its *Cassis de Dijon*<sup>73</sup> ruling, an

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<sup>72</sup> Recital 8 states that ‘this Directive, and in particular its provisions relating to information about any contractual clause on law applicable to the contract and/or on the competent court does not affect the applicability to the distance marketing of consumer financial services of Council Regulation (EC) No. 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters or of the 1980 Rome Convention on the law applicable to contractual obligations’.

<sup>73</sup> Case 120/78 *Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649.

approach based on mutual recognition (and its limits) is still one of the cornerstones of EC law – even if it has to be recognised that this approach has greatly evolved, notably with the decision in *Keck and Mithouard*.<sup>74</sup> However, the relationship between mutual recognition, the ‘equivalence principle’, imperative reasons in the public good and harmonisation/approximation of laws – notably in the particular context of consumer policy – can be analysed through a dynamic approach of the concept of ‘competition between legal orders’.<sup>75</sup> In other words, legal systems *per se* are part of the functioning of the market and, as such and to some extent, may be an element of competition.<sup>76</sup>

### Competition, Equivalence and Rule of Reason

In its *Cassis de Dijon* ruling, the ECJ decided that ‘there is . . . no valid reason why, provided that they have been lawfully produced and marketed in one Member State, [products] should not be introduced into any other Member State’.<sup>77</sup> This doctrine has been the basis for the mutual recognition principle, which can also be defined as ‘the equivalence principle’.<sup>78</sup> The principle is twofold: the equivalence of *substantive requirements*, and the equivalence of *controls* applied to assess the respect of these substantive requirements (i.e. mutual recognition as such which is known as ‘home country control’) prevent the Member States from imposing their own (equivalent) rules and duplicating (equivalent) controls.

A similar approach has been developed by the Court concerning the free provision of services. Article 49 EC requires not only the elimination of all

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<sup>74</sup> See P. Oliver, *Free movement of Goods in the European Community*, 3rd edn, (London: Sweet and Maxwell, 1996), section 6.55 et seq.; M. Van Huffel, ‘Le champ d’application de l’article 30 du Traité de Rome et les arrêts *Keck et Mithouard*, *Hünernmund et Clinique*: la nouvelle liberté de la libre circulation des marchandises ou “l’enfer c’est les autres”?’ (1994) *Revue Européenne de Droit de la Consommation* 95–113; K. Mortelmans, ‘De interne markt en het facettenbeleid na het *Keck*-arrest: Nationaal beleid, vrij verkeer of harmonisatie’ (1994) vol. 42:4 *SEW – Tijdschrift voor Europees en Economisch Recht*, 236–50; N. Reich, ‘The November revolution of the European Court of Justice: *Keck*, *Meng* and *Audi* revisited’ (1994) vol. 31:3 *Common Market Law Review* 459–92; R. Joliet, ‘La libre circulation des marchandises: L’arrêt *Keck et Mithouard* dans les nouvelles orientations de la jurisprudence’ (1994), *Journal des Tribunaux de Droit Européen*, 145–51; and S. Weatherill, ‘After *Keck*: Some thoughts on how to clarify the clarification’ (1996) vol. 33:5 *Common Market Law Review* 885–906.

<sup>75</sup> See N. Reich, *Europäisches Verbraucherschutzrecht*, 2nd edn (Baden-Baden: Nomos, 1993), p. 218; see also, Reich, n. 74, and ‘Competition between legal orders: A new paradigm of law’ (1992) vol. 29:5 *Common Market Law Review* 861–96.

<sup>76</sup> See again, Reich, *ibid.* (1992), esp. at 861.

<sup>77</sup> *Cassis de Dijon*, para. 14.

<sup>78</sup> See the outstanding analysis of A. Bernel, *op. cit.*, n. 43 above, p. 118.

discrimination against a person providing services on the ground of his nationality but also the abolition of any restriction, even if it applies without distinction to national providers of services and to those of other Member States, when it is liable to prohibit or otherwise impede the activities of a provider of services established in another Member State where he lawfully provides similar services.<sup>79</sup> It concerns both substantive requirements as well as controls that might be applied to the provider or to the service.

However, this equivalence principle is tempered by a ‘rule of reason’, which applies for both the free movement of goods and the free provision of services. In the case of products, ‘obstacles to movement within the Community resulting from disparities between the national laws relating to the marketing of the products in question must be accepted in so far as those provisions may be recognised as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer’.<sup>80</sup> In the case of services, ‘as a fundamental principle of the Treaty, the freedom to provide services may be limited only by rules which are justified by imperative reasons relating to the public interest and which apply to all persons or undertakings pursuing an activity in the State of destination, in so far as that interest is not protected by the rules to which the person providing the services is subject in the Member State in which he is established. In particular, those requirements must be objectively necessary in order to ensure compliance with professional rules and to guarantee the protection of the recipient of services and they must not exceed what is necessary to attain those objectives’.<sup>81</sup>

This balanced mechanism has been analysed by Reich,<sup>82</sup> who developed the idea of a ‘competition between legal orders’ that is implied by this mechanism – free cross-border movement without legal barriers and without having to harmonise legal requirements implies the recognition of a certain degree of competition between these legal orders. Competition works therefore as a substitute for harmonisation, since it does not appear necessary to harmonise what can be considered as equivalent.

Nevertheless, the ‘rule of reason’ tempers this idea of competition between legal orders. Competition is thus not left without barriers: distortions of competition may occur, which, under certain circumstances, could be justified. The hindrance is admitted because the rule has positive ‘side-effects’, which supersede the free movement principle.

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<sup>79</sup> See Case 76/90 *Säger v Dennemeyer* [1991] ECR 4221, para. 12.

<sup>80</sup> *Cassis de Dijon*, para. 9.

<sup>81</sup> See again, *Säger*, para. 15.

<sup>82</sup> Reich (1992), *op. cit.*, n. 75 above.

### The *Keck and Mithouard* Ruling and its Possible Application to Services

In (primarily, though not exclusively) *Keck and Mithouard*, the ECJ disturbed somewhat the equilibrium of this twofold mechanism.<sup>83</sup> This ruling also implies a shift in the appraisal of the need to harmonise the legal requirements concerning selling arrangements.<sup>84</sup> This question was not absent from the debates concerning the new Directive 2005/29 on unfair business-to-consumer commercial practices in the internal market.<sup>85</sup>

As noted above, the application of the *Keck* doctrine to services – and particularly financial services – and establishment remains open for discussion.<sup>86</sup> The main argument against its application is based on the idea that the selling method and the service are so enmeshed that limits placed on the selling arrangement would, in fact, impede the selling of the service. That reasoning is not shared here; rather, it is submitted that the *Keck* doctrine is – at least in some cases – applicable to services. For instance, the prohibition against banks imposing the purchase of a life insurance policy when the consumer undertakes a mortgage does not impede the selling of mortgages by a provider originating from another Member State, because the application of such rules is not by nature such as to prevent access of these services from another Member State to the market or to impede access any more than it impedes the access of domestic products. In a recent case concerning banking law,<sup>87</sup> and more precisely the French prohibition of the remuneration of sight accounts, Advocate-General Tizzano, having analysed the applicability of the *Keck* doctrine to freedom of establishment, considered that ‘from a general point of view, as regards the freedom of establishment, national rules of a Member State regulating the pursuit of economic activities constitute restrictions contrary to the Treaty if they are such as to place the operator exercising that freedom in conditions of law or of fact that are worse than those of an operator established

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<sup>83</sup> *Keck and Mithouard*, especially at para. 16: ‘contrary to what has previously been decided, the application to products from other Member States of national provisions restricting or prohibiting certain selling arrangements is not so much as to hinder directly or indirectly, actually or potentially, trade between Member States within the meaning of the *Dassonville* judgment, provided that those provisions apply to all traders operating within the national territory and provided that they affect in the same manner, in law and in fact, the marketing of domestic products and of those from other Member States’.

<sup>84</sup> See Reich, *op. cit.*, n. 75 above, and Van Huffel, *op. cit.*, n. 74 above.

<sup>85</sup> OJ 2005 L149/22.

<sup>86</sup> See the references in n. 11 above; see also, V. Hatzopoulos, *Le Principe Communautaire d'Équivalence et de Reconnaissance Mutuelle dans la Libre Prestation de Services* (Bruxelles: Bruylant; Athina: Sakkoulas, 1999), p. 568.

<sup>87</sup> Case C-442/02 *CaixaBank France v Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR I-8961.

in the said State or if, by reason of their objective or effects, they directly affect access to the market'.<sup>88</sup> The Court seems to have accepted this reasoning,<sup>89</sup> and its approach here can be compared to the 'discrimination *in fact*' aspect of *Keck*.

## The E-commerce (R)evolution

### Fragmentation against unity

In the E-commerce Directive, competition between legal orders is exacerbated by the extension of mutual recognition (the competition effect) to a large part of the content of rule of reason (the exceptions to mutual recognition). In terms of harmonisation, this means that the approach pursued, in contrast to what has been done in the past (even in the Television Without Frontiers Directive), is largely based on mutual recognition and equivalence principles. The limits to these core principles are defined in restrictive terms, creating a narrower category of 'rules pertaining to the general good', which includes consumer protection and investor protection rules. However, the exercise of the exception is restricted and is subject to an appraisal by the Commission, and the status of directives based on a minimal clause remains unclear.

Moreover, compared with 'traditional' harmonised instruments, the 'free movement' principles are broadened with an extended definition of the coordinated field. The alleged advantage derives from the fact that, since it is not possible to harmonise everything, and since it is not possible to wait 20 or 30 years to get an operational legal framework, an approximation of certain key issues will nonetheless exist. In the meantime, 'abuses' of the general good justification are circumscribed, even though the door is not completely closed to some degree of variance as far as the application of the host country rule is concerned. Finally, the Commission is in a position to curve the circumstances in which general good provisions may be relied on, even if the final word remains with the ECJ, which will assess the national rules on a case-by-case basis.<sup>90</sup>

In this context, the 'competition between legal orders principle' does not seem to be adequately designed. Rather, the balance between the equivalence principle and the rule of reason remains largely uncertain, depending from the nature of the rule to be applied. This is particularly true if one considers multi-modal distribution of services, where different approaches apply simultaneously. This might be corrected by the Services Directive, but the current debates indicate that the legal approach of the 'free movement' principle of the

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<sup>88</sup> Ibid., Opinion of Advocate-General Tizzano, para. 76.

<sup>89</sup> Ibid., judgment of the Court, paras 12–14.

<sup>90</sup> The possible bypassing of this power was, however, discussed above.

directive could be to some extent different from the one applied in the E-commerce mode. It needs also to be stressed that financial services will in principle be excluded from the scope of this directive.

Other discrepancies in EC law can also be pointed out. The VAT mechanism applicable to e-commerce, for example, is not based on the country of origin principle,<sup>91</sup> the competent court under the Brussels I Regulation is not necessarily the judge from the country of origin, the law applicable is not necessarily that of the country of origin, and so on. Instead of expected unity, we are faced with a fragmented legal framework.

### Negative integration versus positive harmonisation

Another prominent finding in analysing the E-commerce Directive – but also the Services proposal – is what we could call an evolution to a ‘negative integration’, in contrast to a (more classical) positive (i.e. substantive) harmonisation of national rules.<sup>92</sup> The thrust of the E-commerce Directive is to prohibit obstacles insofar as some precise elements are concerned (exclusion of prior authorisation, conclusion of contracts, and so on), specific prohibitions that are accompanied by a more general prohibition of any other obstacles (Article 3). The concrete fixing of positive harmonised rules remains largely secondary. This is another application of the idea that legal orders may compete, the rule of reason being largely disparaged. However, it is probably in the field of contracts and contractual obligations that this approach is the most problematic.<sup>93</sup> Finally, more generally, it is questionable whether the idea to extend the principle of mutual recognition/equivalence to rules pertaining to the general good category – and which would be justifiable under the requirements of the ECJ – is a reasonable one. Is the rule of reason not the necessary margin of flexibility to allow the mutual recognition to function? Thus, is it therefore reasonable to restrict its scope and its conditions for application beyond the

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<sup>91</sup> See Directive 2002/38, OJ 2002 L128/41 and Council Regulation 792/2002, OJ 2002 L128/1.

<sup>92</sup> See M. Van Huffel, ‘Le consentement électronique: Le droit communautaire’, in J. Laffineur (ed.), *Le Consentement Électronique* (Brussels: Bruylant, 2000), pp. 21–54.

<sup>93</sup> The implementation of this provision has generated very complex – and therefore risky – analysis at national level: see E. Montero and M. Demoulin, *Le traitement des obstacles formels aux contrats en ligne, recommandations relatives à la mise en oeuvre de l’article du projet de loi sur certains aspects juridiques des services de la société de l’information*, Report for the Belgian Minister for Economic Affairs, 2002, 142 pp., available at <http://www.droit.fundp.ac.be/Textes/formalisme.pdf>, and Centre de Recherche Informatique et Droit and Laboratoire de droit économique du Grand Duché de Luxembourg, *Projet de loi luxembourgeois relatif au commerce électronique*, 51 pp., available at <http://www.droit.fundp.ac.be/textes/EcoLU.pdf>.



limits already traced by the Court? This is perhaps more a political issue than a legal one. However, ensuring a real consistency between the different sides of the picture is essential – especially in the field of financial services, where the legal framework is very developed and based on different thinking of competition between legal orders.

## CONCLUSIONS

Some trends clearly emerge from this overview of the E-commerce Directive and its influence on the legal framework for financial services. The complexity of this framework, inherent to the nature of the services to which it applies, has been increased by the application of the new approach put forward in the E-commerce Directive. The fact that the legal concepts of the *acquis* do not exactly coincide with the concepts of the Directive has created legal uncertainty. This is perhaps the reason why financial services have been excluded from the scope of the services proposal, and would be justified if the ‘country of origin principle’ had to be applied also in the field of financial services, taking the *acquis* into due consideration. If one starts from scratch, it is possible to apply a new concept without problems. However, where there is already an important regulation in place, the underlying philosophy of this *acquis* cannot be ignored.

Another difficulty resides in the difference of treatment of the service and of the provider in accordance with the distribution channel which is used. It is perhaps justified to have separate legal regimes for distance transactions and for face-to-face transactions, but it is difficult to argue that different treatments are legitimate for different means of distance distribution, when these channels are used at the same time.

Finally, it should be noticed that market (de-)regulation needs a consistent legal technique of harmonisation. Minimal directives, directives with a minimal clause, full harmonisation directives and country of origin-based directives aiming more at negative harmonisation than at fixing new positive rules can only imply problems of legal co-existence. In view of better regulation, political choices should be made clearly, and legal instruments should reflect these choices with clarity. Too many contradictions are still present in the Regulation in place, and endeavours to simplify this legislation should be made. This implies, on the one hand, that new layers of incompatible rules should be avoided and, on the other hand, that the fact that the law is primarily made for both the citizens and undertakings, which are not always legal experts, is taken into due account.

## 7. Monetary movements and the internal market

**John Usher**

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### INTRODUCTION

The rules governing monetary movements represent a unique evolution of regulatory technique from detailed secondary legislation to directly effective Treaty principle. Liberalisation of capital movements as such was achieved by the enactment of secondary legislation, since the original Treaty provisions, unlike those governing the other freedoms, were held not to be capable of direct effect. The result was that freedom of movement was finally achieved over 20 years late. By way of contrast, the old Article 106 EEC on current payments related to other freedoms was held to be directly effective,<sup>1</sup> albeit only allowing payments in the creditor's currency,<sup>2</sup> and indeed restrictions on payments relating to the other freedoms were sometimes categorised as restrictions on those substantive freedoms.<sup>3</sup> Be that as it may, the lists of capital movements attached to successive directives, culminating in the list annexed to Directive 88/361,<sup>4</sup> include operations that are clearly current payments as well as capital movements as such.

Nevertheless, soon after liberalisation of capital movements had been achieved by legislation, the Maastricht Treaty introduced new rules on capital movements and payments which are broadly drafted and have been held to be capable of direct effect. The introduction of these new rules (Articles 56–60 EC) may be regarded as an element of the second stage of Economic and Monetary Union (EMU), but they apply to all Member States. Article 56 extends to movements to and from third countries as well as within the EC, and even this third country effect is directly effective.<sup>5</sup> Nevertheless, as a

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<sup>1</sup> Joined Cases 286/82 and 26/83 *Luisi and Carbone v Ministero del Tesoro* [1984] ECR 377.

<sup>2</sup> Case 308/86 *Criminal Proceedings against Lambert* [1988] ECR 4364.

<sup>3</sup> Case 95/81 *Commission v Italy* [1982] ECR 2187.

<sup>4</sup> OJ 1988 L178/5.

<sup>5</sup> Joined Cases C-163, C-165 and C-250/94 *Criminal Proceedings against Sanz de Lera and others* [1995] ECR I-4821.

matter of case-law, the definitions in the 1988 Directive continue to be used and they have been broadly interpreted to include, for example, loans and mortgages,<sup>6</sup> the taxation of dividends,<sup>7</sup> the provision of guarantees linked to the performance of services,<sup>8</sup> and the use of ‘golden shares’.<sup>9</sup> There is, therefore, clear potential for overlap with other Treaty freedoms, and the further question then arises as to whether the current capital movement rules open up these overlapping freedoms to third country economic operators.

For those operating in the Eurozone, the elimination of exchange risk and interest rate risk makes it a realistic proposition even for the private citizen to borrow, lend or invest in other participant states. The fact that such movements might also lead to tax avoidance has resulted in the adoption of Directive 2003/48<sup>10</sup> on taxation of savings income. The downside of the current rules is that Article 58(1)(a) EC appears to allow certain forms of tax discrimination, leading to a possible negative result from classifying an operation as a capital movement, although it has recently been applied in very limited manner by the Court of Justice (ECJ) in *Manninen*.<sup>11</sup> Particular problems might be thought also to arise from Article 50 EC, stating that services are only ‘services’ if they do not fall under one of the other freedoms, and Article 51 EC subordinating banking and insurance services to the liberalisation of the movement of capital. However, the Court has classified transactions that might be thought to have fallen within the list in the 1988 Directive as provision of services, and held that it was not, therefore, necessary to consider the free movement of capital rules.<sup>12</sup> Thus, in this area, a new perspective has been put on the relationship between the Treaty freedoms. It is also clear that differential tax treatment based on residence or place of investment may infringe freedom of establishment, so that here also there has been an inducement to classify transactions as freedom of establishment rather than as capital movements.

It may be concluded that through the use of concepts set out in the old legislation in the context of the new Treaty rules, the case-law is developing a broad interpretation of capital movements which could have unanticipated knock-on effects – except where the tax provisions of the capital movement rules would limit other freedoms, which seems unlikely in the light of the decision in *Manninen*.

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<sup>6</sup> Case C-22/97 *Trummer and Mayer* [1999] ECR I-1661.

<sup>7</sup> Case C-35/98 *Staatssecretaris van Financiën v Verkooijen* [2000] ECR I-4071.

<sup>8</sup> Case C-279/00 *Commission v Italy* [2002] ECR I-1425.

<sup>9</sup> Case C-98/01 *Commission v United Kingdom* [2003] ECR I-4641.

<sup>10</sup> OJ 2003 L157/38.

<sup>11</sup> Case C-319/02 *Manninen* [2004] ECR I-7477.

<sup>12</sup> Case C-118/96 *Safir v Skattemyndigheten i Dalarnas Län* [1998] ECR I-1897; and Case C-136/00 *Danner* [2002] ECR I-8147.

## THE ORIGINAL REGULATORY FRAMEWORK

The basic requirement set out in Article 67(1) of the original EEC Treaty was that during the transitional period, Member States should progressively abolish between themselves all restrictions on the movement of capital belonging to persons resident in Member States and any discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested, but only 'to the extent necessary to ensure the proper functioning of the common market'. With regard to transitional and standstill arrangements, the original Article 68(1) required Member States to be 'as liberal as possible' in granting such exchange authorisations as were still necessary after the entry into force of the Treaty, and the original Article 71 required Member States to 'endeavour' to avoid introducing within the Community any new exchange restrictions on the movement of capital and current payments connected with such movements, and to 'endeavour' not to make existing rules more restrictive.

Briefly summarising the remainder of the original version of the Title, Article 69 enabled the Council to issue directives for the implementation of Article 67, acting by a qualified majority from the beginning of the third stage (i.e. 1 January 1966), Articles 70 and 72 dealt with the question of capital movements between Member States and third countries, and Article 73 enabled protective measures to be authorised by the Commission or, under Article 73(2), to be taken by the Member State itself in case of urgency.

The legal effects of Article 67 of the original version of the EEC Treaty were considered by the European Court in *Casati*.<sup>13</sup> It has been seen that Article 67 differed from the other 'freedoms' laid down by the Treaty in that it was not drafted in absolute terms. It does not require restrictions on the movement of capital simply to be abolished; rather it requires them to be abolished 'to the extent necessary to ensure the proper functioning of the common market'. In *Casati*, it was held that the scope of that restriction might vary in time and depended on an assessment of the requirements of the common market and on an appraisal of both the advantages and risks which liberalisation might entail. It was further stated that such an assessment was 'first and foremost' a matter for the Council, and that the obligation to abolish restrictions on movements of capital could not be separated from the Council's assessment of the need to liberalise the category of transactions in question.

In other words, it was not a straightforward rule which a national court, or even the ECJ, could apply directly, but essentially a question of policy for the Council, the role of the Court being limited to checking whether the Council

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<sup>13</sup> Case 203/80 *Criminal Proceedings against Casati* [1981] ECR 2595.

had overstepped the limits of its discretion. The Court concluded that there was no reason to suppose that, by taking the view at that stage that it was unnecessary to liberalise the exportation of banknotes, the Council had in fact overstepped those limits.

With regard to the ‘standstill’ provision in the original Article 71, the Court again noted that by stating that Member States ‘shall endeavour’ to avoid introducing within the Community any new exchange restrictions on the movement of capital and current payments connected with such movements, and shall ‘endeavour’ not to make existing rules more restrictive, the wording of that provision departed noticeably from the more imperative forms of wording used in the other Treaty freedoms, and did not impose on Member States an unconditional obligation capable of being relied on by individuals.

## THE CAPITAL MOVEMENT DIRECTIVES

Although the original Treaty provisions themselves may not have been capable of giving rise to rights enforceable by individuals, the first Council Directive under the original Article 67 was enacted during the first stage of the original transitional period on 11 May 1960;<sup>14</sup> at the end of 1962, it was amended by Directive 63/21.<sup>15</sup> It may be observed that in their recitals, these Directives claim to be made under a number of Treaty provisions, including not only Articles 67 and 69 on capital movements but also the former Article 106(2) on current payments. The basic pattern established by these Directives was to divide capital movements into four lists, with different degrees of liberalisation. Member States were required to grant ‘all foreign exchange authorisations’ for the transactions or transfers set out in List A, which included direct investments (defined so as to exclude purely financial investments) in an undertaking in another Member State, investments in real estate, certain personal capital movements, short (one year) and medium-term (one to five year) credits related to commercial transactions or provision of services, death duties, and damages to the extent they may be regarded as capital,<sup>16</sup> but also transfers in performance of insurance contracts ‘as and when free movement in respect of services’ was extended to them, authors’ royalties and ‘transfers of moneys required for the provision of services’, which would appear clearly to involve current payments.

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<sup>14</sup> JO 921/60.

<sup>15</sup> JO 62/63.

<sup>16</sup> Cf. Directive 63/474 (OJ English Special Edition 1963–64 (I), p. 45) on invisible transactions, which included damages which could not be considered as capital.

The transactions and transfers in List B had to be granted 'general permission' by the Member States.<sup>17</sup> List B largely consisted of various operations in securities, notably acquisition and liquidation by non-residents of domestic listed securities, and acquisition and liquidation by residents of foreign listed securities. On the other hand, while the transactions and transfers in List C had to receive foreign exchange authorisations in principle, Member States could maintain or reintroduce the exchange restrictions which were operative at the date of entry into force of the Directive where such free movement of capital might form an obstacle to the achievement of the economic policy objectives of the Member State concerned. List C included the issue and placing of securities of a domestic undertaking on a foreign capital market and of a foreign undertaking on the domestic capital market, cross-border acquisitions and liquidations of units in unit trusts, and the granting and repayment of certain long-term credits. Finally, List D set out the capital movements which did not have to be liberalised, including, in particular, the opening and the placing of funds on current or deposit accounts, and the physical import and export of financial assets and personal loans.

In 1986, this framework was amended by Directive 86/566,<sup>18</sup> which, in effect, merged the old lists A and B from the earlier Directives into a new List A, and added certain other elements to those lists from the former List C, notably the issue and placing of securities of a domestic undertaking on a foreign capital market and of a foreign undertaking on the domestic capital market, cross-border acquisitions and liquidations of units in unit trusts, and the granting and repayment of certain long-term credits noted above. However, in its Article 2(2), the Directive allowed Spain and Portugal, as an ancillary measure to their accession arrangements, to continue to have the power to re-impose restrictions on certain of the movements which had been transferred from the old List C to List A. What was left of List C was renamed List B, still subject to the power of the Member States to maintain or reintroduce the exchange restrictions which were operative at the date of entry into force of the Directive where free movement of capital might form an obstacle to the achievement of the economic policy objectives of the Member State concerned. It included transactions in unlisted securities, medium and long-term loans and credits not connected with commercial transactions or provision of services, and sureties and guarantees relating thereto. Finally, the old List D became List C, but still not liberalised.

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<sup>17</sup> Although it is only of historic interest, it might be argued that 'general permission' was in fact a wider-ranging obligation than granting 'all foreign exchange authorisations' under List A.

<sup>18</sup> OJ 1986 L332/22.

A new approach was followed by Directive 88/361,<sup>19</sup> which finally established the basic principle of free movement of capital as a matter of Community law with effect, for most Member States, from 1 July 1990. Free movement of capital thus became the only Treaty ‘freedom’ to be achieved in the manner envisaged in the Treaty – by the enactment of a programme of legislation – albeit 20 years after the time limit envisaged in the Treaty. Subject to its other provisions, Article 1(1) of the 1988 Directive provided that ‘Member States shall abolish restrictions on movements of capital taking place between persons resident in Member States’, and although there was still a nomenclature of capital movements annexed to the Directive, it was stated to be to facilitate its application, rather than to introduce distinctions in treatment. Annex I itself stated that the nomenclature was not intended to be an exhaustive list of the notion of capital movements, and it should not be interpreted as restricting the scope of the principle of full liberalisation of capital movements in Article 1. However, in the absence of a Treaty definition, the headings of the nomenclature (which in reality owe much to the previous lists) indicate the concept of capital underlying the Directive: direct investments, investments in real estate, operations in securities normally dealt in on the capital market, operations in units of collective investment undertakings, operations in securities and other instruments normally dealt in on the money market, operations in current and deposit accounts with financial institutions, credits related to commercial transactions or to the provision of services in which a resident is participating, financial loans and credits, sureties, other guarantees and rights of pledge, transfers in performance of insurance contracts, personal capital movements, physical import and export of financial assets, and ‘other capital movements’ (defined so as to include transfers of the moneys required for the provision of services).

The introduction to the Annex further states that the capital movements mentioned are taken to cover all the operations necessary for the purposes of capital movements, i.e. the conclusion and performance of the transaction and related transfers, and should also include access for the economic operator to all the financial techniques available on the market approached for the purpose of carrying out the operation in question.

Many of the movements listed were thus clearly current payments under what was then Article 106(1), even though the Court had clearly held in *Luisi and Carbone* that Article 106(1) was directly effective. At first sight, it might seem that to include such movements in the Directive was superfluous. However, it might be suggested that the difficulties in distinguishing clearly between capital movements and current payments, and the narrow way in

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<sup>19</sup> OJ 1988 L178/5.

which the Court read Article 106 in *Lambert*, holding that it was not relevant to the way an *exporter* received payment, merely being concerned to ensure that the *importer* was able to make the payment, and that it entitled the exporter only to payment in his own currency, meant that there was some practical advantage in including what were possibly current payments within the concept of liberalised capital movements.

During the legislative process doubts were expressed on the wisdom of bringing about the liberalisation of capital movements without taking a number of related measures. In its Opinion,<sup>20</sup> the Economic and Social Committee suggested that liberalisation ought to be accompanied by efforts in such important fields as harmonising the operating rules for financial services<sup>21</sup> and stock markets, the rules governing the solvency<sup>22</sup> and stability of financial institutions, and tax harmonisation. Furthermore, they stated that liberalisation could not be achieved without stabilisation of exchange rates, noting that unstable exchange rates and sudden fluctuations pose a considerable danger for the economies of the various Member States, and concluding that it was becoming more and more difficult to conduct a co-ordinated Community policy, with floating exchange rate and fixed parity currencies co-existing side by side. While this may help to explain the political impetus towards the Maastricht provisions on monetary union, it emphasises the point that internal market legislation in the financial sector has to be viewed in its wider context.

## PAYMENTS RELATING TO OTHER TREATY FREEDOMS

It is self evident that the free movement of goods would be nugatory if a purchaser in one Member State was not able to pay a supplier in another Member State, and the same holds true for the other Treaty 'freedoms'.<sup>23</sup> This was expressly recognised in Article 106 of the EEC Treaty as originally drafted, which was continued until January 1994 as Article 73h EC by virtue

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<sup>20</sup> OJ 1988 C175/1.

<sup>21</sup> See, for example, the Second Banking Directive 89/646 (OJ 1989 L386/1), now consolidated in Directive 2000/12 on taking-up and pursuit of the business of credit institutions (OJ 2000 L126/1).

<sup>22</sup> See, for example, Directive 89/647 on a solvency ratio for credit institutions (OJ 1989 L386/14) and Directive 89/299 on the 'own funds' of credit institutions (OJ 1989 L124/16), now consolidated in Directive 2000/12 (*ibid.*).

<sup>23</sup> Although, conversely, a restriction on the freedom to provide services, justified in the general good may also justify a restriction on correlative monetary movements: see Case C-148/91 *Vereniging Veronica Omroep Organisatie v Commissariaat voor de Media* [1993] ECR I-487.



of the Maastricht amendments. Under paragraph 1 of this provision, each Member State undertook to authorise, in the currency of the Member State in which the creditor or the beneficiary resided, any payment connected with the movement of goods, services or capital, and any transfers of capital and earnings, to the extent that the movement of goods, services, capital and persons between Member States had been liberalised pursuant to the Treaty. The second paragraph further specified that insofar as movement of goods, services and capital were limited only by restrictions on payments connected therewith, these restrictions should be progressively abolished by applying, *mutatis mutandis*, the provisions of the Chapters relating to the abolition of qualitative restrictions, to the liberalisation of services and to the free movement of capital; and under the third paragraph, Member States undertook not to introduce between themselves any new restrictions on transfers connected with invisible transactions, and agreed that the progressive abolition of existing restrictions should be effected in accordance with the general programme on freedom to provide services insofar as such abolition was not governed by the provisions contained in paragraphs 1 and 2 or by the other provisions of the Chapter on the free movement of capital.

The first paragraph was of particular importance in that it was held to be directly effective, giving rise to rights enforceable by individuals before their national courts,<sup>24</sup> at a time when the Treaty rules on free movement of capital did not give rise to such rights.<sup>25</sup> Nevertheless, the substantive rights generated have been fairly narrowly interpreted by the ECJ. The question first arose in *Casati*, which involved a breach of Italian exchange control legislation in relation to the re-export of German bank notes from Italy after their holder had failed to achieve his intention of using them to buy a piece of machinery in Italy – it would appear that the factory was closed for its holidays. Turning to Article 106(1), as it then was, the Court took the view that this provision did not require Member States to allow the movement of bank notes if such movement was not necessary, and indeed standard practice in relation to the transaction in question, holding that the importation and exportation of banknotes was neither necessary nor standard practice in relation to commercial transactions. It might perhaps be questioned whether the Court's view of standard practice in relation to the habits of small businessmen was, in fact, wholly accurate. The view expressed in *Casati*, that there is no requirement to allow cash payments, was followed in *Lambert*, where the Court upheld Luxembourg (and Belgian) rules requiring payments for exports to be by credit transfer or by cheque, and to be converted on the regulated market (which then still existed) rather than the free market.

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<sup>24</sup> See again, *Luisi and Carbone*.

<sup>25</sup> See again, *Casati*.

With regard to the currency in which payment may be made, the ECJ applied a restrictive literal approach to the old Article 106 in *Lambert*, holding that it was not relevant to the way an *exporter* received payment, merely being concerned to ensure that the *importer* was able to make the payment. However, it may be suggested that both aspects are equally important to the achievement of the genuine free movement of goods and services, and that this judgment takes an unduly narrow approach. It had, however, been noted by the Court in *Luisi and Carbone* that the original Article 106 only applied to liberalise current payments made in the currency of the Member State of the creditor, which helps explain the decision in *Casati*, since in that case Article 106 would only have justified payment in *lire*.

Indeed, it may be suggested that the substantive Treaty provisions relating to the 'freedom' at issue may themselves have a wider scope: a hindrance on the payment for goods imported from another Member State may amount to a restriction on the free movement of those goods. The matter came to light in *Commission v Italy*,<sup>26</sup> in relation to an import deposit scheme. Under Italian law, in order to deter currency speculation, importers paying for goods in advance of their release from customs clearance had to lodge an interest-free security or guarantee. The Court found that although the measures in question were enacted for the purpose of preventing currency speculation, they were not specific rules for the attainment of that objective but general rules which affected normal commercial transactions where payment was made in advance. Since they were undeniably a hindrance to trade, the Italian rules were classified as measures equivalent to quantitative restrictions. The Italian Government next argued that these measures could be justified under Article 30 (then Article 36) EC on grounds of public policy, since they had as their objective the safeguarding of a fundamental interest of the State, the defence of its currency. However, the Court, following well-established case-law, re-affirmed that Article 30 applied only to matters of a non-economic nature.

The Italian Government had also, in effect, argued that the rules at issue were a matter of monetary policy, and therefore could not be subject to the rules on the free movement of goods. The Court pointed out, however, that the Treaty contained specific provisions (then Articles 108 and 109, now Articles 119 and 120) allowing for protective measures to counter difficulties in the balance of payments, and concluded that the requirement in the then Article 104 that each Member State should pursue the economic policy needed to ensure the equilibrium of its overall balance of payments and to maintain confidence in its currency did not, of itself, permit derogations from the free movement of goods.

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<sup>26</sup> See n. 3 above.

On the other hand, the provision of services in the financial sector is also subject to the express statement in Article 51(2) EC that the liberalisation of banking and insurance services connected with movements of capital should be effected in step with the progressive liberalisation of movements of capital, which came in practice to mean that if a service related to a capital movement which had not been liberalised, the Treaty rules on freedom to provide services could not be invoked, i.e. the capital movement rules prevailed over the freedom to provide services. In *Van Eycke*,<sup>27</sup> where it was held that since the opening of a savings account in another Member State was not at that time liberated under the capital movement Directives, it was not a breach of the Treaty provisions on freedom to provide services for Belgium to limit tax exemptions on such accounts to deposits in local currency at credit institutions having their head office (*siège social*) in Belgium. Indeed, even after liberalisation of capital movements had in principle been achieved, the recitals to the Second Banking Directive<sup>28</sup> recognised that capital safeguard measures under the 1988 Capital Movements Directive might lead to restrictions on the provision of banking services.

## CURRENT PAYMENTS AND CAPITAL MOVEMENTS

One of the aims of Articles 56–69 EC, which by virtue of the Maastricht amendments entered into force on 1 January 1994 as a new Chapter on ‘Capital and Payments’, would appear to be to ensure that capital movements and current payments are treated in the same way. Article 56(1) provides that within the framework of the provisions set out in the chapter on capital and payments, all restrictions on the movement of capital between Member States (and between Member States and third countries) shall be prohibited, and Article 56(2) provides that within the same framework, all restrictions on payments between Member States (and between Member States and third countries) shall be prohibited. However, the earlier case-law made a distinction between them, and the distinction also helps to explain why restrictions historically tended to be authorised under what continue in force for the non-participants in monetary union as Articles 119 and 120 EC on the protection of the balance of payments, rather than under other Treaty provisions, notably the original Article 73, which only allowed protective measures to be taken in relation to capital movements as such.

The distinction was particularly examined in *Luisi and Carbone* in relation

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<sup>27</sup> Case 267/86 *Van Eycke v ASPA NV* [1988] ECR 4769.

<sup>28</sup> See n. 21 above.

to Italian residents who had acquired more than the permitted amount of foreign currency, claiming it was to pay for various services in France and Germany. Under the capital movements Directives then in force, there was no requirement to liberalise the physical transfer of banknotes, but the original Article 106 did require current payments relating to other Treaty freedoms to be authorised in the creditor's currency.<sup>29</sup> The Court noted that the Treaty did not define what was meant by movements of capital, and held that it was not necessarily the case that any physical transfer of financial assets constituted a movement of capital. After comparing the original Articles 67 and 106, the Court concluded that current payments are transfers of foreign exchange, which constitute the *consideration* within the context of an underlying transaction, while movements of capital are financial operations essentially concerned with the investment of the funds in question rather than remuneration for a service, noting that the original Article 67(2) of the Treaty recognised that there could be current payments connected with the movement of capital. It was therefore held that the physical transfer of banknotes could not be classified as a movement of capital where the transfer in question corresponded to an obligation to pay arising from a transaction involving the movement of goods or services.

While this distinction between the consideration and the underlying transaction may seem clear, it does give rise to practical difficulties. To take the simple example of a with-profits life assurance policy, part of the premium will be used for investment purposes (presumably 'capital' in the Court's definition), and part will be used to meet expenses and to pay for the life assurance (presumably both payments for services). Although the Court endeavoured to state that there was a clear distinction between movements of capital and current payments, it remains the case that the series of Directives on the free movement of capital enacted under the original Article 67 of the Treaty appears to have covered both types of transaction,<sup>30</sup> although, intriguingly, the Directives required transfers in respect of capital movements to be made on the same exchange rate conditions as those governing payments relating to current transactions, a terminology which appeared to recognise that there were two different concepts. In the version resulting from Directive

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<sup>29</sup> Even if Directive 63/340 'on the abolition of all prohibitions on or obstacles to payments for services where the only restrictions on exchange of services are those governing such services' (OJ English Special Edition 1963–64 (I), p. 31) made under Article 106(2) expressly excluded services in connection with transport and foreign exchange allowances for tourists.

<sup>30</sup> Directive 88/361 (OJ 1988 L178/5), replacing Directive of 11 May 1960 (OJ 1960, p. 921), as amended by Directive 63/21 (OJ English Special Edition 1963–64 (I), p. 5) and Directive 86/566 (OJ 1986 L332/22).

86/566,<sup>31</sup> to take a historic example, list A, which was a list of transactions which had to be liberalised, expressly included transfers in performance of insurance contracts ‘as and when free movement in respect of services’ was extended to them. Indeed, list A did actually expressly include transfers of monies required for the provision of services, which was a clear overlap with the concept of current payments enounced in *Luisi and Carbone*.

The distinction between current payments and capital movements was continued both in the European Economic Area Agreement and in the Europe Agreements with Central and Eastern European countries. In the context of the European Economic Area (EEA), Article 40 of that Agreement provides that there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in EC Member States or European Free Trade Area (EFTA) States ‘and no discrimination based on the nationality or on the place of residence of the parties or on the place where such capital is invested’. Article 41 provides that current payments connected with the movement of goods, persons, services or capital between Contracting Parties within the framework of the provisions of the Agreement shall be free of all restrictions. So far as the Europe Agreements with Central and Eastern European countries were concerned, it was provided that payments should be authorised in freely convertible currency to the extent that the transactions underlying the payments concern movements of goods, services or persons between the Parties which had been liberalised pursuant to the Agreement.<sup>32</sup> Furthermore, the Member States of the Community undertook from the entry into force of the respective Agreements not to introduce any new foreign exchange restrictions on the movement of capital and current payments connected therewith between residents of the Community and the relevant Central or East European State, and not to make existing arrangements more restrictive.<sup>33</sup> However, they did not undertake (except to the extent of holding consultations) to eliminate previously existing restrictions. On the other hand, the Central and Eastern European countries, with the notable exception of Estonia, benefited from transitional arrangements imposing no immediate obligation to liberalise all capital movements. The old distinctions, therefore, lingered on in this wider context.

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<sup>31</sup> OJ 1986 L332/22.

<sup>32</sup> See Article 60 of the Agreements with Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Romania, Slovakia and Slovenia, and Article 59 of the Agreements with Hungary and Poland.

<sup>33</sup> See, for example, Article 61(2) of the Agreements with Bulgaria, the Czech Republic and Slovakia, Article 61(3) of the Agreement with Romania, and Article 60(2) of the Agreements with Hungary and Poland.

## THE CURRENT RULES

### **Extensive Interpretation**

The Treaty on European Union introduced new provisions on ‘capital and payments’ with effect from 1 January 1994, the date set for the start of the second stage of EMU. The fundamental rules are set out in paragraph 1 of Article 56 EC, which states that within the framework of the provisions set out in that chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited. Paragraph 2 states that within the same framework, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.

At first sight, a fundamental distinction between these provisions and the original provisions – and indeed from the situation reached under the 1988 Directive – is that it appears that movements to and from third countries are to be treated in the same way as movements between Member States. With hindsight, this can be seen as anticipating the need to reassure the international money markets with regard to the external movement and availability of the Euro. However, in reality, there are differences which remain. Under Article 57, the provisions of Article 56 are stated to be without prejudice to the application to third countries of any restrictions which existed on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment (including investment in real estate), establishment, the provision of financial services or the admission of securities to capital markets; in other words, they do not require existing lawful restrictions to be abolished in these (admittedly limited) areas.

Under Article 59, where, in exceptional circumstances, movements of capital to or from third countries cause, or threaten to cause, serious difficulties for the operation of economic and monetary union, the Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Central Bank (ECB), may take safeguard measures with regard to third countries for a period not exceeding six months if such measures are strictly necessary. Finally, by virtue of Article 60, the Council may take urgent measures under Article 301, where Community action to interrupt or reduce economic relations with one or more third countries is required by a common position or in a joint action adopted under the European Union (EU) provisions on a common foreign and security policy, in relation to the movement of capital and on payments as regard the third countries concerned. Indeed, pending such measures, Member States themselves may, under the second paragraph of Article 60, take unilateral measures against a third country with

regard to capital movements and payments 'for serious political reasons'. The freedom is therefore not absolute.

Be that as it may, to the extent that a payment or capital movement is not excluded, Article 56 has been held to be directly effective, even with regard to capital movements to third countries such as Switzerland and Turkey.<sup>34</sup> This in itself is an interesting development, given the Court's reluctance in earlier case-law automatically to extend concepts developed in the context of the internal market to situations governed by similar language in relations with third countries. So, for example, in *Polydor*,<sup>35</sup> in the context of the free movement of goods, it was held that even where a free trade agreement does expressly prohibit not only quantitative restrictions but also measures having effects equivalent to quantitative restrictions, the same interpretation of that phrase need not be given in the context of trade with a non-Member State as will be given in the context of trade between Member States, since there is no intention to create a single market under free trade agreements.

A synthesis of the approach to the direct effect of provisions of international agreements was given in the context of an agreement between the Community and Portugal in the *Kupferberg* case.<sup>36</sup> The Court started from the principle that it is open to the Community and the third country to agree what effect the provisions of the agreement are to have in the internal legal order of the contracting parties, and that the matter fell to be decided by the courts only in the absence of express agreement on the point, emphasising however, that it was open to the courts of one contracting party to consider that certain provisions were directly effective even if that view was not shared by courts of the other contracting party. It then went on to consider whether the provision at issue could be regarded as unconditional and sufficiently precise to have direct effect in the light of the object and purpose of the agreement, concluding that the provision at issue imposed an unconditional rule against discrimination in matters of taxation, dependent only on a finding that the products affected were of like nature, so that it could be applied by a court and produce direct effects throughout the Community. The Court did emphasise, however, that despite the fact that the provision at issue had the same object as Article 95 (now Article 90) EC, each of these provisions should be interpreted in its own context, and that the interpretation given to Article 90 could not be applied by way of simple analogy to the corresponding provision of an agreement on free trade. However, in *Sanz de Lera*, the judgment does not discuss these issues, and simply holds Article 56 to be directly effective in itself and on its own terms.

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<sup>34</sup> See again, *Sanz de Lera*.

<sup>35</sup> Case 270/80 *Polydor v Harlequin* [1982] ECR 379.

<sup>36</sup> Case 104/81 *Hauptzollamt Mainz v C.A. Kupferberg & Cie KG* [1982] ECR 3641.

Nevertheless, despite the fact that free movement of capital rules now apply to movements into and out of the Community, the 1988 definitions drafted to cover movements within the Community continue to be used. This was made clear when the Court confirmed that a mortgage fell within the scope of a capital movement as defined in the Directive in *Trummer and Meyer*,<sup>37</sup> and further held that this interpretation should continue to apply to the free movement of capital under Article 56.

However, there has been a lack of consistency in determining whether an activity falling within the lists in the Annex to the Directive should be categorised as a capital movement or as falling within the scope of another ‘freedom’. In *Ambry*,<sup>38</sup> it was held that for France to require the compulsory financial security provided by a travel agent to be guaranteed by a credit institution or insurance company situated in France breached the Treaty rules on freedom to provide services – although it may be observed that the list in the Annex to the 1988 Capital Movements Directive expressly includes guarantees granted by non-residents to residents.<sup>39</sup> Nevertheless, in *Commission v Italy*,<sup>40</sup> it was held that an Italian requirement that undertakings engaged in the provision of temporary labour established in other Member States had to lodge a guarantee with a credit institution having its registered office or a branch office in Italy was a breach both of the freedom to provide services under Article 49 and of the free movement of capital under Article 56. It was held to restrict the free movement of capital on the basis that under point IX of Annex I to Directive 88/361, guarantees granted by non-residents to residents or by residents to non-residents constitute movements of capital, which should therefore be liberalised under Article 56(1).

A similar potential for overlap may also be seen in the relationship between the free movement of capital and the freedom of establishment: in *Verkooijen*, receipt by a resident of one Member State of dividends on shares in a company whose seat was in another Member State was treated as free movement of capital falling under Directive 88/361, whereas in *Metallgesellschaft and Hoechst*,<sup>41</sup> the payment of dividends by a subsidiary company to a parent company resident in another Member State was treated as a question of freedom of establishment. The broad use of the capital movement rules to deal with issues which might be thought to involve questions of freedom of establishment is very clearly shown in the series of decisions in relation to ‘golden

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<sup>37</sup> [1999] ECR I-1661.

<sup>38</sup> Case C-410/96 *Criminal Proceedings against Ambry* [1998] ECR I-7875.

<sup>39</sup> Annex I, heading IX A.

<sup>40</sup> See n. 8 above.

<sup>41</sup> Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Hoechst v Inland Revenue* [2001] ECR I-1727.



shares',<sup>42</sup> where measures designed to enable the public authorities to limit the size of shareholdings or restrict the disposal of assets in privatised companies were held to amount to restrictions on investment in breach of the rules on the free movement of capital.

Against this background of conflicting case-law, an examination may be made of the broad concept of capital movements exemplified in *Trummer and Meyer*. The facts were quite simple and undisputed. In 1995, Mr Mayer, a German resident, sold a share in a property situated in Austria to Mr Trummer, an Austrian resident. It was agreed that Mr Trummer could have until the end of 2000 to settle the purchase price, which was fixed in German marks, and that payment should be secured by way of a mortgage over his share of the property. The problems arose when they tried to register the transaction in the local land register: registration of the mortgage was refused on the ground that the sum involved was not denominated in Austrian schillings. This view was upheld in the regional appeal court (*Landesgericht Graz*); in the *Oberster Gerichtshof* (which eventually made the reference), it was said that registration of a security right in respect of a foreign-currency debt was valid only where it was denominated in Austrian schillings in a sum corresponding to the foreign-currency debt as at the date of application for registration. The *Oberster Gerichtshof* therefore considered that the claim could only be allowed if the refusal of registration constituted a restriction on the movement of capital and payments prohibited by Article 56 EC, and it referred to the European Court the question of the compatibility of the Austrian rule with Article 56 (then still Article 73b).

The Court observed that it was necessary first to consider whether the creation of a mortgage to secure the payment of a debt payable in the currency of another Member State was covered by Article 56. Article 56 requires in its first paragraph that, within the framework of the chapter in which it appears, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited. Its second paragraph states that within the same framework, all restrictions on payments between Member States, and between Member States and third countries, shall be prohibited. Unfortunately, as the Court noted, the EC Treaty does not define the terms 'movements of capital' or 'current payments'. However, as noted earlier in this chapter, Directive 88/361 finally established the basic principle of free movement of capital and set out a nomenclature of capital movements

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<sup>42</sup> Case C-483/99 *Commission v France* [2002] ECR I-4781; Case C-367/98 *Commission v Portugal* [2002] ECR I-4731; Case C-503/99 *Commission v Belgium* [2002] ECR I-4809; and Case C-98/01 *Commission v United Kingdom* [2003] ECR I-4641.

in its Annex I, which was stated to be to facilitate its application rather than to introduce distinctions in treatment.

The present author suggested in 1994<sup>43</sup> that in the continued silence of the Treaty, the Annex to the Directive remained a useful source of illustration of the principle of the free movement of capital even after the entry into force of Articles 56–60 under the Maastricht Treaty. Such a view had, in fact, been accepted by the *Landesgericht* in *Trummer and Mayer*, but the *Landesgericht* interpreted the Annex so as not to cover the transaction in question. For its part, the ECJ took the view that Article 56 ‘substantially reproduces the contents of Article 1 of Directive 88/361’ and held that ‘the nomenclature in respect of movements of capital annexed to Directive 88/361 still has the same indicative value, for the purposes of defining the notion of capital movements, as it did before the entry into force of Article [56] et seq., subject to the qualification, contained in the introduction to the nomenclature, that the list set out therein is not exhaustive’.<sup>44</sup>

The Court had in fact already held, in *Svensson and Gustavsson*, that borrowing money from a bank in another Member State to buy a house fell within the scope of the Directive.<sup>45</sup> Though it was subsequently suggested by Advocate-General Tesaurò, in his Opinion in *Safir*, that a narrower concept of capital movements should be adopted, the Court confirmed in *Trummer and Mayer* that a mortgage fell within the scope of a capital movement as defined in the Directive. More specifically, it was held both that the mortgage in this case was inextricably linked to a capital movement (the liquidation of an investment in real property)<sup>46</sup> and that the mortgage as such was a capital movement under Point IX of the nomenclature as an ‘other guarantee’ under the heading ‘sureties, other guarantees and rights of pledge’. In those circumstances, the Court held that an obligation to have recourse to the national currency for the purposes of creating a mortgage must be regarded, in principle, as a restriction on the free movement of capital within the meaning of Article 56 of the EC Treaty.

As mentioned earlier in this chapter, in respect of the decisions in *Ambry* and *Commission v Italy*, serious legal issues arise from the classification as a capital movement of an economic activity which might otherwise be regarded as a service; a similar need for clarification was seen to arise in the relationship between free movement of capital and freedom of establishment, looking

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<sup>43</sup> J. Usher, *The Law of Money and Financial Services in the European Community*, 1st edn (Oxford: Oxford University Press, 1994), p. 19.

<sup>44</sup> *Trummer and Mayer*, para. 21.

<sup>45</sup> Case C-484/93 *Svensson and Gustavsson v Ministre du Logement* [1995] ECR I-3955.

<sup>46</sup> Point II of Annex I to the Directive.

to *Verkooijen*, *Manninen* and *Metallgesellschaft and Hoechst*. There is, therefore, clear potential for overlap with other Treaty freedoms, as occurred in, for example, *Svensson and Gustavsson*. The question then arises as to whether the current capital movement provisions effectively extend the other freedoms to third country nationals or residents. It does not take much imagination to envisage the possible consequences of this approach to the capital movement provisions if, as in *Trummer and Mayer* or *Commission v Italy*, they are interpreted broadly so as to include activities which might economically be regarded as the provision of services (such as the provision of mortgage credit or of guarantees). Does it mean that a borrower resident in the Community has an enforceable Community law right to take out a mortgage with a provider in a third country, and does it mean that a lender in a third country has an enforceable Community law right to offer a mortgage to a borrower in a Member State? Conversely, does it mean that a lender in the Community has an enforceable Community law right to offer a mortgage to a borrower in a third country, and that a borrower in a third country has an enforceable Community law right to take out a mortgage with a provider in the Community (and therefore presumably the right to enter the Community for that purpose)?

It is in this context that the relevance of Article 57 EC may be seen. Under Article 57, the provisions of Article 56 are stated to be without prejudice to the application to third countries of any restrictions which existed on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment (including investment in real estate), establishment, the provision of financial services or the admission of securities to capital markets. In other words, they do not require pre-1994 lawful restrictions to be abolished in these areas which, apart from direct investment, expressly overlap with freedom of establishment and freedom to provide services. Their broader geographical scope is not the only way in which the broad interpretation of the capital movement provisions may give rise to problems with regard to freedom of establishment or the provision of services: tax discrimination is also an issue.

### **The Tax Issue**

At first sight, Article 58(1)(a) EC appears to allow certain forms of tax discrimination, leading to a possible negative result from classifying an operation as a capital movement. It states that the provisions of Article 56 (i.e. the liberalisation of capital movements and payments inside and outside the Community):

shall be without prejudice to the right of Member States:

(a) to apply the relevant provision of their tax law which distinguish between tax-

payers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested; . . . .

This appears to be a clear authorisation to discriminate in the tax system between residents and non-residents, and no doubt reflects the fact that residence is widely used to determine the national legislation to which a taxpayer is subject. It could, however, allow discrimination *against* non-residents, and against those investing in other Member States, which could clearly conflict with the fundamental Treaty freedoms relating to establishment, provision of services and movement of workers. On the other hand, it has been suggested that the aim of Article 58(1)(a) was to permit discrimination *in favour of* inward investment, which could conflict with the rules on state aids (Articles 87–89 EC), and which also raises the question of tax competition. However, the provision must be taken in its context: in effect, it is drafted as a permission to take measures which might interfere with the free movement of capital and payments, rather than *carte blanche* to discriminate. In other words, the fact that a measure may be justifiable as a restriction on the movement of capital and payments does not necessarily make it acceptable as a state aid. However, this is an aspect on which there has not been any litigation, and arguments could be made for a broad interpretation. In any event, Article 58(1)(a) is subject both to the caveat in Article 58(3) that such measures ‘shall not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments as defined in Article 56’ and to a Declaration made by the Member States when the Maastricht Treaty was signed, stating that:

[t]he Conference affirms that the right of Member States to apply the relevant provisions of their tax law as referred to in [Article 58(1)(a)] of this Treaty will apply only with respect to the relevant provisions which exist at the end of 1993. However, this Declaration shall apply only to capital movements between Member States and to payments effected between Member States.

It may be suggested that this, at the very least, amounts to a political commitment not to introduce any new measures of the type at issue in the context of monetary movements between Member States. Be that as it may, the classification as a capital movement of an economic activity which could be regarded as involving freedom of establishment or freedom to provide services has the potential to give rise to awkward tax questions. Further problems might be thought to arise from Articles 50 (stating that services are only ‘services’ if they do not fall under one of the other freedoms) and 51 EC (subordinating banking and insurance services to the liberalisation of the movement of capital).

While it may be wondered how Article 58(1)(a) may be reconciled with the

concept of a single market for financial services, and more particularly how it may be reconciled with the principle of non-discrimination underlying the Treaty provisions on free movement of persons and provision of services, it was made clear in 2004, in *Manninen*, that the prohibition of arbitrary discrimination in Article 58(3) enables Article 58(1)(a) to be interpreted in line with the case-law on tax discrimination under the other Treaty freedoms. Before that decision, however, various other approaches had been suggested. The most straightforward was to argue that Article 58(1)(a) is only concerned with monetary movements as such,<sup>47</sup> and that it does not apply to situations governed by the other Treaty freedoms.

It may be submitted, however, that this straightforward approach does not appear to take account of Article 43 (second paragraph) or Article 51(2) of the EC Treaty. These provisions were not altered by the Single European Act (SEA) or by the Maastricht, Amsterdam or Nice Treaties. The second paragraph of Article 43 EC defines freedom of establishment as including the right to take up and pursue activities as self-employed persons, and to set up and manage undertakings, 'subject to the provisions of the Chapter relating to capital', and Article 51(2) states that the liberalisation of banking and insurance services connected with movements of capital shall be effected in step with the progressive liberalisation of the movement of capital. This link between the Treaty rules on establishment and the provision of services and the rules relating to the movement of money was noted in the recitals to the Second Banking Directive, which recognised that capital safeguard measures under the 1988 Capital Movements Directive may lead to restrictions on the provision of banking services. The provision of banking and insurance services, therefore, appears expressly to be subordinated to the rules on monetary movements.

The link was applied in a restrictive way by the ECJ in *Van Eycke*, as discussed above. By way of contrast, in *Safir*, it was held that for Sweden to impose a different tax regime for insurance policies purchased from providers outside Sweden (which would have the effect of deterring Swedish residents from taking out such policies, even though it was intended to achieve tax neutrality between policies purchased inside and outside Sweden), was a breach of Article 49, and that since it concerned the provision of services, there was no need to consider the capital movement provisions. Such an approach is difficult to reconcile with the wording of the Treaty – though it may be

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<sup>47</sup> See F. Vanistendael, 'The consequences of *Schumacker* and *Wielockx*: Two steps forward in the tax procession of *Echternach*' (1996) vol. 33:2 *Common Market Law Review* 255–69; and P.J. Wattel, 'The EC Court's attempts to reconcile the Treaty freedoms with international tax law' (1996) vol. 33:2 *Common Market Law Review* 223–54.

suggested that the wording of the Treaty is hardly appropriate in the context of the 12 Member States sharing a single currency – but it was subsequently followed in *Danner*. However, earlier case-law on services had indicated that differentiation on the basis of place of investment might be justified. In *Bachmann*,<sup>48</sup> the Court held that tax deductions on life and sickness insurance premiums could be limited to payments made to insurers established in Belgium, on the basis that there was no other way of preserving the coherence of the tax system (which required tax to be paid on the ultimate benefits). It might be observed that if a requirement that a provider of a financial service should be established within the jurisdiction of the Member State concerned is the only way of ensuring that a Member State's tax legislation is observed, it indicates a need for a considerably greater degree of co-operation between the tax authorities of the Member States. It also has the effect of making provision of services, in the Treaty sense, impossible.

However, that was not the end of the story. The ECJ returned to the matter in *Wielockx*.<sup>49</sup> This involved a Belgian national resident in Belgium who was a partner in a business established in the Netherlands and whose entire income was earned in the Netherlands. He paid money into a pension reserve in the Netherlands, and claimed tax relief on that part of his income. This was refused on the basis that relief was only given to Dutch residents, and the Netherlands government invoked the *Bachmann* case to argue that in the case of a Belgian resident, the Netherlands authorities would grant the tax relief on the pension contributions but the Belgian authorities would collect the tax on the pension when it was received. However, the Court, while accepting that in principle the situations of residents and non-residents are not generally comparable, held that a non-resident taxpayer who receives all or almost all his income in the state in which he works is objectively in the same situation as concerns income tax as a resident of that state. Furthermore, on the question of tax cohesion, the Court followed Advocate-General Léger in noting that the arrangements between the Netherlands and Belgium resulted from a double taxation convention following the OECD model under which a state taxes all pensions, irrespective of their source, received by residents, but waives the right to tax pensions received abroad, irrespective of their source. It therefore held that tax cohesion was to be established not at the level of one individual taxpayer but in the reciprocity of the rules applicable in the Contracting States. The Netherlands could not, therefore, justify a discriminatory refusal of tax relief in this case.

While subsequent case-law has continued to make reference to *Bachmann*

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<sup>48</sup> Case C-204/90 *Bachmann v Belgium* [1992] ECR I-249.

<sup>49</sup> Case C-80/94 *Wielockx v Inspecteur der Directe Belastingen* [1995] ECR I-2493.

as the authority for the principle that the need to safeguard the cohesion of the tax system may justify rules which are liable to restrict fundamental freedoms, there has in fact been no subsequent example of such discriminatory tax treatment being held to be justified. Indeed, in *Danner*, it was held that coherence of the tax system did not justify a Finnish refusal to grant tax relief on pension contributions paid in Germany.

With regard to the overlap with freedom of establishment, there is a long line of case-law indicating that differential tax treatment based on residence or place of investment may infringe Article 43 EC.<sup>50</sup> In this context also, therefore, there might appear to be an inducement to classify transactions as freedom of establishment rather than as capital movements. In the context of freedom of establishment, if an undertaking does establish a permanent presence in another Member State, then whatever form that establishment takes, it has been clear since *Commission v France* that Member States may not treat companies differently for tax purposes depending on the type of establishment present within their jurisdiction. It was there held, in the context of French legislation granting shareholders' tax credits to French insurance companies but not to branches or agencies in France of foreign insurance companies, that France could not treat branches of foreign insurance companies whose main offices were in other Member States differently from those insurance companies which took the form of French-based companies which were subsidiaries of those foreign insurance companies. In other words, branches (which are a part of the foreign undertaking in another Member State) and subsidiaries (which are formed under local law but controlled by the foreign undertaking) had to be treated the same way, both being forms of establishment recognised in what is now Article 43 EC. Furthermore, it was made clear in that case that there was no way restrictions could be imposed on the freedom of establishment in order to prevent tax evasion,<sup>51</sup> even though it might be legitimate outside that context to operate differential tax treatment on the basis of residence, as was subsequently held in *Werner*.<sup>52</sup>

However, when the question of residence did arise in the context of freedom of establishment in *Commerzbank*,<sup>53</sup> it was held that a German company which traded in the United Kingdom (UK) through a branch established there

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<sup>50</sup> See, for example, Case C-330/91 *R. v Inland Revenue Commissioners ex parte Commerzbank* [1993] ECR I-4017; Case C-251/98 *Baars v Inspecteur der Belastingen* [2000] ECR I-2787; and see again, *Metallgesellschaft and Hoechst*.

<sup>51</sup> See also, Case C-9/02 *de Lasteyrie du Saillant v Ministère de l'Économie, des Finances et de l'Industrie* [2004] ECR I-2409.

<sup>52</sup> Case C-112/91 *Werner v FZA Aachen-Immenstadt* [1992] ECR I-249. This case, nevertheless, distinguished and reaffirmed the judgment in the French tax case.

<sup>53</sup> Case C-330/91 *R. v Inland Revenue Commissioners ex parte Commerzbank* [1993] ECR I-4017.

but which was fiscally non-resident in the UK, was entitled to receive interest on the repayment of tax which should not have been charged to it, if an undertaking resident in the UK would have received interest on such a repayment – and it made no difference that the only reason for the repayment of the tax was the fact that the German company was not resident in the UK. A similar approach has been taken in *Colmer*,<sup>54</sup> where tax relief for a holding company depended on the residence of its subsidiaries. Subsequently, in *Baars*,<sup>55</sup> it was held that Dutch legislation which gave an exemption from wealth tax for Dutch residents with a controlling shareholding in a company established in the Netherlands but did not give that exemption for a controlling shareholding in a company established in another Member State (in that case Ireland), breached the Treaty rules on freedom of establishment, and in *Metallgesellschaft and Hoechst*, the subtraction of the payment of dividends by a subsidiary company to a parent company resident in another Member State to advance corporation tax when no advance corporation tax was required on payments of dividend to a parent company resident in the UK was held to be a breach of the Treaty rules on freedom of establishment.

With regard to free movement of workers, in *Schumacker*<sup>56</sup> and *Commission v Luxembourg*,<sup>57</sup> it was made clear that discrimination cannot be justified where the taxpayer benefits from the rules on free movement of workers, and in *Asscher*,<sup>58</sup> it was made clear that discrimination cannot be justified where the taxpayer benefits from the rules on freedom of establishment. In the *Schumacker* case, it was held that where the state of residence could not take account of the taxpayer's personal and family circumstances because the tax payable there was insufficient to enable it to do so, the Community principle of equal treatment required that in the state of employment the personal and family circumstances of a foreign non-resident be taken into account in the same way as those of resident nationals, and the same tax benefits should be granted. In *Commission v Luxembourg*, it was held that it was a breach of the rules on the free movement of workers for Luxembourg to retain and not repay excess amounts of tax deducted from the earnings of Community nationals who resided or worked in Luxembourg for less than the whole tax year; and in *Asscher*, the Netherlands could not impose a higher income tax liability on a non-resident to compensate for the fact that he paid social security contributions in another Member State. On the other hand, it

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54 Case C-264/96 *ICI v Colmer* [1998] ECR I-4695.

55 Case C-251/98 *Baars v Inspecteur der Belastingdienst* [2000] ECR I-2787.

56 Case C-279/93 *Finanzamt Köln-Altstadt v Schumacker* [1995] ECR I-225.

57 Case C-151/94 *Commission v Luxembourg* [1995] ECR I-3685.

58 Case C-107/94 *Asscher v Staatssecretaris van Financiën* [1996] ECR I-3089.



was accepted by the ECJ in *Gilly*<sup>59</sup> that a frontier worker may have to accept less than perfect equality of treatment under a double taxation agreement.

On the face of it, there is, therefore, a conflict between the Treaty rights of freedom of establishment, freedom to provide services and free movement of workers as interpreted in *Commerzbank*, *Wielockx*, *Schumacker*, *Commission v Luxembourg* and *Asscher*, and Article 58(1)(a) EC if it really does authorise discriminatory tax treatment. One approach to this problem, long advocated by the present author, is to take account of the fact that Article 58(1)(a) only entered into force on 1 January 1994 and to recall the Declaration attached to the Maastricht Treaty, set out above. While a mere Declaration may not amend the terms of the Treaty, it has long been established in other areas of Community law that it may be binding upon its author.<sup>60</sup> If the Member States are bound by their Declaration, it may be submitted that its effect is that with regard to monetary movements between Member States, the only discriminatory measures which may be maintained under Article 58(1)(a) are those which were lawfully in force at the end of 1993. Since the *Commerzbank*, *Wielockx*, *Schumacker* and *Asscher* cases all relate to situations arising before the end of 1993, it may be suggested that the discrimination on the basis of residence found unlawful in those cases cannot be revived under Article 58(1)(a). However, this approach will also not work if situations which at first sight might appear to involve the provision of services (such as the creation of a mortgage) are categorised as movements of capital – unless (as in *Safir*), the wording of the Treaty is ignored, and it is held that the free movement of capital rules do not have to be considered if a situation can be categorised as provision of services – and it is not the approach which has been followed by the Court in the recent judgment of its Grand Chamber in *Manninen*. Here, the Court appears to have resolved the problem through a strict interpretation of Article 58(1)(a), read in conjunction with the prohibition of arbitrary discrimination in Article 58(3). This approach had been foreshadowed in *Verkooijen*,<sup>61</sup> where the Court suggested that Article 58(1)(a) had been anticipated by its judgment in *Bachmann* and that before its entry into force, distinctions based on the residence of taxpayers would be compatible with Community law if they applied to situations which were not objectively comparable or could be justified by overriding reasons in the public interest,

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<sup>59</sup> Case C-336/96 *Gilly v Directeur des Services Fiscaux du Bas-Rhin* [1998] ECR I-2793.

<sup>60</sup> In the context of declarations under Regulation 1408/71 on social security (OJ 1971 L149/2, as amended), see Case 35/77 *Beerens v Rijksdienst voor Arbeidsvoorziening* [1977] ECR 2249.

<sup>61</sup> Although, it should be noted, that the facts in this case arose before the entry into force of Article 58(1)(a).

in particular in relation to the cohesion of the tax system; it was emphasised that a desire to promote the domestic economy by encouraging domestic investment could not be such an overriding interest, nor could a loss of tax revenue.

The *Manninen* case arose from the refusal of the Finnish authorities to grant a Finnish taxpayer a tax credit in relation to a dividend received from a Swedish company, which had been taxed in Sweden, when such a credit would have been granted on a dividend received from a Finnish company taxed in Finland. In principle, the Court held this to be a restriction on the free movement of capital prohibited by Article 56 EC, on the basis that the Finnish tax legislation had the effect of deterring fully taxable persons in Finland from investing their capital in companies established in another Member State. It also found that such a provision had a restrictive effect as regards companies established in other Member States, in that it constituted an obstacle to their raising capital in Finland. Since revenue from capital of non-Finnish origin received less favourable tax treatment than dividends distributed by companies established in Finland, the shares of companies established in other Member States would be less attractive to investors residing in Finland than shares in companies which had their seat in that Member State.

The Court then turned to the question of whether this restriction was capable of being justified under Article 58(1)(a). It started by observing that this provision had to be interpreted strictly, as a derogation from the fundamental principle of the free movement of capital, and that it 'cannot be interpreted as meaning that any tax legislation making a distinction between taxpayers by reference to the place where they invest their capital is automatically compatible with the Treaty'.<sup>62</sup> It emphasised that a distinction must therefore be made between unequal treatment, which is permitted under Article 58(1)(a), and arbitrary discrimination, which is prohibited by Article 58(3), and stated that its case-law showed that, for national tax legislation like that at issue to be capable of being regarded as compatible with the Treaty provisions on the free movement of capital, the difference in treatment must concern situations which are not objectively comparable or be justified by overriding reasons in the general interest, such as the need to safeguard the cohesion of the tax system. The Court also added a proportionality test, as under the other 'freedoms', stating that in order to be justified, the difference in treatment between different categories of dividends must not go beyond what was necessary in order to attain the objective of the legislation.

Observations had been submitted by the Finnish, French and UK governments, which argued that the dividends paid were fundamentally different in

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<sup>62</sup> *Manninen*, para. 28.

character according to whether they came from Finnish or non-Finnish companies. However, the Court took the view that the Finnish tax legislation was designed to prevent double taxation of company profits by granting to a shareholder who receives dividends a tax advantage linked to the taking into account of the corporation tax due from the company distributing the dividends, and that shareholders fully taxable in Finland found themselves in a comparable situation, whether they received dividends from companies established in that Member State or from companies established in other Member States.

The three governments further argued that the Finnish tax legislation was objectively justified by the need to ensure the cohesion of the national tax system, citing *Bachmann*. In this context, the Court explained its judgment in *Bachmann* on the basis that it had acknowledged that the need to preserve the cohesion of a tax system might justify a restriction on the exercise of the fundamental freedoms guaranteed by the Treaty. However, for an argument based on such justification to succeed, a direct link had to be established between the tax advantage concerned and the offsetting of that advantage by a particular tax deduction, and it declared that the *Bachmann* judgment was based on the finding that, in Belgian law, there was a direct link, in relation to the same taxpayer liable to income tax, between the ability to deduct insurance contributions from taxable income and the subsequent taxation of sums paid by the insurers. The Court also emphasised that an argument based on the need to safeguard the cohesion of a tax system must be examined in the light of the objective pursued by the tax legislation in question,<sup>63</sup> repeating that the Finnish tax legislation was designed to prevent double taxation of company profits distributed to shareholders. In this context, it concluded that the granting to a shareholder who was fully taxable in Finland and who held shares in a company established in Sweden of a tax credit calculated by reference to the corporation tax owed by that company in Sweden would not threaten the cohesion of the Finnish tax system, pointing out that when the shareholder fully taxable in Finland received dividends, the profits distributed had already been subject to taxation by way of corporation tax, irrespective of whether those dividends come from Finnish or from Swedish companies. Therefore, the objective pursued by the Finnish tax legislation, which was to eliminate the double taxation of profits distributed in the form of dividends, could be achieved by also granting the tax credit in favour of profits distributed in that way by Swedish companies to persons fully taxable in Finland.

The Court recognised that, for Finland, granting a tax credit in relation to corporation tax due in another Member State would entail a reduction in its tax

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<sup>63</sup> Citing *de Lasteyrie du Saillant*.

receipts in relation to dividends paid by companies in other Member States, but it pointed out that it had been consistently held in the case-law that reduction in tax revenue cannot be regarded as an overriding reason in the public interest which may be relied on to justify a measure which is, in principle, contrary to a fundamental freedom.<sup>64</sup>

The Finnish and UK governments further raised the argument that the EC Treaty rules on the free movement of capital apply not only to movements of capital between Member States but also to movements of capital between Member States and non-member countries. The Court's response was to point out that the case in no way concerned the free movement of capital between Member States and non-member countries – which clearly leaves the issue open for debate.

The Court's ruling, therefore, was that Articles 56 and 58 EC preclude legislation whereby the entitlement of a person fully taxable in one Member State to a tax credit in relation to dividends paid to him by limited companies is excluded where those companies are not established in that State. Interpreted in this way, it may be suggested that there is little real prospect of a difference in treatment of tax discrimination under Article 58(1)(a) and its treatment under the rules governing freedom to provide services, freedom of establishment and free movement of workers, where the taxpayers concerned can be regarded as being in a comparable situation.

## CONCLUSION

As was indicated at the outset of this chapter, the rules governing monetary movements represent a unique evolution of regulatory technique from detailed secondary legislation to directly effective Treaty principle. However, the definitions of capital movements and payments created in the context of liberalisation by secondary legislation have been continued into the era of directly effective Treaty provisions on freedom of capital movements. While those definitions were created in the context of rules which applied only within the internal market, they are now being applied in the context of rules on the free movement of capital which are unique (in the context of EC Treaty freedoms) in that they are not limited to the internal market. Furthermore, these definitions have a clear potential for overlap with other Treaty freedoms, notably freedom to provide services and freedom of establishment, with intriguing (and unresolved) consequences for the relationship of free movement of capital to other Treaty freedoms. In particular, the question is raised as to whether,

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<sup>64</sup> Citing *Verkooijen* and *Danner*.

under the guise of free movement of capital, a third country economic operator may offer services or exercise freedom of establishment within the EC. Many such activities would clearly be subject to the restrictions permitted in Article 57 of the EC Treaty, but such restrictions depend on the substantive scope of national law rather than Community law. Even within the internal market of the EC, the broad definitions of capital movements have blurred the distinctions between the freedoms, and the European Court has found itself apparently ignoring the hierarchy of freedoms set out in the EC Treaty. In defiance of the wording of Article 50 of the EC Treaty, it has held that activities falling within the definitions of the Capital Movements Directive were services, and that, therefore, it was not necessary to consider the provisions on capital movements.

However, the Court has now resolved what had been thought to be one of the most problematic aspects of this overlap between the freedoms, the fact that the wording of Article 58 on capital movements allows for tax discrimination on the basis of the taxpayer's residence or on the basis of the place of investment. If taken at face value this could have made the achievement of a single market for financial services a legal impossibility, but following the judgment in *Manninen*, it now appears that the criteria for determining whether tax discrimination is justifiable in the context of free movement of capital are comparable to those used in the context of freedom of establishment, freedom to provide services and free movement of workers. It may be suggested that this will lead to another incremental step in the development of the single internal market, requiring Member States in some circumstances to take account of tax paid in other Member States and to give tax relief for payments made in other Member States. In this area, the internal market is still on the move.

## ADDENDUM

A further cautious step in this direction has been taken by the Grand Chamber in its judgment in *Marks and Spencer v Halsey* in the context of freedom of establishment.<sup>65</sup> The case involved UK rules on group tax relief under which that relief was only allowed for losses incurred in the United Kingdom, whereas Marks and Spencer wished to set off losses incurred by its subsidiaries in Belgium, Germany and France. The ECJ accepted that in principle the UK rules were a justified restriction on freedom of establishment in so far as they were intended to protect a balanced allocation of the power to

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<sup>65</sup> Case C-446/03 *Marks and Spencer v Halsey* [2005] ECR I-10837.

impose taxation between the various Member States concerned, to avoid the risk of the double use of losses, and to avoid the risk of tax avoidance which would exist if the losses were not taken into account in the subsidiaries' Member States.<sup>66</sup> However, the ECJ also considered that the UK rules would be disproportionately restrictive where the non-resident subsidiary had exhausted the possibilities available in its State of residence of having the losses taken into account in its State of residence for the relevant accounting periods, and there was no possibility for the foreign subsidiary's losses to be taken into account in its State of residence for future periods either by the subsidiary itself or by a third party, in particular where the subsidiary had been sold to that third party. The ECJ therefore concluded that where in one Member State the resident parent company demonstrates to the tax authorities that those conditions are fulfilled, it is contrary to freedom of establishment to preclude the possibility for the parent company to deduct from its taxable profits in that Member State the losses incurred by its non-resident subsidiary. Thus there are circumstances where a Member State is required to set off losses incurred in another Member State against tax due in the first State.

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<sup>66</sup> The ECJ took the view that within a group of companies, losses might be transferred to the companies established in the Member States which apply the highest rates of taxation and in which the tax value of the losses is therefore the highest.

## 8. Abstractness and concreteness in the preliminary reference procedure: implications for the division of powers and effective market regulation

**Gareth Davies<sup>1</sup>**

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### INTRODUCTION

Community law is enforced by two sets of courts; those of the Member States, and those of the Community. The rhetoric surrounding this is of co-operation. Nevertheless, any sharing of function is also a sharing of power, and unless the boundaries are permanently fixed, there will also be the potential for competition. That may be more apparent, and more discussed, in the context of the other organs of government; the two sets of civil servants, in national ministries and the Commission, the two sets of parliamentarians, and the cabinet-like Council and its national equivalents. However, it is also true of courts.

It is true that courts are different: unlike other organs, they do not directly reflect the current will of government or parliament, and this means that the division of powers here is less obviously a democratic or political issue. However, in a careful sense of both those words, it clearly is. Courts reflect the societies in which they sit, and are formed by them. They are another branch of democracy, another way of reflecting the people, and, of course, all power is political.

As a consequence, courts have a dual role in the allocation of competences in the Community. They adjudicate it, but they are also an important part of it. They must decide, but they must also decide whether they should decide. This chapter focuses on how the Court of Justice (ECJ) does the second of these things. It does this through an examination of the Court's behaviour during the preliminary reference procedure. It asks how the Court interprets its own function in that procedure, as well as its relationship with national courts, and so

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<sup>1</sup> I am very grateful to Bibianne Bon for discussion of many relevant issues, and help with research. Faults remain, of course, my own.

in turn their function. The emphasis is on whether the Court is right to take such an extensive view of its own competences and, in particular, to delve into the facts of cases as much as it does, or whether it would be better for it to take a more abstract approach and leave more work for its national peers.

These questions are asked for a number of reasons. In part, there is the desire to study an emerging Community legal system, and its character, and to see what and how much it owes to the Member States' legal systems and, in particular, the common and civil law traditions and concepts of law and judging. However, there is also the more practical concern to understand the consequences of different ways of interpreting Article 234, both for the legal systems and courts involved, and for the Community policies that they are called upon to adjudicate, especially the internal market. Are references, as currently used, an efficient contribution to market regulation, or an over-centralising, legalistic drag on economic integration? The question must be seen in the context of current tendencies towards regulatory competition and diversity. Does the reference procedure support or challenge these dynamics?

The interests above are given impetus by the surprising absence of relevant scholarship.<sup>2</sup> Perhaps for black-letter lawyers, used to examining judgments on their own terms, criticising what they say or do not say, the question of whether they should be there at all seems unrealistic and so of marginal importance, too theoretical, and even subversive or disrespectful. On the other hand, for political scientists, such meta-questions are interesting, but not always accessible. The argument in this chapter is not built on the leading constitutional judgments that are well-known, even outside legal circles, but on sometimes mundane rulings in diverse policy areas and the consistent patterns that emerge. These will only be apparent to the writer for whom these are his or her daily texts.

After this introduction, the next section looks at the characteristics of the Community that give courts a prominent role, and argues that their potential freedom and power is far more than is customary within Member States. Hence the need to consider how that power will be divided up. The third section of this chapter outlines the relevant aspects of the preliminary reference procedure itself, and in particular the distinction between interpretation and application of the law. This is followed by a discussion, with reference to

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<sup>2</sup> Although see J. Snell, 'European courts and intellectual property: A Tale of Hercules, Zeus and Cyclops' (2004) vol. 29:2 *European Law Review* 178–97; and J.C. Cohen, 'The European preliminary reference and U.S. Supreme Court review of state court judgments: A study in comparative judicial federalism' (1996) 44 *American Journal of Comparative Law* 421–61. Many other writers refer in a line to the questions raised here, without going further. They tend broadly to approve of the Court's approach.



case-law on the internal market, of how the Court interprets that distinction. Subsequent parts analyse the Court's behaviour. First, why has it chosen an interventionist interpretative path, limiting the freedom of national courts and extending its own? The classical answer, its desire for uniformity of Community law, is critically examined. Secondly, how much does it owe to tradition? It seems to display a very common law understanding of the law, and yet the reference procedure owes much to continental European systems. Both sides of this create problems. The common law is labour intensive, and demands decentralisation of interpretative creativity. Resisting this, the ECJ creates a workload with which it cannot cope. From the other side, the classically continental reference procedure is coherent where the higher court has competence to interpret all the laws that come before it. Lacking that, a court can not fully answer questions of conflicts of laws; yet that is what the ECJ, despite a lack of competence to interpret national law, insists it must do.

A parallel is then drawn between issues here and those surrounding regulatory competition. It suggests that as with its legislative competence, the Community attempts to define its powers in both an ambiguous and an extensive way, giving it the option of centralisation, even if that option is not always exercised. It is argued that this is inefficient, and creates an adjudicative system poorly adapted to a large and dynamic market. As with legislation, the risk of some loss of uniformity is more than outweighed by the huge waste of national resources entailed in infantilising and marginalising the role of national courts in interpreting Community law. Finally, it is suggested that recasting the ECJ as the appeal court it almost is would solve some problems.

## THE JUDICIALISATION OF POLITICS AND THE ROLE OF COURTS IN THE COMMUNITY

A fractious society creates irresolvable, constantly changing and dynamic questions. Consensus, where it exists, is often short-lived and fragile. This requires similarly flexible and adaptable norms – interpretation is a faster, more subtle tool than legislation, as well as being perhaps more safely insulated from waves of populism – and a consequence is that the judiciary takes a greater role in the great political questions of the time. This is most evident in the United States (US), where the Supreme Court is one of the leading actors in that society's self-formation.

Three important elements in allowing such judicialisation to occur are the presence of a directly effective, legally enforceable constitution, a system of precedent, and an explanatory and well-argued style of judgment. The first

creates a basis for annulment of acts of public authorities, even of the legislator, and so creates a stage for direct conflict, for a battle of wills. Admittedly, interpretation without annulment can also be a powerful tool, but at least in the public perception it is likely to be less dramatic or controversial – there is no contest, but merely a legal point likely to be inaccessible to most. Moreover, constitutions typically contain rights and principles that are broad and open to debate – thus they effectively give a wide discretion to courts to challenge the legislator. They create a true opponent.

Yet the battle is not the war, and while a decision in a specific case may have repercussions, few case-outcomes are, in themselves, enough to change the course of a society. No single law or individual, or group, is that essential. However, when the reasoning behind a decision is fully argued and laid out, and when that decision is subsequently binding on other courts, then the court does not just decide the case, but lays down a new rule for the future. Its judgment is then more far-reaching and as a court builds up a body of such judicial legislation, it does develop the power to steer the land.<sup>3</sup>

All these three elements have emerged in the European Union (EU). The authority assumed by the ECJ – effectively, in conjunction with national courts – to annul national acts is well-known. Less often considered is the way the Court has developed a semi-discursive style of judgment, in which it not only lays down general principles to be followed in the future, but also provides reasons for these, and roots them in previous decisions. This legitimates the principles as new quasi-laws, and encourages national courts to accept them.<sup>4</sup>

In fact, the potential power of courts in the Community legal order arguably goes beyond anything to be found in individual Member States. The language of the EC and EU Treaties notoriously leaves ample room for interpretation. This is partly a function of their relative brevity, given the size of the tasks they delimit, but also of their purposive nature. Interpreting with a view to ends, which are themselves disputable, adds a further level of ambiguity to already open-textured law.

This makes it perhaps strange that, during the recent intense focus on a clearer and better division of powers, little attention has been given to how the

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<sup>3</sup> See generally J. Vining, *The Authoritative and the Authoritarian* (Chicago: University of Chicago Press, 1986), cited in J.H.H. Weiler, 'The judicial après Nice', in G. de Búrca and J.H.H. Weiler (eds), *The European Court of Justice* (Oxford: Oxford University Press, 2001), pp. 215–26 at 225; M. Lasser 'Anticipating three models of judicial control, debate and legitimacy: The European Court of Justice, the Cour de cassation, and the United States Supreme Court', Jean Monnet Working Paper 1/03, available at <http://www.jeanmonnetprogram.org/papers/index.html>.

<sup>4</sup> Although Weiler argues that the Court is still too Cartesian and cryptic, and needs to go further in the common law direction (Weiler, *ibid.*, p. 225); see also Lasser, *ibid.*, pp. 36–53. On the Court's development of precedent, see below n. 91.

ECJ performs its tasks. Emphasis was placed instead on the description of Community powers as a way of containing them, and on supervision of subsidiarity; another indeterminate idea.<sup>5</sup> Yet this creates, at best, an incomplete strategy. Concepts such as free movement and fair competition, even less a clean environment or a high level of consumer protection, can only be described in precise terms at the cost of excluding what are ongoing and important social dialogues about what such things are or should be. Working with living, changing concepts means having imprecise law.<sup>6</sup> Thus, rather than looking at the texts, a better, or at least a necessary additional, source of predictability and legal certainty is the behaviour of the courts who read them. If this follows accepted and known norms, then while the law may change, it does so in an understandable way.

## INTERPRETATION AND APPLICATION IN THE PRELIMINARY REFERENCE PROCEDURE

Certain types of legal action are reserved to the European Court of Justice (ECJ), and national courts play no role. Here there is little to discuss concerning division of functions. That issue becomes important only in the context of preliminary references, which avoid a simple hierarchical relationship between courts, such as between deciding court and court of appeal, in favour of a co-operative sharing out of the various activities necessary to decide a case.<sup>7</sup>

Article 234 EC provides that national courts may refer a question concerning the interpretation of the EC Treaty to the ECJ. The ECJ has limited this right to circumstances in which the answer to that question is necessary to decide a case currently before the national court. This idea of sending a question to another court has its origins in continental legal systems. A number of these have courts which are empowered to answer questions, often on the constitutionality of lower laws, but do not formally decide the case.<sup>8</sup> There is

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<sup>5</sup> See G. Davies, 'The post-Laeken division of competences' (2003) vol. 28:5 *European Law Review* 686–99.

<sup>6</sup> See S. Weatherill, 'Competence', in B. de Witte (ed.) *Ten Reflections on the Constitutional Treaty for Europe* (Florence: Robert Schuman Centre for Advanced Studies, 2003), also available via [www.iue.it/RSCAS](http://www.iue.it/RSCAS), pp. 45–67.

<sup>7</sup> Or a 'separation' of functions – see Case C-30/93 *AC-ATEL Electronics* [1994] I-2305, esp. at para. 16.

<sup>8</sup> The German, Austrian, Spanish and Italian constitutional courts all know such a function; see *The International Encyclopedia of Comparative Law* (The Hague: Martinus Nijhoff, 2002) vol. XVI (Civil Procedure), pp. 107–14.

also a similarity with courts of cassation. These are appeal courts, but once again they do not decide the case; they merely consider whether the lower court has correctly used the law. If they find it has not, they refer the case to be re-decided by the lower court, or another court of that level. They do not provide a replacement judgment.<sup>9</sup>

In both these cases, there is a distinction made between interpreting and applying, or between law and fact. The higher body considers and interprets legal matters, but does not determine matters of fact, nor does it apply the law to the facts, which functions it leaves to the referring court, which in turn decides the case and issues the operative judgment. This distinction also operates in Community law, and has been expressed (and repeated) by the ECJ. It has jurisdiction to interpret the Treaties, as it often emphasises, but not to apply that interpretation to the facts in the case, which task is the exclusive competence of the national referring court. Nevertheless, it remains far from obvious what this formula means, and what the difference between interpretation and application actually is.<sup>10</sup>

Interpretation could be understood in an abstract sense. Then interpretations of Article 28 would include the famous proposition in *Dassonville*,<sup>11</sup> as well as the finding in *Cassis de Dijon*<sup>12</sup> that the application of formally equal national standards can be contrary to that Article, and the suggestion in *Keck*<sup>13</sup> that rules having no difference in their effect on imports and national goods are outside of Article 28 altogether.<sup>14</sup> Application, the task of the national court, would then consist in applying these principles to the case – asking whether, on the facts before them, the national measure is proportionate, or whether it has an unequal effect on national and imported goods.

However, interpretation can also be understood to go a great deal further. It

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<sup>9</sup> Such courts are found in Belgium, France and the Netherlands (*ibid.*).

<sup>10</sup> See generally, F. Dumon, *The Case-law of the Court of Justice: A Critical Examination of the Methods of Interpretation* (Luxembourg: Europa Instituut, 1976); L.N. Brown and T. Kennedy, *The Court of Justice of the European Communities*, 5th edn (London: Sweet and Maxwell, 2000); and D.N. MacCormick and R.S. Summers, *Interpreting Precedent: A Comparative Study* (Aldershot: Dartmouth Publishing, 1997).

<sup>11</sup> Case 8/74 *Procureur du Roi v Dassonville* [1974] ECR 837, para. 5: '[a]ll trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade are to be considered as measures having an effect equivalent to quantitative restrictions'.

<sup>12</sup> Case 120/78 *Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein* (*Cassis de Dijon*) [1979] ECR 649.

<sup>13</sup> Joined Cases 267 and 268/91 *Criminal Proceedings against Keck and Mithouard* [1993] ECR I-6097.

<sup>14</sup> See S. Enchelmaier, 'The awkward selling of a good idea, or a traditionalist interpretation of *Keck*' (2003) 22 *Yearbook of European Law* 249–322.

could be understood to include assessment of the facts in the light of the law.<sup>15</sup> Thus, the concrete finding that the rule on alcohol levels under consideration in *Cassis* (or a rule of that form) is in fact disproportionate, or the finding in *Keck* that selling arrangements are generally rules of equal effect, can also be seen as an interpretation of the Treaty in the particular case. On this reading, the application task left over to the national court is a mechanical, residual one. It is reduced to a primary fact-finder but with even that function limited, since certain factual questions – such as whether consumers might be confused – may be essentially redefined as questions of Community law, for the ECJ. Under such a view of interpretation, it could be said that Community law includes a degree of *a priori* fact finding.<sup>16</sup>

## THE COURT OF JUSTICE'S APPROACH

The ECJ is quite consistent in its doctrine; application is for the national court, the only one competent to assess the facts, and the legality or proportionality of the particular national measure; 'the court [has] no jurisdiction either to apply the Treaty to a specific case, or to decide upon the validity of a provision of domestic law in relation to the Treaty';<sup>17</sup> and 'it is for the national court to apply the rules of Community law, as interpreted by the Court, to an individual case. No such application is possible without a comprehensive appraisal of the facts of the case.'<sup>18</sup> Also, 'Article [234] . . . does not give the Court jurisdiction to take cognizance of the facts of the case'.<sup>19</sup> Yet at the same time, the Court will reject questions that do not provide sufficient factual information, and emphasises that it can only deal with references where the context is made very clear.<sup>20</sup> Moreover, it is well-known that it often delivers judgments

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<sup>15</sup> Cf. 'qualification' of the facts, to use Bengoetxea, MacCormick and Soriano's term: see J. Bengoetxea, N. MacCormick and L.M. Soriano, 'Integration and integrity in the legal reasoning of the European Court of Justice', in G. de Búrca and J.H.H. Weiler (eds), *op. cit.*, n. 3 above, pp. 43–86 at p. 60. They distinguish between finding fact, which is for the national court, and qualifying it, which is law, and for the ECJ. That distinction is certainly imaginable (see the next section) but it is here argued that it is neither inevitable nor fully coherent: qualification can also be seen as part of fact-finding; there are no neutral data.

<sup>16</sup> A quality it shares with medieval theology.

<sup>17</sup> Case 6/64 *Costa v Enel* [1964] ECR 585, pp. 592–3.

<sup>18</sup> Case C-320/88 *Staatssecretaris van Financiën v Shipping and Forwarding Enterprise Safe BV* [1990] ECR I-285, para. 11.

<sup>19</sup> Case 13/68 *Salgoil SpA v Ministero per il Commercio con l'Estero* [1968] ECR 453, p. 459.

<sup>20</sup> See Case 104/79 *Foglia v Novello* [1980] ECR 745 and Joined Cases C-

so specific that the case is effectively decided, in which it rules unambiguously on matters of fact.<sup>21</sup>

This does seem to disclose some flexibility of approach, which is deserving of analysis in itself.<sup>22</sup> However the examples below show what perhaps does not need to be shown; that when it wants to, the Court considers itself quite competent to engage with the facts and take a very broad view of interpretation indeed.<sup>23</sup>

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320–322/90 *Telemarsicabruzzo SpA v Circostel, Ministero delle Poste e Telecomunicazioni and Ministero della Difesa* [1993] ECR I-393., See also H. Rasmussen, ‘Remedying the crumbling EC judicial system’ (2000) vol. 37:5 *Common Market Law Review* 1071–112 at 1102.

<sup>21</sup> Apparently in more than two-thirds of references – see Rasmussen, *ibid.*, p. 1101. See also, Cohen, *op. cit.*, n. 2 above, pp. 429–30; and F. Mancini, ‘From *CILFIT* to *ERT*: The constitutional challenge facing the European Court’ (1991) 11 *Yearbook of European Law* 1–13.

<sup>22</sup> The question of consistency is not so interesting here; a power to interpret the facts does not necessarily entail an obligation so to do. However, a study of why the Court chooses to be interventionist or not in particular cases would be worthwhile (for such studies in the specific context of proportionality, see n. 39 below). One might expect three factors to influence it. Most obviously, the degree of information provided in the reference will clearly affect the extent to which the Court feels able to judge the case. However, one might also expect that ‘politics’ would play a role; how important is the case, for Community law generally and for the parties and the Member State(s), and how controversial is it? The former would argue for intervention, the latter might make a hands-off approach attractive. Lastly, one might perhaps expect that, with time, the Court would move towards more abstract interpretation. Thus, a new area of law might call for concrete (simple) answers, which serve as examples to national courts. With time, as they become more familiar with the law, the ECJ might become more comfortable with allowing the national judge greater autonomy, and so retreat to a more abstract approach. At first glance, this latter trend does not seem to be apparent; see P. Craig and G. de Búrca, *EU Law*, 3rd edn (Oxford: Oxford University Press, 2003), pp. 472–3; and H. Schermers and D. Waelbroek, *Judicial Protection in the European Union*, 6th edn (The Hague: Kluwer Law International, 2001), p. 238.

<sup>23</sup> Examples are from the internal market. Another area about which analogous arguments could be made is sex discrimination law; see S. Pager, ‘Strictness vs. discretion: The European Court of Justice’s variable vision of gender equality’ (2003) 51 *American Journal of Comparative Law* 553–608. In references concerning Member State liability for breaches of Community law, the Court tends also to the concrete: see generally P. Craig and G. de Búrca, *ibid.*; P.J.G. Kapteyn and P. Verloren van Themaat (edited and revised by L.W. Gormley), *Introduction to the Law of the European Communities*, 3rd edn (The Hague: Kluwer Law International, 1998), pp. 504–10; and J. Steiner and L. Woods, *Textbook on EC Law*, 8th edn (Oxford: Oxford University Press, 2003), p. 548.

## Free Movement

The most startling and consistent specificity comes in the application of the free movement articles, especially those governing goods. The abstract principles developed by the Court in this area are really quite simple, and could be summed up in a few paragraphs, but the considerable and growing body of case-law is mainly concerned with endless specific applications of these principles, with the deciding of a repetitive stream of formally similar cases.

The most obvious example is the case-law following *Cassis*. That case made clear that Article 28 forbade the use of national standards to exclude imports, unless those standards served some legitimate aim (i.e. were not merely protectionist or cost-saving) and their application to imports was proportionate – genuinely necessary for that aim, not going beyond what was necessary, and not resulting in disproportionately heavy disadvantages for the importer compared with the claimed benefits for the consumer or society in general. The overwhelming majority of cases on standards and product rules ever since have been requests for the ECJ to consider a particular national measure in the light of these principles. The question usually comes down to ‘is the national measure proportionate?’.

Of course, proportionality can be seen as a question of Community law, and so the determination of whether a measure is proportionate as a legitimate element of interpreting that law. There are two problems with this. One is that the ECJ has stated in terms of varying certainty that the proportionality of national measures is a question of fact, for the national court<sup>24</sup> – thereby contradicting its own practice – and the other is that this must, at least in part, be the case. Any sensible assessment of whether a measure really goes beyond what is necessary, or what its effects are, requires a good factual investigation of the type that the ECJ is neither competent nor able to perform on a reference.<sup>25</sup> If it attempts to, the result is often an answer that betrays a half-understanding of the factual situation, and yet no hesitation in drawing sweeping conclusions about it.<sup>26</sup>

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<sup>24</sup> Case C-145/88 *Torfaen Borough Council v B&Q plc* [1989] ECR I-3851, para. 16; Case C-313/94 *Fratelli Graffione v Ditta Fransa* [1996] ECR I-6039, para. 25; and Case C-405/98 *Konsumentombudsmannen (KO) v Gourmet International Products* [2001] ECR I-1795, para. 33. See also Case C-169/91 *Stoke on Trent City Council v B&Q plc* [1992] ECR I-6635; Case C-95/01 *Criminal Proceedings against Greenham and Abel* [2004] ECR I-1333; Case C-368/95 *Vereinigte Familienpress Zeitungsverlags- und vertriebs GmbH v Heinrich Bauer Verlag* [1997] ECR I-3689; and Case C-312/89 *Union départementale des syndicats CGT de l’Aisne v SIFEF Conforama, Société Arts et Meubles and Société Jima (SIFEF)* [1991] ECR I-997.

<sup>25</sup> See M. Jarvis, *Application of EC Law by National Courts: Free Movement of Goods* (Oxford: Clarendon Press, 1998), pp. 190–95 and 217–25.

<sup>26</sup> *Ibid.*, p. 192.

The clearest examples are from cases concerning consumer protection, by far the most common value to be posed against free movement in the goods context. In such cases, the Court regularly decides what will or will not cause confusion. Thus, it has decided that persons buying education material from door-to-door sellers are particularly likely to make rash or ill-considered choices, because they are likely to belong to a vulnerable group, and so a ban on such sales may be justified.<sup>27</sup> It also famously decided that the word ‘Clinique’, because of its resemblance to the German word for hospital, would confuse German consumers into thinking that the make-up products sold under this name had some medical value.<sup>28</sup> In other cases, it has decided whether consumers would be confused by a marking on a Mars bar wrapper saying ‘10% extra’,<sup>29</sup> whether a label provides sufficient protection from unduly strong or weak alcoholic drinks,<sup>30</sup> and even what the German word *bier* really means (the Court was right – but it was still not an interpretation of the Treaty).<sup>31</sup>

The fact that these cases concerned consumers does, to some extent, make them special. Much has been written on the Court’s deliberate close control of factual issues in the consumer sphere, and some reasonable policy justifications for this are provided.<sup>32</sup> Nevertheless, a high degree of control could also have been maintained by provision of carefully crafted principles. Moreover, such principles might well have been of more use to the national court, providing more guidance for future cases, than a brief and possibly unconvincing interpretation of the facts.<sup>33</sup> Several Advocates-General have tried, without obvious success, to nudge the Court in this direction.<sup>34</sup>

Other areas of free movement show a similar approach. A notable non-consumer *Cassis*-type case concerned a Danish recycling scheme.<sup>35</sup> This inevitably imposed some burdens on importers and the question was whether

<sup>27</sup> Case 382/87 *Buet v Ministère Public* [1989] ECR 1235.

<sup>28</sup> Case C-315/92 *Verband Sozialer Wettbewerb eV v Clinique Laboratoires SNC and Estée Lauder Cosmetics GmbH* [1994] ECR I-317.

<sup>29</sup> Case C-470/93 *Verein gegen Unwesen in Handel und Gewerbe Köln eV v Mars GmbH* [1995] ECR I-1923.

<sup>30</sup> Case 120/78 *Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649.

<sup>31</sup> Case 178/84 *Commission v Germany (German Beer)* [1987] ECR 1227, paras 31–34.

<sup>32</sup> See the discussion in S. Weatherill, ‘The role of the informed consumer in European Community law and policy’ (1994) 2 *Consumer Law Journal* 49–69.

<sup>33</sup> See n. 86 below.

<sup>34</sup> See for example, Advocate-General Fennelly in Case C-220/98 *Estée Lauder Cosmetics GmbH & Co. OHG v Lancaster Group GmbH* [2000] ECR I-117, para. 31 of the Opinion.

<sup>35</sup> Case 302/86 *Commission v Denmark (Danish Bottles)* [1988] ECR 4607.



the environmental aims justified this. The Court reached a view, at odds with most Danish opinion, that specific aspects of the scheme were not necessary and so disproportionate. This can be understood as a controversial balancing of free trade against environment, but it can also be seen as a controversial assessment of how the scheme worked and which aspects were central to it – the facts.

The Court has also been keen to engage with the arcania of the organisation of sport. In *Bosman*,<sup>36</sup> it enthusiastically rolled its shirt sleeves up to examine the football transfer rules. During an immensely long judgment, the Court engaged with the purposes of the transfer rules, their effects on young players and the creation of a national pool of talent, as well as their financial consequences for clubs and players, before concluding that the transfer system went beyond what was necessary for the game. It was an interpretation of that system more than of the Treaty. By contrast, in *Lehtonen*,<sup>37</sup> the Court decided that equivalent questions in the context of professional basketball were only for the national court.

In none of these contexts can it be said that the Court is unaware of the line it is treading. In numerous other cases, it has explicitly accepted that proportionality assessment is essentially factual and for the national court.<sup>38</sup> Rather, it seems to take the view that where the facts, in its view, are clear, then application and interpretation may legitimately be merged into one, and the division of functions between courts ceases to be important.<sup>39</sup>

Analogous examples could be taken from cases concerning the legitimacy of reliance on a Treaty exception. Among these, the Court has decided for itself what English law says about pornography,<sup>40</sup> and the financial effect of

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<sup>36</sup> Case C-415/93 *Union Royale Belge des Sociétés de Football Association ASBL v Bosman* [1995] ECR I-4291.

<sup>37</sup> Case C-176/96 *Lehtonen and Castors Canada Dry Namur-Braine ASBL v Fédération Royale Belge des Sociétés de Basket-ball ASBL (FRBSB)* [2000] ECR I-2681.

<sup>38</sup> See above n. 24.

<sup>39</sup> See *Stoke on Trent*, para. 14. More political factors influencing the extent to which the Court chooses to claim proportionality for itself – such as the nature of the interests at stake, political sensitivity and the importance of the question – are discussed in G. de Búrca, ‘The principle of proportionality and its application in EC law’ (1993) 13 *Yearbook of European Law* 105–50. That the ECJ in practice sees itself as having an optional competence to apply proportionality is also supported by F. Jacobs, ‘Recent developments in the principle of proportionality in European Community Law’, in E. Ellis (ed.), *The Principle of Proportionality in the Laws of Europe* (Oxford: Hart Publishing, 1999), pp. 1–21 at 19–20; T. Tridimas, ‘Proportionality in EC law: Searching for the appropriate standard of scrutiny’, also in Ellis (ed.), pp. 65–84 at 78–80; and J. Jans, ‘Proportionality revisited’ (2000) 27 *Legal Issues of Economic Integration*, 239–65 at 255–9.

<sup>40</sup> Case 34/79 *R v Henn and Darby* [1979] ECR 3795.

free movement on the Dutch health service,<sup>41</sup> as well as what UK policy toward scientologists is.<sup>42</sup> In at least two of these it was flatly wrong, and the third is endlessly debatable, an essentially economic and political question, and almost a textbook example of where the law cannot be applied rationally without extensive factual research.<sup>43</sup>

Yet the most satisfying set of cases for present purposes concerns selling arrangements. In early cases, when the Court still saw them as obstacles to movement, it had sometimes decided proportionality itself,<sup>44</sup> and at other times stated this was ‘a question of fact to be determined by the national court’.<sup>45</sup> However, that observation became almost redundant when, in *Keck*, the Court seemed to find that selling arrangements are not obstacles to movement anyway – so proportionality would not need to be considered. Yet the judgment was, to put it kindly, nuanced. The Court stated that selling arrangements fell outside Article 28 only insofar as they had an equal effect on national and imported products. This proposition suggests a fact/law, interpretation/application distinction.

The question is, who decides when there is an unequal effect? This would seem obviously to be a matter for the national court. However, in a string of cases the ECJ implicitly rejected that, concluding, despite evidence to the contrary, that there was no inequality of effect.<sup>46</sup> It seemed to be juridifying the concept, removing its empirical content.<sup>47</sup> Such a course of action is plainly at odds with the normal meaning of words – if effect is not a matter of

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<sup>41</sup> Case C-385/99 *Müller-Fauré and van Riet* [2003] ECR I-4509; and Case C-157/99 *Geraets-Smits and Peerbooms* [2001] ECR I-5473.

<sup>42</sup> Case 41/74 *Van Duyn v Home Office* [1974] ECR 1337.

<sup>43</sup> See also Case C-112/00 *Eugen Schmidberger v Austria* [2003] ECR I-5659, where despite very abstract questions from the national court the ECJ chose to assess the facts and decide a very difficult socio-political point concretely.

<sup>44</sup> See again, *Stoke on Trent*; and see also, Case C-332/89 *Criminal Proceedings against Marchandise* [1991] ECR I-1027; and Case C-312/89 *Union Départementale des Syndicats CGT de l’Aisne v SIDEF Conforama, Société Arts et Meubles and Société Jima (Conforama)* [1991] ECR I-997.

<sup>45</sup> *Torfaen*, para. 16.

<sup>46</sup> Case C-292/92 *Hünermund v Landesapothekerkammer Baden-Württemberg* [1993] ECR I-6787; Case C-391/92 *Commission v Greece* [1995] ECR I-1621; Joined Cases C-69 and C-258/93 *Punto Casa SpA v Sindaco del Comune di Capena and others* [1994] ECR I-2355; Joined Cases C-418 etc./93 *Semeraro Casa Uno and others v Sindaco del Comune di Erbusco and others* [1996] ECR I-2975. See also Case C-189/95 *Criminal Proceedings against Franzén* [1997] ECR I-5909; and Joined Cases C-34–36/95 *Konsumtombudsmannen v De Agostini and TV-Shop* [1996] ECR I-4661, showing the first signs of a softening of the approach.

<sup>47</sup> Cf. Enchelmaier, op. cit., n. 14 above.

fact, what is? – and attracted great criticism.<sup>48</sup> Then in *Gourmet* it half changed its mind, finding, following an analysis of the particular market and circumstances, that the rule in question did have an unequal effect. This clearly is not an artificial legal question. Nevertheless, the Court decided the point, rejecting the Commission's view that it was for the national court to do so – it applied the law.<sup>49</sup>

A second controversial proposition in *Keck* was that selling arrangements of equal effect do not prevent access to the market. On one level this is fairly obvious; if the effect is equal and access was prevented then it would be impossible to sell domestic goods either. Only a very select group of rules would have this consequence. However, until *Gourmet* it was not clear that equal effect was to be understood in any realistic way. Equality 'in law and fact' seemed to be fairly formalistically assessed, with equality in law dominating. In that case, this second proposition is troublesome. To find that selling arrangements generally do not prevent market access is not just a finding of fact, but one that has been criticized as being simply wrong.<sup>50</sup> Thus, while the Court maintained a formalistic interpretation of the *Keck* proviso, its view of the effects of selling arrangements could also be seen as a disastrous foray beyond the legitimate interpretation of Article 28 (as prohibiting measures that prevent market access) into applicatory fields (deciding what kind of measures those are).

In any case, all of the above are merely indicative. The important point is that building judgments around the way national rules work and their consequences, and discussing and deciding these, is the norm. There is no sense of a court whose competence is in any sense confined to the Treaty. Rather it is merely a starting point. Indeed, throughout all these cases, a particular technique often emerges. The Court does often state an abstract rule of law, but instead of stopping there, and letting the national court use this, it then proceeds to apply that rule to the facts in the next paragraph or paragraphs. It may formally use the language of hypothesis – 'a rule such as', instead of 'this rule' – but that difference is of no more than procedural significance.<sup>51</sup> In essence, it is applying the law.

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<sup>48</sup> See N. Reich, 'The November revolution of the European Court of Justice: *Keck*, *Meng* and *Audi* revisited' (1994) vol. 31:3 *Common Market Law Review* 459–92. See also S. Weatherill, 'After *Keck*: Some thoughts on how to clarify the clarification' (1996) vol. 33:5 *Common Market Law Review* 885–906; and C. Barnard, 'Fitting the remaining pieces into the goods and persons jigsaw' (2001) vol. 26:1 *European Law Review* 35–59.

<sup>49</sup> See P. Koutrakos, 'On groceries, alcohol and olive oil: More free movement of goods after *Keck*' (2001) vol. 26:4 *European Law Review* 391–407.

<sup>50</sup> See Weatherill, *op. cit.*, n. 48 above, p. 894.

<sup>51</sup> It is part of a 'formalist fiction'. To take it seriously as reflecting a division of functions would be 'slavish formalism'. Nevertheless, it is not without political importance. See Cohen, *op. cit.*, n. 2 above, pp. 422 and 433–4; cf. Snell, *op. cit.*, n. 2 above.

## Competition Law

In competition law there are a higher proportion of direct actions brought by the Commission against undertakings, in which the Court is full function i.e. it must fact-find and decide the case. One would therefore expect that judgments under such actions would be more detailed and fact-oriented than those given on a reference. In fact, such a difference is not always apparent. Whether the complaint of anti-competitive behaviour is being adjudicated before the Court itself, or before a national court, it often appears to treat its role as identical. *Bronner* is a particularly egregious example, in which there is detailed consideration of the practicalities of newspaper distribution in Austria, and highly disputable conclusions are drawn about the economics of this.<sup>52</sup> That case laid down the principle that a refusal to allow a competitor to use an ‘essential facility’ could be an abuse of dominance. The essentiality or otherwise of a facility turns on practical questions such as whether it could be replicated by the competitor. Investigation of that, one might think, is precisely what the reference procedure would leave to the national court. Not, however, in this case.<sup>53</sup>

Competition law is vulnerable to such an approach because of the increasing realisation that a sensible law of competition requires extensive economic and market analysis. Early law from the Court tended to treat matters of effect in an *a priori* way, issuing rulings on what constituted a restriction on competition that did not correspond to generally held views of the economic reality. As a result of intense criticism, both it and the Commission have gradually moved towards treating concepts such as ‘dominance’ and ‘restriction of competition’ as essentially factual – to be determined in conjunction with economists and industry experts.<sup>54</sup> This is currently widely considered to be a good thing for the quality of the regulatory regime, and so for competition and European economies. However, it does have as a consequence that one would expect a significant transfer of applicatory competence to national courts. Yet, perhaps partly because most actions begin before the Court rather than being references, and so the Commission and Court are used to competition cases

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<sup>52</sup> Case C-7/97 *Bronner v Mediaprint* [1998] ECR I-7791.

<sup>53</sup> See also, for example, Case 395/87 *Ministere Public v Tournier and Verney* [1989] ECR 2565; Case C-179/90 *Merci Convenzionali Porto di Genova v Gabrielli* [1991] ECR I-5889; Case C-18/93 *Corsica Ferries v Corpo de Piloti del Porto di Genova* [1994] ECR I-1783; and Case C-41/90 *Höfner and Elser v Macrotron GmbH* [1991] ECR I-1979.

<sup>54</sup> See A. Jones and B. Sufrin, *EC Competition Law* (Oxford: Oxford University Press, 2001), pp. 495–504; J. Faull and A. Nikpay, *The EC Law of Competition* (Oxford: Oxford University Press, 1999), chapter 1.

being centred on economic investigation, there sometimes seems to be no inclination to step back from it when the point arises on a reference.

Having said that, many competition references are answered in an abstract way, far more so than in free movement. One reason for this may be that competition cases often involve quantitative issues, and to deal with these on a reference might be impossible, and would be an extreme assumption of national competence; a step too far. It is where issues are factual, but qualitative, that the lines between competences become difficult and vague. Such situations are likely to occur where the law provides a framework for balancing values – such as in free movement and sex discrimination. Then law and fact are intertwined. Consistently with this, the Court has gone a long way towards application in competition references involving public undertakings and Article 86 EC.<sup>55</sup>

## Taxation

A similar lack of difference between direct and reference actions can be seen in the law on Article 90 EC, the prohibition of discriminatory taxation. Here there are a number of cases discussing the concepts of ‘similar products’ or ‘indirect protection’, both central concepts in that article. Similarity, according to the Court, arises from a combination of objective characteristics and consumer substitutability. In many of the direct actions this has involved looking at, for example, the manufacture of particular drinks, their content and qualities, and how they are perceived and consumed in particular countries, in order to make a finding. In the rather smaller number of actions where similarity has arisen on a reference, the judgments read very similarly, with the Court asking, and answering, presumably on the basis of the file before it, the same questions. Analogous remarks could be made about protective effect.<sup>56</sup>

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<sup>55</sup> See for example, Joined Cases C-159–60/91 *Poucet and Pistre* [1993] ECR I-637; Case C-41/90 *Höfner and Elser v Macrotron GmbH* [1991] ECR I-1979; Joined Cases C-180–84/98 *Pavlov and others v Stichting Pensioenfonds Medische Specialisten* [2000] ECR I-6451; Case C-67/96 *Albany International BV v Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I-5751; Joined Cases C-115–17/97 *Brentjens' Handelsonderneming BV v Stichting Bedrijfspensioenfonds voor de Handel in Bouwmaterialen* [1999] ECR I-6025; and Case C-219/97 *Maatschappij Drijvende Bokken v Stichting Pensioenfonds voor de Vervoer- en Havenbedrijven* [1999] ECR I-6121.

<sup>56</sup> See, for example, Case 112/84 *Humblot v Directeur des Services Fiscaux* [1985] ECR 1367; Case 433/85 *Feldain v Directeur des Services Fiscaux* [1987] ECR 3536; Case 193/85 *Cooperativa Co-Frutta Srl v Amministrazione delle Finanze dello Stato* [1987] ECR 2085; Case 140/79 *Chemical Farmaceutici SpA v DAF SpA* [1981] ECR I; Case 243/84 *John Walker v Ministeriet for Skatter* [1986] ECR 875; Case 45/75

## Common Customs Tariff

What is sometimes cited as the most spectacular example of Court specificity is the case-law concerning customs duties imposed on goods entering the Community.<sup>57</sup> This has resulted in judgments of great detail, in which the Court considers whether a soft cotton shirt with no collar, three buttons and pictures of sheep is to be seen as nightwear or leisure wear, and suchlike.<sup>58</sup> The policy surrounding this is particularly obvious; it seems clear that goods should be subject to the same duties whichever Member State they enter the Union through.<sup>59</sup> Nevertheless, this could be achieved by having particularly precise law – which to a large extent it is – and so, the argument that the Court exceeds its competence is the same here as elsewhere. An alternative approach would be to specify in the EC Treaty that all customs questions are to be dealt with exclusively by the ECJ or the Court of First Instance, avoiding the division of functions that applies elsewhere, and effectively creating a single Community customs court.

## THE DESIRE FOR UNIFORMITY

Before looking at the practical and principled problems raised by the Court's broad view, it is worth asking why it acts as it does.<sup>60</sup> What are the reasons for

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*Rewe-Zentrale des Lebensmittel-Großhandels GmbH v Hauptzollamt Landau/Pfalz* [1976] ECR 181; and Case 216/81 *COGIS v Amministrazione delle Finanze dello Stato* [1982] ECR 2701.

<sup>57</sup> See H. Schermers and D. Waelbroek, *Judicial Protection in the European Union*, op. cit., n. 22 above, p. 238.

<sup>58</sup> A quick survey of case-law under the heading 'Common Customs Tariff' reveals an abundance of examples. Simply to give a flavour, see Case C-276/00 *Turbon International v Oberfinanzdirektion Koblenz* [2002] ECR I-1389 and Case C-259/00 *Biochem v Oberfinanzdirektion Nürnberg* [2002] ECR I-2461. See also, the cases cited in Schermers and Waelbroek, op. cit., n. 22 above.

<sup>59</sup> Which has caused one Advocate General to urge the Court – with success – not to feel nervous of the division of functions between courts and simply decide the case, such is the importance of customs uniformity, see Case 40/69 *Hauptzollamt Hamburg-Oberelbe v Bollman* [1970] ECR 69, pp. 80 (Court of Justice) and 85–8 (Advocate-General). See also, Schermers and Waelbroek, op. cit., n. 22 above.

<sup>60</sup> Cf. Snell, art. cit., n. 2 above. He makes two additional points, not discussed in the text above: (1) that it is too difficult to formulate abstract judgments, at least in early cases – courts need time to feel their way to the principle (p. 190) – and (2) that the absence of dissenting judgments creates a need for consensus among all the judges, and this is much easier to reach on the result, and on a factual analysis, than on the underlying principle. Both are fair points, but it is suggested they do not carry enough weight to change the conclusions reached here.

folding application into interpretation and giving the Court control over both? There is a general argument about the nature of the Court to be made, which is worth sketching to provide a framework, an argument about the Court's role in the legal system, and then two more specific and legal arguments about preliminary references.

The general argument begins with Article 7 EC, which entrusts the Court, along with the other Community institutions, with the purposes of the Community. This creates an unusual situation for a court; rather than being a neutral arbiter between Community and Member States, as for example the American Supreme Court is between the Federal Government and the states, it is clearly encouraged to take sides. This is a sensitive point – one must be careful not to make unjustified accusations of bias – but it may well be fair to say that the Court does not conceive of itself in terms entirely analogous in their neutrality to its national equivalents. It does accept, to some extent, the Community mission, and that does influence its approach to the law.

Perhaps that is unfair; one could argue that all courts are partly entrusted with policy, in that they are entrusted with enforcing the laws designed to implement those policies. There is no strangeness in Article 7 EC. Yet there does seem to be a difference in emphasis. The High Court, when it enforces the Financial Services Act, is achieving government policy in that area, but it would probably not imagine its obligation to that policy to go beyond the law, but rather to be entailed in it. It begins with the text, albeit that it may interpret that in the light of the policy. By contrast, the ECJ seems to begin with the policy goals, and then see what it can do with – or sometimes without – the text to achieve them.<sup>61</sup> In that light, the approach to preliminary references can be seen as just another example of purposive interpretation. The Court has licence to do whatever is necessary.

Such a licence might even justify an attempt to reform the whole legal system. It is sometimes argued that this is what the ECJ is trying to do. By intervening to a high degree in national cases, and giving full answers to questions, it is trying to break out of the limited reference procedure and recast itself in the mould of an appeal court, with full competence to decide the case. This move goes in parallel with the limiting of other, non-reference, means of access, notably the narrow interpretation of individual concern to challenge Community acts.<sup>62</sup> The ultimate destination is then a single path to a full-function Court, and its inauguration as the supreme court of Europe – at least where Community law is involved.

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<sup>61</sup> See Brown and Kennedy, *op. cit.*, n. 10 above, p. 344, and Sir Patrick Neill, quoted therein, p. 322.

<sup>62</sup> Cf. H. Schepel and E. Blankenburg, 'Mobilizing the European Court of Justice', in de Búrca and Weiler (eds), *op. cit.*, n. 3 above, pp. 9–42, p. 31.

This would be analogous to the role of the Federal Supreme Court in the US. The weakness of the argument is that many would see the Court as having that status already. On the other hand, clearly it could be seen – as this chapter argues – as having a more limited function, and if that is not the prevailing view, then perhaps that is an indication of the success of its expansionist strategy.

The specific arguments suggest why a broad approach could be seen as necessary. The least convincing of these can be dealt with shortly. It locates the explanation for the cases above in the way questions are asked. They tend to be phrased very concretely and so, it can be argued, call for concrete answers. Defenders of the Court point out that ‘national judges expect an answer to their question’, and the co-operative relationship demands that it be given. This is unconvincing. If the Court provides abstract rules and tells national judges to work with them, there seems little reason to think they will not do so; it is, after all, the function of a judge to apply rules, and there is no reason to doubt their capacity to do this. If, on the other hand, the Court, in its answers, also considers the facts of the case to an extent that essentially determines the outcome, then the clear message is that such consideration falls within its task, and so national judges will, correctly, continue to refer each new set of facts to the Court. While national judges could break out of this spiral by a robust determination themselves of what is interpretation and what is application, this question itself is perhaps also one of interpretation, so that correctly, if the activities of the Court are to be confined, it is for the Court itself to make that clear; it cannot then blame national courts and their questions for the concreteness of its judgments.<sup>63</sup>

Indeed, there is no indication that it is unhappy with such concreteness, or is seeking to train national courts away from it.<sup>64</sup> The Court has even ruled that questions are not acceptable where they do not contain sufficient factual background to enable it to assess the question in context. It has also ruled that it will not answer hypothetical questions, and Advocates-General have urged it not to answer questions where the Community law in point is being applied outside of a Community law context – for example, where national law and Community law use identical terms, and for the sake of a consistent interpretation the national judge wants to know what the Community law rule would

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<sup>63</sup> Although, see Arnall’s implicit point that an insensitive response to references could drive national courts to stop sending them; A. Arnall, ‘The past and future of the preliminary rulings procedure’ (2002) vol. 13:3 *European Business Law Review*, 183–91 at 185.

<sup>64</sup> A trend towards more concreteness is identified by several writers: see Schermers and Waelbroek, *op. cit.*, n. 22 above, p. 239; and Craig and de Búrca, *op. cit.*, n. 22 above, p. 378.



mean. The theme in all these situations is that a question can only be assessed and answered in its full factual context, which is clearly only the case if the answer is to some extent dependent upon those facts.<sup>65</sup> It may be said that the Court sees its function as giving an interpretation of the facts in the light of the Treaty, rather than just an interpretation of the Treaty itself.<sup>66</sup>

A much more important reason – indeed the determining factor in the use of Article 234 – is the well-known desire of the Court to achieve uniformity of Community law.<sup>67</sup> Abstract interpretations leave more room to the national court, and so create the risk that cases will be decided differently both from how the Court itself would do so, but also from court to court, or Member State to Member State.<sup>68</sup>

This is certainly a real possibility. Yet from another perspective, the uniformity argument is very problematic. On the one hand, it must be doubtful whether marginalising the function of national courts is the right way to induce them to use Community law properly. In any case, even if they assent to centralisation of the assessment of facts, can the ECJ really cope with the work? On the other hand, arguments for and against limiting the freedom of individual judges to interpret and apply the law in the case before them bring to the fore the different legal traditions of the Member States, and raise the question of whether Community law is more common or civil, and whether blending these two risks a loss of coherence. These two matters are the subject of the next two sections.

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<sup>65</sup> K. Lenaerts, ‘Form and substance of the preliminary rulings procedure’, in D. Curtin and T. Heukels (eds), *Institutional Dynamics of European Integration* (Dordrecht: Martinus Nijhoff, 1994), vol. II, 355–80, p. 358; and G. Bebr, *Development of Judicial Control of the European Communities* (Dordrecht: Martinus Nijhoff, 1981), p. 432.

<sup>66</sup> See Bengoetxea, MacCormick and Soriano, *op. cit.*, n. 15 above.

<sup>67</sup> See for example, Case 66/80 *International Chemical Corporation v Amministrazione delle Finanze dello Stato* [1981] ECR 1191.

<sup>68</sup> See T. Tridimas, ‘Knocking on heaven’s door: Fragmentation, efficiency and defiance in the preliminary reference procedure’ (2004) vol. 40:1 *Common Market Law Review*, 9–50 at 24. A particularly good example of this risk is Case C-109/01 *Secretary of State for the Home Department v Akrich* [2003] ECR I-9607. Here, the Court found that Article 10 of Regulation 1612/68 (OJ 1968 English Special Edition L257/2, p. 475) could not be used to bring third country spouses into the EU, but only to take them from Member State to Member State. However, if they had already been living as the spouse of migrant worker within a Member State, then even though that may have been without legal basis, it could be contrary to Article 8 ECHR (the right to a family life) to deport them. This leaves the national court then to decide whether the absence of a legal right to residence is outweighed in the individual case by human rights considerations based on accumulated *de facto* residence. Clearly, results of such a balancing process will vary widely. However, this is best seen as a result of the open and imprecise nature of human rights norms, rather than of a failure by the Court to provide sufficient guidance.

## CONSEQUENCES: CENTRALISATION, ALIENATION AND JUDICIAL OVERLOAD

If interpretation includes assessing the facts, then any new fact set can be seen as requiring an interpretation of the EC Treaty. The idea that most new fact sets merely require an application of existing interpretations is sidelined. Thus, the number of potential references is hardly less than the number of potential cases where Community law is relevant.<sup>69</sup> The potentially negative consequences for the workload of the ECJ are obvious. It is surprising in this context that so much energy has been devoted to solving the problem of the Court's slowness via structural rearrangements, while it seems clear that almost no structure will enable it to cope so long as it maintains such a broad view of its competence. Indeed, if there are now considerably fewer references than there are cases concerning Community law, that is to a large extent because lower courts have a discretion to refer, and exercise that discretion with an eye on cost and time – so that the more efficient the court system, the greater the reluctance that one might expect to refer, leading perhaps to a new non-uniformity of Community law because of the differing degrees of participation of the Court in the national caseload.<sup>70</sup> If, in the future, the ECJ were to become able to deal with cases quickly (as a result of one of the structural improvements so often discussed), then one could probably expect the number of references to increase until the system was once again flooded. It seems very unlikely that the Court can ever escape overwork as long as it maintains such a universal potential role.<sup>71</sup>

Moreover, the references that do come are likely to be of little general interest – just repetitions of analytically familiar situations, solved without interesting reference to general principles.<sup>72</sup> Thus, the Court's capacity to provide a unifying framework for the law is diminished. As well as this, each reference

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<sup>69</sup> See Rasmussen, art. cit., n. 20 above, at 1108; see also, the Opinion of Advocate-General Jacobs in Case C-338/95 *Wiener S.I. GmbH v Hauptzollamt Emmerich* [1997] ECR I-6495.

<sup>70</sup> See Tridimas, art. cit., n. 68 above, at 17 and 37–38.

<sup>71</sup> Cf. the discussion of intensity of review as a tool for controlling workload, strict review operating as an intimidatory factor reducing references in P. Craig, 'Community Court jurisdiction revisited', in de Búrca and Weiler (eds), op. cit., n. 3 above, pp. 177–214, pp. 187–8.

<sup>72</sup> Perhaps this will change now that the Court's rules of procedure allow it to give a (quicker and simpler) reasoned order where the answer to a reference 'may be clearly deduced from existing case-law' (Article 104(3) of the Rules of Procedure of the Court of Justice, OJ 2003 C193/1). However, that seems unlikely, since the Court's fascination with factual detail will probably lead it to focus on the uniqueness of each fact set, rather than the analytic familiarity of the problem.

is clumsier and slower because dealing with it requires a much closer engagement with the facts, which the Court may not handle well.<sup>73</sup>

The question also arises of when exactly national courts should refer. In the case of courts of last instance this is reasonably clear, but in the case of lower courts, is the discretion absolute? Also, is that discretion to be exercised purely in the light of practical factors (cost and time) or is the difficulty of the point of Community law also something that must, as a matter of Community law, be taken in to account? In other words, are lower national courts allowed, or encouraged, to interpret Community law themselves, or should they only not refer when the case calls for no more than a mechanical application of existing interpretations?<sup>74</sup>

Clearly they do – and may – interpret to a considerable extent themselves. Indeed it is this very fact which makes it necessary to make references by final courts compulsory,<sup>75</sup> although this does create the paradoxical situation that courts of last instance are never allowed to use Community law in any creative or intelligent way, referring everything that is not blindingly obvious,<sup>76</sup> while lower courts have in fact much wider Community law interpretative powers. Yet at the same time it seems implicit in the organisation of the system that there is an interpretative quasi-monopoly in the hands of the ECJ. The emphasis on uniformity of outcome, and the purpose of the reference procedure as an aid to this, is only coherent if the idea is that interpretation is in fact centrally controlled.

An additional argument in this direction arises from *CILFIT*,<sup>77</sup> in which the Court can be understood as stating that there are no clear points – thus impli-

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<sup>73</sup> See Case C-206/01 *Arsenal Football Club plc v Reed* [2002] ECR I-10273, noted by A. Arnall (2003) vol. 40:3 *Common Market Law Review* 753–69 and G. Davies (2003) vol. 28:3 *European Law Review* 408–17; see also, Jarvis, op. cit., n. 25 above, pp. 192–5.

<sup>74</sup> For examples of the UK approach, see Lord Denning in *Bulmer v Bollinger* [1974] 2 WLR 202 (criticised in F. Jacobs, ‘When to refer to the European Court’ (1974) 90 *Law Quarterly Review*, 486–93 at 492) and Sir Thomas Bingham MR in *R. v International Stock Exchange ex parte Else* [1993] QB 534, all discussed in Craig and de Búrca, op. cit., n. 23 above, pp. 453–7. The irony is that this national court discussion of when a court should refer is, in itself, an interpretation of Article 234 that really merits a reference. Existing court judgments on discretion to refer have been in the context of a decision *to* refer, rather than *not to*. Although the statements affirm lower court freedom, that context is importantly different. See, for example, Case C-127/92 *Enderby v Frenchay Health Authority* [1993] ECR I-5535.

<sup>75</sup> Article 234 EC provides that while lower courts may, final courts *must* refer questions of Community law.

<sup>76</sup> Case 283/81 *CILFIT v Ministero della Sanità* [1982] ECR 3415, para. 16.

<sup>77</sup> *Ibid.*

citly all should be referred.<sup>78</sup> This has been softened, or at least put in a more relaxed way, by *Köbler*,<sup>79</sup> where the Court found there was no need for a court of last instance to refer where the point was ‘clear from the settled case-law of the Court’.<sup>80</sup> Yet this also reaffirms the fundamental principle that final courts should not be interpreting themselves, but only applying what the Court has already decided. On the other hand, the Court also found in *Köbler* that even erroneous decisions of national final courts are protected by *res judicata*, and while damages may be awarded if the errors of law are manifest, the Court’s interpretation of that concept was narrow. The judgment as a whole almost seems like a nod and a wink to supreme courts, telling them that while they must refer, if they do follow an errant path then, so long as they are not too blatant, they will be allowed to get away with it; their judgments will remain in force, and damages are unlikely.<sup>81</sup>

Thus national court interpretations of Community law, while sometimes creative and purposive, take place in a grey area of semi-legitimacy, a sort of tolerated but not approved practice, where the assumption seems to be that ultimately any point of law will make its way to the ECJ. Moreover, national final courts have, in principle, no interpretative competence at all.<sup>82</sup> This creates a difficult situation for the national judge. He has no obligation to refer and, if he chooses not to, must then use Community law as intelligently as any other law, interpreting as necessary. However, he is also aware that his authority to do so is ambiguous. This must create an uncomfortable relationship with the law, which is likely to resolve itself either into defiance,<sup>83</sup> which may well

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<sup>78</sup> Rasmussen, art. cit., n. 20 above, at 1092–93, but cf. Tridimas, art. cit., n. 68 above, at 42–44. See also, A. Arnulf, ‘The use and abuse of Article 177’ (1989) vol. 52:5 *Modern Law Review*, 622–39 at 626, where he argues that ‘the over-all effect of *CILFIT* would be to encourage national courts to decide points of Community law for themselves. This could only jeopardise the uniform application of the Treaty.’

<sup>79</sup> Case C-224/01 *Köbler v Republik Österreich* [2003] ECR I-10239.

<sup>80</sup> *Ibid.*, para. 118.

<sup>81</sup> However, see Case C-453/00 *Kühne & Heitz NV v Produktschap voor Pluimvee en Eieren* [2004] ECR I-837. If the national procedure allows for re-opening of judgments, for example in the light of new facts, then inconsistency with subsequent jurisprudence of the ECJ will also be a reason to do so. The reasons for re-opening cases were thus extended by the Court, in a way that some Dutch lawyers considered to undermine legal certainty. This case shows the danger of last courts not referring.

<sup>82</sup> See Cohen, art. cit., n. 2 above, at 438–44. Hence, perhaps, according to Brown and Kennedy, higher national courts cannot bind lower courts on points of Community law (op. cit., n. 10 above, pp. 379–81).

<sup>83</sup> Cf. Weiler’s discussion of the ‘compliance pull’ resulting from formally allowing national courts to decide cases in J.H.H. Weiler, ‘Journey to an unknown destination: A retrospective and prospective of the European Court of Justice in the arena of political integration’ (1993) vol. 31:4 *Journal of Common Market Studies* 417–46 at 422.

lead to anti-Court interpretations, or a mechanical and unimaginative use of the law out of fear of crossing boundaries, which is bad justice, or in fact a reluctant referral of every point despite the cost and time involved. In other words, national courts are alienated from Community law and inhibited from good use of it. Nor do they have the chance to have their interpretations approved or disapproved; the ECJ does not examine prior national judgments in detail as a court of appeal would, so that there is no chance for them to build up a body of approved expertise in this way. They are, as has been noted, emasculated and infantilised.<sup>84</sup>

This problem is exacerbated by the purposive nature of Community law. Using it correctly often requires a far more activist approach than that with which national judges are familiar. In particular, proportionality assessments involve second guessing the legislator on the desirability and necessity of national measures, something with which the ECJ is comfortable, but more conventional courts are not. Hence the evidence seems to be that national courts apply proportionality in disparate and often unsatisfactory ways, being generally less critical of national measures than the ECJ is or would be.<sup>85</sup> This could be seen as an argument for the Court's approach, showing that if it does not decide all cases uniformly is threatened (although in fact there could well be a fairly uniform approach throughout the Community – just a less Community-oriented one). However it can equally be seen as a result of that approach. By deciding each case in a common law way, on the facts, without principled explanation of what it is doing, the Court minimises the general usefulness of its judgments. It issues endless decrees that this measure is necessary and proportionate while that one is not, without explicitly unpacking its legal process to any extent. It does not, in short, explain in any detail exactly what proportionality is, and how it should be applied, beyond the basic three steps that every textbook contains. An abstract filling in of what is to be understood by 'necessity' or third-stage 'proportionality' (and the processes that a national judge should go through to discover these) is precisely the sort of thing that could be seen as interpreting the Treaty and would be of great use to national judges that are not prepared simply to replace the legislators' assessment of what needs to be done in a particular aim with their own, but who would be prepared to follow a clearly defined and more law-like set of steps to review legislation.<sup>86</sup>

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<sup>84</sup> See P. Allott, 'Preliminary rulings: another infant disease' (2000) vol. 25:5 *European Law Review* 538–47 at 542; Rasmussen, art. cit., n. 20 above, at 1092; F. Mancini, 'The making of a constitution for Europe' (1989) vol. 26:3 *Common Market Law Review* 595–614 at 606 (noting the infantilisation, but approving it). See also Cohen, art. cit., n. 2 above, at 438.

<sup>85</sup> Jarvis, op. cit., n. 25 above, pp. 220–21.

<sup>86</sup> See Jarvis, op. cit., n. 25 above, pp. 206–7; Koutrakos, art. cit., n. 49 above,

What this indicates is that the crossing of the boundaries of interpretation is not merely a usurping of the national court's function, but also undermines the ECJ's own. By becoming concrete, it fails to be general, and so does not give the guidance for which it is employed. It is the difference between, as the adage would have it, giving a fish, and teaching to fish.<sup>87</sup>

## CULTURAL ORIGINS

A picture of the reference procedure in purely pragmatic colours misses much. It, and the way the Court views it, are products of the practices and ideologies of the Member States. Looking through the lens of the civil law and the common law, as well as a comparison of the procedure with national cassation, casts a gently illuminating light, not so much providing solutions to problems as highlighting the background to them.

The discussions below are not intended to represent the views of typical continental or UK (or Irish) lawyers. There must be few individuals, and there are certainly no systems, that are pure embodiments of the doctrine they hold most dear. Rather, the common law and civil law have been merging and converging for centuries. Yet in all the resulting mixtures two sources of dogma can be identified, two concepts of the law and its function, and these idealised philosophies continue to be important in the explanations and justifications of each system. Considering the preliminary reference procedure from these perspectives, while it may not correspond to actual opinions held, may still help to indicate how the streams of the common and civil law have come to reach a new and unique blend in the law of the Community.

### **A Civil Law View**

Law and judgments are quite clearly separate in civil law doctrine, and the uniformity of law consists in the application of identical abstract rules in all courts. The interpretation and application of that law is decentralised to individual judges, who do not formally allow themselves to be influenced by how other judges are deciding similar cases.<sup>88</sup> Indeed, to do so could be seen as at odds with the idea of judicial independence. Yet that autonomous interpretation

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at 402; J. Snell, 'True proportionality and free movement of goods and services' (2000) vol. 11:1 *European Business Law Review* 50–57 at 55.

<sup>87</sup> 'Give a man a fish and you feed him for a day. Teach him to fish and you feed him for a lifetime' (traditional).

<sup>88</sup> See Brown and Kennedy, *op. cit.*, n. 10 above, pp. 368–9.

and application is not seen as threatening the uniformity of the law – since judgments are not law. The risk of unequal application of the law is minimised by appeals, and by a common training process for judges. A significant amount of the legitimacy of most civil law derives from acceptance of the institutions of the legal process.<sup>89</sup>

A classical civil lawyer would not then see any risk to the uniformity of Community law in allowing national courts to apply it freely, and insofar as he was concerned by differing outcomes, he might look to a solution found in common educational processes – something that has a considerable academic following on the continent. He would be trying to create a common conceptual framework in the minds of lawyers, a common dogmatic system. His underlying vision is of law as abstract propositions, which might well lead to a view of its understanding and interpretation as a process of restatement in other, also abstract, terms. Then he would be inclined to see the ECJ as often doing far more than merely interpret.

Yet the civil lawyer would come across a troubling paradox if this were not the case. If the ECJ were to provide abstract interpretations, then it would become a legislator. This follows because its answers are, necessarily (if the Article 234 EC procedure is not to be comical), binding in the case. However, if its statements are general, then obviously they represent generally applicable propositions<sup>90</sup> and, given their binding nature, are essentially new laws.<sup>91</sup> The function of the Court would then be to lay down new rules within the limits of the Treaty, a function that is analytically indistinguishable from that of a legislator which lays down new rules within the function of a constitution or rules of procedure. The only difference may lie in the tightness of those constraints but, in fact, as is well known, and as a glance at the language of the Treaty will show, the constraints imposed on the freedom of the ECJ are, at most, not uncomfortably tight. In fact, in the sense that the Treaty gives the ECJ the monopoly on interpreting what its own powers of interpretation are, it is considerably freer than most traditional legislators.

Yet the concept of the court as rule-maker is one that is most alien and repugnant to civil law systems. The more civil they are, the more they hold fast to the doctrine that a court merely decides a case, it does not lay down new

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<sup>89</sup> See Lasser, *op. cit.*, n. 3 above, pp. 16–22.

<sup>90</sup> See Cohen, *art. cit.*, n. 2 above, at 434–45.

<sup>91</sup> ‘Abstract precedents’ perhaps. See Snell, *art. cit.*, n. 2 above, at 192. See generally on the Court and precedent, Brown and Kennedy, *op. cit.*, n. 10 above, pp. 369–81; Craig and de Búrca, *op. cit.*, n. 23 above, pp. 439–45; Cohen, *art. cit.*, n. 2 above, at 434–48; A. Toth, ‘The authority of judgments of the European Court of Justice: Binding force and legal effects’ (1984) 4 *Yearbook of European Law* 1–77.

rules.<sup>92</sup> A purely interpretative function, where interpretation is understood abstractly, must be abhorrent to the civil law. Thus, the paradox is that if Community law is to be seen as following in the civil law tradition, guided by its principles, and thus conceiving of law as abstract, then it is also alien to the civil law, because it makes its courts into legislators.<sup>93</sup>

There are two ways out. One is just to shrug and accept that Community law is civil only in parts – although given the value placed on overall coherence in civil law systems, ‘partly civil’ is almost as troublesome a concept as ‘fairly unique’. Another is to ask whether the act of measuring facts against legal principles can also be seen as interpretation of those principles. If that is the case, then the meaning of the law (for interpretation is surely about discovering meaning) lies in the results of specific cases; but that is a reasonable working definition of the common law.

### **A Common Law View**

The common law lawyer should, therefore, be the most comfortable with the ECJ. His traditional view, no doubted rooted in the bog of Anglo-Saxon common sense, that abstract rules determine nothing, and the law is only discovered by looking at what has been decided in individual cases, and proceeding by analogy therefrom (the inductive approach), will lead him to consider that the only sensible and meaningful way of interpreting a Treaty is simply to use it; to look at each case on its merits, make a decision, and leave posterity and lawyers to pronounce the principles which, with time, will surely emerge. Accordingly, one might expect little criticism of the court’s methodology in English literature, and little there has been.

However, the common lawyer should still be unhappy with the division of functions, because his conception of interpretation is that it *is* application; the

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<sup>92</sup> See Lasser, *op. cit.*, n. 3 above, pp. 14–15; Brown and Kennedy, *op. cit.*, n. 10 above, p. 368; Snell, *art. cit.*, n. 2 above, at 192.

<sup>93</sup> Very civil countries, such as France, avoid this problem by having their higher courts give effectively yes/no answers, without argument or principle other than restatement of legislation. This may seem like an unfair description to the civil lawyer, but is very much how it looks to the outsider. However, the problem with this approach is that it does not translate; the only accountability a court experiences is through scrutiny of its judgments, and thus they must be complete and persuasive. Brief, formal judgments can only be democratically acceptable in a context where the court is seen as having such a high level of inherent legitimacy, and experiences such total public trust, that it does not have to explain its actions. This may be achievable in a tightly coherent society with a strong republican tradition of respect for institutions, but is not achievable in the less homogenous Community; see Lasser, *op. cit.*, n. 3 above, for fuller discussion of this.



division of the two is precisely what he, if true to his stereotype, will reject as foreign and wrong.<sup>94</sup> For him, Article 234 EC, at least as interpreted by the Court, is incoherent. He is happy with the practice, but not the principle behind it.

For the common lawyer the issue is really one of quality. He wants a precedent, which requires a judgment containing a fully argued analysis of the facts. When the Court provides one of its simplistic descriptions of the effects of a measure on competition or free movement, it fails to give that. From his perspective it just looks like a second-rate court.<sup>95</sup>

Thus he will be in a state of permanent frustration, and more than his civil law colleague will feel that Community law is permanently unclear, or in a mess. He is, therefore, likely to be a rich source of references. Given the lack of detail in ECJ judgments, he is likely to find again and again that there is insufficient precedent to decide his case. Of course, he may find the national court interpretation acceptable, but he will rarely find a reference inappropriate. Whereas his civil law colleague may really wonder what the merit is in asking for yet another repetition of the same old principles, the common lawyer will see the uniqueness of his set of facts, and thus the potential of a new question for the Court. The common lawyer, if the same robust sense that gave him the common law did not also incline him to a respect for considerations of cost and time, could be a dangerously rich source of workload.

### Comparing with Domestic Reference Procedures

Blurring law and fact is not unique to Community law. It occurs to varying extents in national reference systems as well, despite their adherence to a similar interpretation/application division of functions. Yet the problems arising seem to be somewhat less, to judge by the stability and wide acceptance of those systems. Although the structure has been transplanted, it looks as if the new context makes different demands, and there are features of the Community system which impose stresses that do not arise nationally.<sup>96</sup>

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<sup>94</sup> 'It is as clear as legal history can make it that interpretation apart from judicial application is impracticable; that it is futile to attempt to separate the functions of finding the law, interpreting the law and applying the law.' R. Pound, *The Spirit of the Common Law* (Boston: Marshall Jones, 1921), p. 179.

<sup>95</sup> According to Brown and Kennedy, a particular complaint of common lawyers, accustomed to an adversarial system, is that the Court frequently adjudicates on points that were not argued before it (op. cit., n. 10 above, pp. 402–3). If so, that will no doubt only reduce the quality of judgment of such matters. See also, Lasser, op. cit., n. 3 above, pp. 52–5.

<sup>96</sup> Also political and organisational features; see Lasser, op. cit., n. 3 above, pp. 36–8 and 47.

One of these is the lack of competence of the ECJ to interpret national law.<sup>97</sup> An important difference between similar national procedures and the Community one is that the national court of cassation or constitutional review will be competent to interpret all aspects of the law before it. Where a statute may conflict with the constitution, it is competent to determine authoritatively what the constitution requires, but also what the statute means. By contrast, the ECJ does not have competence to interpret national law. If the question referred to it concerns a possible conflict between national and Community measures, it must – or should – accept the national court’s assessment of what the national law says and means. This follows partly from attribution; the Treaty allows the ECJ to interpret the Treaty, but says nothing about it interpreting conflicting national measures. It is also a matter of common sense. Context is important to interpretation and given the diversity of legal systems in the Community, the most authoritative view on what national law says and entails must come from the courts of the system where it resides. The ECJ lacks the relevant experience and knowledge to come to an adequate assessment. So unlike the national context, which enables legal points to be fully handled by the higher court – and so also allows for the highly specific and terse judgments of the French courts, which avoid the problem of legislating through abstract answers<sup>98</sup> – the Community system makes the answering of questions of Community law a co-operative venture, in which the resources of the courts on both sides of the reference are necessary.

Another factor is that national systems all have some form of docket control in place, which prevents reference becoming an unreasonable centralisation of decision-making.<sup>99</sup> In some cases, such as with the German Constitutional Court, only questions of a certain type, constitutional questions, are referred. Most court cases do not involve constitutional issues, and so this narrows the range of possible references. By contrast, while Community law can certainly be compared with an emerging constitution in academic argument, it is far more broad-ranging than most constitutions, now embracing issues of trade, social policy and even crime, often on a detailed and technical level. Referring points of Community law entails referring points from a far greater spread of domestic legal actions. When one considers that the source group for references is the whole community, and thus far greater than within a single nation, it is apparent that the demands made on a constitutional court with a reference

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<sup>97</sup> *Information note on references by national courts for preliminary rulings*, issued by the Court, at paragraph 3, available at <http://curia.eu.int/en/instit/txtdocfr/autrestxts/txt8.pdf>; see also, Case 75/63 *Hoekstra v Bestuur der Bedrijfsvereniging voor Detailhandel en Ambachten* [1964] ECR 177.

<sup>98</sup> See n. 93 above.

<sup>99</sup> See Snell, art. cit., n. 2 above, pp. 184–5.

procedure are not comparable to those potentially made on the Community court.

Other systems, such as the Dutch and French, use cassation for appeals on any point of law, thus do have the broad range of reference. However, they do this on appeal, so that there is already a judgment in place.<sup>100</sup> This must reduce the impetus to go to cassation. Not only does the presence of a judgment give a certain finality – most cases are not appealed; most judges are right most of the time – but this tendency is reinforced by the fact that the national judge in interpreting national law has an authority that the national judge interpreting Community law does not. Even if a national court has issued a judgment, and the question of a reference comes up during an appeal against that, so that the reference can be seen as essentially an appeal against the earlier national interpretation of Community law, the motivation for such a reference is greater than the motivation to an equivalent appeal to a national court of cassation on a point of national law, in proportion to the extent that national judges are seen to be masters of national law more than of Community law. Their view simply does not count for as much in the Community law context – and, it is suggested, they are more likely to be wrong.

Finally, the need for clear divisions of function in the national processes is not as great as within the Community system, not merely for functional reasons but also for political ones. Who assesses and interprets the facts, the lower court or the court of cassation or review, is neither a question of subsidiarity, politics nor national autonomy when the procedure is domestic. There is no question of local legal culture and practice being misunderstood, nor of foreign values being imposed. In short, all the reasons which led to the need for division of functions in the Community context are absent.

### **The Community Blend**

Although structurally the Court owes most to French law, it has never adopted the very abbreviated style characteristic of higher courts in that system.<sup>101</sup> Rather, for understandable reasons, it has chosen to adopt a relatively discursive, explanatory, educatory style, to create precedents and examples, and to root law in fact and outcome rather than abstractions. This is part of an attempt to create the certainty and consistency and clarity that is the strength of common law/precedential systems. It also allows the incremental, reactive change that is another of their virtues.

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<sup>100</sup> *Ibid.*, especially the point that a decision on cassation is easier than one on a reference, because much of the work of factual analysis and organisation is already done in the lower court's judgment.

<sup>101</sup> Lasser, *op. cit.*, n. 3 above, p. 36; and see n. 93 above.

Yet the common law is also unwieldy and labour intensive. It works because it is a collective enterprise, in which courts at all levels share the task of developing the law, and there is a multi-directional, constant dialogue between them all, through precedent and the art of distinguishing. This multipolarity gives it its organic, evolutionary and incremental character, and provides the manpower to build up the dense network of implicit rules that are its key.

One court cannot do all that, and should not do all that. The common law spirit demands more dialogue and response. In the Community context we may call it subsidiarity, but if law is to be made by courts then national courts must also have a role in the development of the whole. It is the Court's failure to develop a conceptual framework that allows this, while still preserving its role as the unifying force that any supreme court must be, that stops Community law either taking root, or developing the richness of jurisprudence that it might. It denies others a role, without being able fully to fill that gap itself.

## REGULATORY COMPETITION BETWEEN LEGAL SYSTEMS

The parallel between the judicial division of competences and the analogous division in positive law-making is striking. Also there, the Community interprets its own competences almost open-endedly. It is not that it leaves nothing to the Member States, but that their activities are conditional; there is no guarantee that the Community will not act in the same sphere, and take precedence.<sup>102</sup> Thus, in reality, almost all competences are shared. This is strikingly evidenced in the proposed constitution where, after some doctrinal wrangling, it was realised that the internal market could only be seen as a shared competence.<sup>103</sup> Yet the internal market is itself hardly well defined, touching on almost every area of life.

In the judicial sphere it is perhaps harder for the Community to invade national powers. The national court initiates and so in a sense is the master of the reference procedure, and also of the case in which it takes place. The ECJ

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<sup>102</sup> Leading to the possibility of spreading Community powers. Dashwood comments that 'we have to rely on the Court of Justice to hold the line' (A. Dashwood, 'The Limits of European Community Powers' (1996) vol. 21:2 *European Law Review* 113–28, n. 27 and accompanying text). See also, S. Weatherill, *op. cit.*, n. 6 above and G. Davies, *art. cit.*, n. 5 above.

<sup>103</sup> See Article 13 of the Draft Treaty establishing a Constitution for Europe, OJ 2003 C169/1.

is not in a position directly to prevent this; ultimately national courts could always fight back. Yet courts are obedient, and one cannot expect a duel. In practice, if the Court defines away the national court role in Community law, it is likely to achieve this result.

This disturbs the broader functioning of the Community and the internal market. Even though the desire of the Community not to limit itself is consistent with its purposive and changing nature, and ambiguity has been a traditional and sometimes constructive tool in the integration process,<sup>104</sup> the uncertainty it causes also functions to inhibit the creativity and dynamism of the Member States, and so ultimately of the Community itself. Centralisation is not good resource management.

In the jargon of the time, the consistent tension is between regulatory competition, subsidiarity and the virtues of local democracy, on the one side, and uniformity on the other.<sup>105</sup> Obviously a balance is necessary. However, to achieve this balance a degree of protection of the more vulnerable national level is necessary. That means, in this context, a principled division of functions between courts. At the moment, local autonomy is a refugee, without legal home. National courts have no intelligent part to play in Community law. Yet given the low standard of much of the ECJ's self-expression (no doubt a language problem), the need in an integrating Europe for legal systems to understand each other better, and the need for the law itself to adapt to the environment in which it finds itself, this rejection of national judicial resources is a waste.

In the internal market, this is particularly the case. Courts and legal systems are of great importance to economic activity, and their efficiency influences economic success. They could, in consequence, be seen as possible arenas for competition, and Community law would provide a mechanism for containing this within a common framework, preventing it becoming a race to deregulate, but rather becoming a race to administer the law well. Thus the same principles would be applied in different courts, and efficiency and quality of interpretation would be factors influencing location and behaviour of economic actors, and so determining success in the market for law. This is a fascinating,

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<sup>104</sup> See generally on this K. Alter, *Establishing the Supremacy of EC Law: The Making of an International Rule of Law in Europe* (Oxford: Oxford University Press, 2001).

<sup>105</sup> See C. Barnard and S. Deakin, 'Market access and regulatory competition', in C. Barnard and J. Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Oxford: Hart Publishing, 2002), pp. 197–224; N. Bernard, 'The future of European economic law in the light of the principle of subsidiarity' (1996) vol. 33:4 *Common Market Law Review* 633–66; and N. Reich, 'Competition between legal orders: A new paradigm of EC law?' (1992) vol. 29:5 *Common Market Law Review* 861–96.

and no doubt economically desirable, chance to explore empirically the merits of different systems – a sort of laboratory experiment in which Community law provides the common element placed in a diversity of circumstances. For Europe as a whole, it is a chance to negotiate its way slowly towards a court system, perhaps a common courts system, that combines the best of them all, and results in efficient regulation of the EU as a whole.

## REFERENCE VERSUS APPEALS

A simple reference procedure is not the right one for the Community. It is far too centralising, and can only function if answers are abstract. Yet in a Community with such cultural differences abstraction may not be enough to ensure sufficiently uniform application. Moreover, as Community law spreads into ever new areas, the concept of the reference becomes ever more insulting; it is as if a national judge was told that he had better ask advice whenever a point of contract, criminal law, tort or property law arose, and not just decide it himself. A logical step is to move to an appeal structure. Much has been written on this,<sup>106</sup> so discussion here is confined to advantages and disadvantages relevant to the topic in hand.

It would not be necessary to put the ECJ at the end of the appeals process, after all national remedies have been exhausted. Appeal could be possible at any stage after the first judgment – or perhaps after the first appeal.<sup>107</sup> However, the key point would be that the appeal would be from a prior decision, and the ECJ would be expected to review, and approve or disapprove, that decision. This could be – it is suggested should be – in a cassation form, where the Court would not provide a replacement judgment but confine itself to indicating where things had gone wrong, then referring the matter back to the national court for redecision.

The advantages are several. First, Community law is always interpreted and applied in full by national courts to begin with, providing quicker use of the law and giving national courts practice. Second, that national use of the law is then reviewed by the ECJ, thus providing feedback to the national court, but

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<sup>106</sup> See generally, H. Rasmussen, art. cit., n. 20 above; P. Craig, op. cit., n. 71 above, pp. 201–4; the Court's own paper on *The Future of the Judicial System of the European Union* (1999) and the *Report by the Working Party on the Future of the European Communities' Court System* (2000, compiled for the Laeken convention), both available at [http://curia.eu.int/en/instit/presentationfr/index\\_savoirplus.htm](http://curia.eu.int/en/instit/presentationfr/index_savoirplus.htm); P. Allott, art. cit., n. 84 above, at 545.

<sup>107</sup> See H. Rasmussen, art. cit., n. 20 above, at 1104–7; P. Craig, op. cit., n. 71 above, p. 196.

also information on the law and on the behaviour of their peers, to courts in other Member States, something that will encourage cross-border legal communication and convergence of interpretations.<sup>108</sup>

The function of the ECJ would be largely the same; it would consider points of Community law. Thus the same questions of interpretation and application, and abstraction and concreteness, could arise. However, the role of national courts would be made more central to the system and this would render the respect for these lines less vital. Moreover, if forced to build its judgments around those of the national court, to respond to them, the ECJ would find it harder to impose its own view of the facts. Thus national courts' control of their proper domain would be strengthened. The power of the first word, and of the full explanation, is considerable.

At the moment it is also the case that references often come to the court at a stage of proceedings where national judgments have been given. However, the Court rarely considers these in any depth. It responds far more fully to the arguments of the parties and the Commission – although not always to these. It clearly feels that these have something to contribute to the adjudication, where its judicial colleagues in the Member States do not. That perception would have to change on cassation.

The disadvantage of appeals, it is sometimes said, is that it would damage the co-operative relationship between courts and replace it with a hierarchical one. This seems somewhat unrealistic. The very limited amount of challenge that the ECJ has experienced over the years, despite its purposive and sometimes incoherent rulings, suggests that national courts already treat it as their hierarchical superior within the realm of Community law, and indeed it is that. An appeal structure would be a more honest reflection of how things already are.<sup>109</sup> Nor would it threaten the ability of national courts to decide cases, at least if appeal was by cassation, or the dominance of national courts over national law. The ECJ would simply remain, as it is now, the last word on points of Community law.

A move in this direction may be represented by *Köbler*. The core of this judgment was that damages could be awarded against national courts, even national supreme courts, which made manifest errors of Community law. As has been widely commented, it will take a brave lower judge to entertain a new

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<sup>108</sup> Cohen argues that appeal is clearly a much more effective way to achieve uniformity of law, and the only reason a reference procedure was chosen instead was political sensitivity: J.C. Cohen, *op. cit.*, n. 2 above, pp. 444–5; see also, S. Weatherill, 'Can there be common interpretation of European private law?' (2002) vol. 31:1 *Georgia Journal of International and Comparative Law* 139–66 at 162–6.

<sup>109</sup> Rasmussen, *art. cit.*, n. 20 above, at 1102. See also, Tridimas, *art. cit.*, n. 68 above, at 36; Cohen, *op. cit.*, n. 2 above, p. 436.

action claiming damages against the supreme court, and an even braver one to rule that the supreme court made a manifest error. In practice, it seems that no such finding would be made without a reference asking whether the supreme court was indeed in error, and manifestly so. Thus the finding in *Köbler* opens up a route to cassation-type judgments, where the ECJ will be called upon to review the rulings of national courts. Although this is likely to involve very concrete and specific references and answers, the difference from current practice is that the answers will be based upon analysis of a judicial decision, rather than of a dispute.

## CONCLUSION

This chapter is not a call for abstract judgments as such. It is more a taking note of the fact that very concrete judgments and a reference procedure are a bad combination. Part of the solution to that should lie in less ‘concreteness’ – the Court must learn to trust and let go a little, not just in the cause of decentralisation, but also in its own cause of teaching national courts to use Community law. The time when ‘leading by the nose’ was appropriate, if that ever was, is past.

However, there is also much to be said for the common law habit of discovering law in the facts, and rendering the story prior to the principle. It is the story that makes the law clear to non-lawyers, renders, if enough stories are told, the outcomes of cases certain, and also makes judges and courts accountable. Thus, there should also be a role for a Supreme Court of Community Law that can review judgments, or judge cases, as a whole, and is not confined to the Treaty text. Certainly the tendency of the ECJ to treat its jurisdiction over the cases referred to it so broadly indicates that it hungers for full involvement. Then the task is to allow that involvement in a way that does not deprive the involvement of national courts, and that allows them to interpret and part-own Community law.

Fears of loss of unity if changes are made are probably exaggerated. There is already no control over what happens in courts that choose not to refer, and while the Court’s style gives it much control over those that do, its lack of generality minimises the broader impact of its judgments. A different approach would increase uniformity in some ways, decrease it in others, and probably have no apocalyptic effect.

What it would do is chime with the direction of the Community and of law generally. The choice to make directives the major legislative tool, as well as the increasing attention given to complex and often troublesome matters like closer co-operation, minimum harmonisation and the use of framework directives are all signs of the recognition that there cannot be absolute uniformity



for all. A single homogenous legal system is neither desirable nor practical. In these solutions a choice is made to opt for a common framework of principle, and then to allow divergence and diversity within defined bounds.

So it is with a more abstract approach to interpretation, and a system of cassation. The real work is left to national courts, and the Court functions rather like the European Court of Human Rights, perhaps sometimes laying down an important new principle, but often simply supervising the margin of appreciation.

Many words could be picked to summarise all this; subsidiarity, or regulatory competition, or efficiency in the use of resources. However, the key element is decentralisation. The Court's current behaviour is profoundly centralising. Yet it sits now, not as sole owner and operator of an additional and confined legal system, that it may legitimately monopolise, but at the centre of a whole new multi-faceted European legal order. It needs to ask itself how much of the function of that order can reasonably be centralised in a single court.

Certainly, if it wishes to be seen as a true constitutional court, with the status and respect that are often accorded to these, then self-restraint will be a far more effective path than un-legal policy-led *ad hoc* interventionism. Just as a central function of constitutions is to allocate power, a central function of constitutional courts is to protect that allocation, even at the cost of sometimes denying their own role and influence. They must not be concerned purely with substantive policy, but also with the system they protect, and the rights of other players in it. Thus, they must be ready to deny themselves power to rule, to decide not to decide, where the constitution gives that power to other courts – even if, precisely when, those other courts may decide differently. It is concern with such questions, and the readiness to self-denial that must go along with it, that makes them constitutional.

Finally, one should place the Court in the context of the times. This is an age of movement away from hierarchy and central control, towards local autonomy and individual freedom. There is little market for control any more, but rather for empowerment. Management, of individuals, groups, companies, and countries, is achieved more by manipulation and ideas, and less by compulsion. As in society, as in economics, so in law.

## 9. The internal market and the individual

**Robert Lane**

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### INTRODUCTION

Revolutionary though it may have been at the time, it is now almost hackneyed to refer to direct effect and the rights which individuals – ‘individuals’ here in its normal, if misleading, Community law sense of both natural and juristic (private) persons – derive from the EC Treaty (Treaty). In the well-worn passage from *van Gend en Loos*, Community law is ‘a new legal order of international law . . . [which] confer[s] upon them rights which become part of their legal heritage’.<sup>1</sup> Since then, the rights of the individual, both procedural and substantive, and their protection and extension have a long and generally honourable pedigree in the case-law of the Court of Justice. The individual as beneficiary of Community law is no longer in any question.

A newer phenomenon is the issue of duties borne by the individual. At the sharp(est) end there are significant questions to be asked – which have not begun to receive answers – in the context of the development since 1993 of citizenship of the European Union (EU); whether citizenship can continue to produce rights but impose no duties; and whether tolerance of reverse discrimination can survive its further development. However the question arises also in the more immediate, and significantly more complex, context of the place of the individual in the internal market. Most of the rules in the Treaty intended to give effect to the internal market are addressed to the Member States (in all their guises). The achievement of the ‘four freedoms’, and the case-law of the Court of Justice attendant to it, has been concerned almost exclusively with the dismantling and prohibition of legislative and regulatory impediments to the internal market – the underlying presumption being that it is the hand of the state which must be neutered and, tacitly, that the individual is best left unregulated in his affairs. But latterly questions have come to the fore which address the individual, not only as beneficiary of the internal

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<sup>1</sup> Case 26/62 *Algemene Transport- en Expeditie Onderneming van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 1, p. 12.

market, but also as an active contributor to it: in other words, whether it is legitimate, or necessary, to regulate the conduct of the individual.

In one respect, of course, the individual has always borne obligations under the Treaty. The competition rules provided in Articles 81 to 86 EC are addressed (for the most part) not to the state but to private parties ('undertakings'), and seen as the flip side of the internal market coin, a wholly necessary corollary to the rules of the four freedoms ensuring that private persons do not use market power and private law tools (essentially contract) to undo the work achieved by the rest of the Treaty. It was, in fact, the presence of these provisions in the Treaty which was one of the principal considerations enabling the Court to discern its direct effect in *van Gend en Loos*.

But here is a problem. Competition law is inherently self-contradictory. Its benefits for the individual, in the Community context, are (seen to be) self-evident: for example, the licence it provides parallel traders to subvert 'official' distribution networks goes to making the internal market efficient and is what brings to the individual its benefits. However, it does so by limiting the freedom of other individuals, and so runs fundamentally counter to the neo-liberal orthodoxy to which the Treaty cleaves. If it is the free market and its discipline (Adam Smith's invisible hand)<sup>2</sup> which maximises consumer welfare, the greatest service the individual can render the Community is to pursue his own self-interest with unfettered zeal; and he is not to be reproached for doing so. It is the balancing of this oxymoron – regulation of a free market, or limitations to the freedom of the individual within it – which has long been the concern of competition law. But it has been an issue restricted to that realm.

No longer. The original distinction (the rules regulating the internal market are public law rules and the rules regulating competition (and so the individual) are private law rules) is beginning to break up. Application of the latter has edged increasingly closer to the regulatory authority and activity of the state ('the publicisation of competition law'); but, more profound and more complex, at the same time the rules on free movement are edging towards the creation of obligations for individuals ('the privatisation of free movement').<sup>3</sup> It is no longer simply in restrictions to contractual and commercial freedom

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<sup>2</sup> A. Smith, *An Inquiry into the Nature and Causes of The Wealth of Nations* (London: Printed for W. Strahan and T. Cadell, 1776), Bk IV, Chapter II.

<sup>3</sup> This dichotomy of the 'publicisation of competition' and the 'privatisation of free movement' was first adopted in D. Waelbroeck, 'Les rapports entre les règles sur la libre circulation des marchandises et les règles de concurrence applicables aux entreprises dans la CEE', in F. Capotorti et al. (eds), *Du Droit International au droit de l'intégration: Liber Amicorum Pierre Pescatore* (Baden-Baden: Nomos, 1987), pp. 781–805.

that the individual (undertaking) serves the internal market: at last, we now know that the *Cassa di Risparmio di Bolzano* bears direct burdens not only under Article 81, but also under Article 39.<sup>4</sup> And having leapt the chasm to Article 39, it is, perhaps, a mere skip thence to the horizontal direct effect of the Treaty provisions on free movement of goods. We have seen preliminary skirmishes in the context of Article 28, but they are bagatelles compared to a full-blooded direct effect bearing upon individuals. Then, if Article 28 falls, will/must Articles 43 and 49 (and 56?) follow?

Notwithstanding the long tradition of protection of his or her rights, outwith the competition rules (and Article 141 EC),<sup>5</sup> the duties of the individual is a new playing field. It raises fundamental issues of the individual as agent of the internal market; and many of the tools, or the legal reasoning, applied by the Court hitherto (and this is all of the Court's making) will require to be refashioned significantly. Throughout there are solid policy reasons both for and against horizontal direct effect, and whatever reasoning which comes to be applied will require a new subtlety and suppleness.

In order to consider his place in the internal market it is proposed to deal first with the more traditional considerations of the individual as beneficiary of the Treaty, and his role in the development of his rights and the obligations of others; first, because on this side of the ledger his contribution to the development of Community law is not to be underestimated; and second, because recent case-law of the Court of Justice has caused subtle shifts in that position. Consideration will then turn to the other side of the ledger, and the development of burdens for, and regulation of, the individual in the interests of the internal market.

## TREATY RIGHTS AND THE VIGILANT INDIVIDUAL

The protection of individual rights springs of course from *van Gend en Loos* and direct effect, the bulk of it concerned with the deprivation of Community rights by a national authority. The argument was put forward by the Dutch and Belgian governments in *van Gend en Loos* that by providing autonomous enforcement mechanisms in Articles 226 to 228 EC – themselves remarkable at the time – the intention was to oust other means of enforcement, such as, of course, any remedy available from a national court. This was not necessarily wrong-headed: it is resonant with familiar canons of statutory construction on rights and remedies. But the Court said the existence of those provisions was

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<sup>4</sup> Case C-281/98 *Angonese v Cassa di Risparmio di Bolzano* [2000] ECR I-4139.

<sup>5</sup> Considered below, pp. 260–61.

immaterial: '[t]he vigilance of the individuals concerned to protect their rights amounts to an effective supervision in addition to the supervision entrusted . . . to the diligence of the Commission and of the Member States'.<sup>6</sup> We know that the Member States are anything but diligent in pursuing breaches of Community law by other Member States under Article 227, cases raised under it having been carried to the stage of judgment only twice.<sup>7</sup> It is therefore for the Commission, in discharging its duty of 'ensur[ing] that the provisions of this Treaty . . . are applied',<sup>8</sup> to chase after the delinquent Member State. However, the Commission cannot be compelled to take up the cudgel,<sup>9</sup> and aside from being woefully understaffed, there are circumstances in which it cannot, or will not, act – in the light of, for example, the wider political considerations it must take on board.

The individual labours under no such restraint and, acting wholly from self-interest, and instituting the dialogue between national courts and the Court of Justice which is part of the judicial architecture of the Treaty, the vigilant individual becomes the catalyst for the development of the law. It was through the resistance of van Gend en Loos to the additional 5 per cent Benelux duty on its German ureaformaldehyde that we have direct effect in the first place, and the disinclination of Sr. Costa to pay his 1,925 *lire* electricity bill that we have primacy.<sup>10</sup> But there is wide scope in Community law for the contribution of the irritating litigant. Would the principles of equal pay and equal treatment under Article 141 EC and its ancillary legislation have advanced, or advanced as quickly, had Mlle Defrenne been less persistent<sup>11</sup> and Miss Marshall less doughty?<sup>12</sup> Would Italian universities have been dragged into offering proper contracts and employment rights to foreign language assistants without the efforts of Sra Allué and Mr Petrie?<sup>13</sup> It was long clear that many of the rules

<sup>6</sup> *Van Gend en Loos*, p. 13.

<sup>7</sup> Case 141/78 *France v United Kingdom* [1979] ECR 2923; Case C-388/95 *Belgium v Spain* [2000] ECR I-3123. A third case is in the pipeline: Case C-145/04 *Spain v United Kingdom*, pending.

<sup>8</sup> Article 211 EC.

<sup>9</sup> Case 48/65 *Lütticke v EEC Commission* [1966] ECR 19; and Case 247/87 *Star Fruit v Commission* [1989] ECR 291.

<sup>10</sup> Case 6/64 *Costa v ENEL* [1964] ECR 585.

<sup>11</sup> Case 80/70 *Defrenne v Belgium* [1971] ECR 445; Case 43/75 *Defrenne v SABENA (Defrenne II)* [1976] ECR 455; Case 149/77 *Defrenne v SABENA (Defrenne III)* [1978] ECR 1365.

<sup>12</sup> Case 152/84 *Marshall v Southampton and Southwest Hampshire Area Health Authority (Teaching) (Marshall I)* [1986] ECR 723; and Case C-271/91 *Marshall v Southampton and Southwest Hampshire Area Health Authority (Teaching) (Marshall II)* [1993] ECR I-4367.

<sup>13</sup> Case 33/88 *Allué and Coonan v Università degli Studi di Verona* [1989] ECR 1591; Joined Cases C-259 etc./91 *Allué and others v Università degli Studi di Verona*

adopted by the Union of European Football Associations (UEFA) sailed close to the Treaty wind, but it took a jobbing Belgian footballer to get them set aside.<sup>14</sup> And the received wisdom, when it began its long march for reparation, was that Factortame Ltd was on a fool's errand.<sup>15</sup>

This has an important impact in another respect, which is the protection of Community rights not from the intrusion or in the lethargy of national authorities, but rather from the Community itself; or, put another way, from judicial control of the Community, and in particular the standing of the individual to cause the lawfulness of a Community measure to be tested before the Court. It is well known that, save for an administrative measure of which he is the addressee, the individual is barred from seeking the annulment of Community legislation under Article 230 EC in almost all circumstances. There was a large tremor in 2002 with *Jégo-Quééré*,<sup>16</sup> but it proved a false dawn,<sup>17</sup> things settling back into comfortable *status quo*. The challenge set by the Court in *Unión de Pequeños Agricultores*, that alteration of the system was a matter wholly for the Member States,<sup>18</sup> found no sympathy with them, the Treaty establishing a Constitution for Europe providing only insignificant change.<sup>19</sup> But the Court also reminded us forcefully in *Unión de Pequeños Agricultores* of the importance of Article 234 EC as an indirect means of judicial control of the Community institutions, by which adequate judicial protection of the individual was secured.

However, the Court had begun to cut back on the availability of Article 234

[1993] ECR I-4309; Case C-90/96 *Petrie and others v Università degli Studi di Verona* [1997] ECR I-6527; and Case T-191/99 *Petrie and others v Associazione Lettori di Lingua Straniera in Italia* [2001] ECR II-3677.

<sup>14</sup> Case C-415/93 *Union Royale Belge des Sociétés de Football Association ASBL v Bosman* [1995] ECR I-4921.

<sup>15</sup> Joined Cases C-46 and 48/93 *Brasserie du Pêcheur v Germany and R. v Secretary of State for Transport*, ex parte *Factorame* [1996] ECR I-1029. The case was finally settled (with agreed damages of some £55 million, including costs) only in 2001; see *Factorame v Secretary of State for the Environment, Transportation and the Regions* [2002] EWCA Civ 22, [2002] 2 All ER 838. In the event, *Brasserie du Pêcheur* was on a fool's errand, for the *Bundesgerichtshof* found the test of causation not to be satisfied: BGH, 24. Oktober 1996, BGHZ 134, 30.

<sup>16</sup> Case T-177/01 *Jégo-Quééré v Commission* [2002] ECR II-2365.

<sup>17</sup> *Jégo-Quééré* was overturned (indirectly) within two months in Case C-50/00 P *Unión de Pequeños Agricultores v Council* [2002] ECR I-6677 and reversed on appeal as Case C-263/02 P *Commission v Jégo-Quééré* [2004] ECR I-3425.

<sup>18</sup> *Unión de Pequeños Agricultores*, para. 45: 'it is for the Member States, if necessary, in accordance with Article 48 EU, to reform the system currently in force'.

<sup>19</sup> Treaty establishing a Constitution for Europe, OJ 2004 C 310/1, Article III-365(4). The one change is that it will no longer be necessary for an individual to show individual concern to challenge a regulatory act which entails no implementing measures. 'Regulatory act' (*acte réglementaire*; *Rechtsakte mit Verordnungscharakter*) is not defined, and, should the Treaty enter into force, will doubtless engender significant debate and litigation.

in *TWD Textilwerke Deggendorf*.<sup>20</sup> according to the Court, an individual with clear standing to challenge Community legislation under Article 230, but having failed to do so, cannot be allowed subsequently to raise a plea of illegality in national proceedings with a view to an invalidity reference under Article 234; it would constitute a second bite of the cherry, a circumvention of the time bar of Article 230(5) and so an abuse of process.

According to the Court, an individual must have been ‘undoubtedly’ entitled,<sup>21</sup> ‘obviously’ entitled,<sup>22</sup> or enjoy standing ‘clear beyond doubt’<sup>23</sup> to raise an action under Article 230 before being estopped from raising the plea in the context of Article 234. Yet that is so in all cases for the ‘privileged applicants’ of Article 230(2) – the Commission, the Council, the Parliament and the Member States – who enjoy absolute privilege, requiring to show no interest whatsoever, to seek the annulment of a Community act. But the price of this privilege is that once the two month time bar is up, the welcome mat in Luxembourg is snatched away. The extent of this is perhaps best illustrated in the recent *Ouzo* case,<sup>24</sup> in which the Commission raised enforcement proceedings against Greece for applying a reduced rate of excise duty to ouzo and not to other (non-Greek) spirituous drink, in breach, in the Commission’s view, of Article 90 EC. Greece relied upon a 1992 directive on harmonisation of excise duties on alcohol,<sup>25</sup> which, it claimed, authorised the differential rates. The Commission had raised no objection at the time and had expressed no doubt as to the compatibility of the Directive provision with Article 90 until 1997.<sup>26</sup> It therefore carefully restricted the action to Article 90 and emphasised that it did not seek to challenge the legality of the Directive directly or indirectly, save to submit that it – being secondary legislation – must be compatible with, and cannot derogate from, Treaty rules. This is axiomatic. But the (full) Court said that ‘the Commission’s action, which seeks directly to challenge the rate of excise duty that the Hellenic Republic was authorised to apply to ouzo on the basis of Article 23(2) of Directive 92/84, indirectly but necessarily amounts to a challenge of the lawfulness of that provision’.<sup>27</sup> And, as Community legislation is presumed to be lawful (unless, very exceptionally, non-existent) until withdrawn, annulled or inval-

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<sup>20</sup> Case C-188/92 *TWD Textilwerke Deggendorf v Germany* [1994] ECR I-833.

<sup>21</sup> *Ibid.*, para. 24.

<sup>22</sup> Case C-241/95 *R. v Intervention Board for Agricultural Produce ex parte Accrington Beef* [1996] ECR I-6699, para. 15.

<sup>23</sup> Joined Cases C-261 and 262/01 *Belgium v van Calster* [2003] ECR I-12249, para. 55 of the Opinion of Advocate-General Jacobs.

<sup>24</sup> Case C-475/01 *Commission v Greece* [2004] ECR I-8923.

<sup>25</sup> Directive 92/84, OJ 1992 L316/21.

<sup>26</sup> *Commission v Greece*, para. 20 of the Opinion of Advocate-General Tizzano.

<sup>27</sup> *Ibid.*, para. 17 of the judgment of the Court.

idated, and Greek duties were consistent with the Directive, the Commission was barred from challenging its legality as an ancillary (but ‘necessary’) plea in Article 226 proceedings, notwithstanding the apparent authority of Article 241 EC to do so.

The consequence of this is that there is abroad a directive which is in all likelihood unlawful for infringement of the Treaty,<sup>28</sup> but which is operable and (now) immune from review at the instance of the powerful (the Commission, the Council, the Parliament and the Member States) but *not* at the instance of an individual, who may, *sine die*, challenge it either in a national court (seeking an Article 234 invalidity reference) or, if the appropriate circumstances were to arise (which seems here unlikely), in the Court of First Instance, invoking an Article 241 plea of illegality. The Commission could of course submit to the Council a proposal for amendment of the Directive in order that Greece lose the concession, but as it would be unlikely to attract enthusiastic Greek support (or that of France, which enjoys a similar concession under the Directive), and as it would (being an Article 93 measure) require unanimity in the Council, it would seem a pointless exercise.

The irony is that we shall probably never know whether the 1998 regulation on fishing net mesh sizes<sup>29</sup> (the subject matter of the annulment proceedings in *Jégo-Quéré*) or the 2001 regulation on olive oil<sup>30</sup> (*Unión de Pequeños Agricultores*) are unlawful because of the restricted standing of individuals under Article 230; and at the same time the Commission cannot challenge the lawfulness of the 1992 Directive in *Ouzo* because of its own extensive standing under Article 230. It is only the individual – a thirsty Greek with a taste for whisky? – who can do that now.

## THE RESPONSIBILITY OF THE INDIVIDUAL FOR THE INTERNAL MARKET

In the nature of the *matryoshka* which is the scheme of the EC Treaty, the tasks of the Community were to be achieved ‘by establishing a common

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<sup>28</sup> Advocate-General Tizzano did consider the substance of the case, and found for Greece. However, the Commission had for some reason restricted its claim to a breach of Article 90(1), by which it was required to show ouzo and other drink to be ‘similar’ products, and not Article 90(2), where it would be required to show only that they were competing products. Given previous case-law on competing refreshment (for example, Case 170/78 *Commission v United Kingdom (Beer and Wine)* [1980] ECR 417, [1983] ECR 2265), it is unlikely the Court would have disagreed.

<sup>29</sup> Regulation 1162/2001, OJ 2001 L159/4.

<sup>30</sup> Regulation 1638/98, OJ 1998 L210/32.



market’;<sup>31</sup> a key activity within which is ‘an internal market characterised by the abolition, as between Member States, of obstacles to the free movement of goods, persons, services and capital’;<sup>32</sup> and the internal market, in turn, being ‘an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of this Treaty’.<sup>33</sup> What is not entirely clear from these provisions is to whom the Treaty entrusts the burdens to do it. To be sure, Treaty obligations are assumed by and addressed to the Member States, its signatories, in all of their manifestations; but we also know, since 5 February 1963 for those who did not have the eyes to see, that the subjects of the new Community legal order are not just the Member States, but also their nationals.<sup>34</sup> Perusal of the texts would likely lead the reader to conclude that the bulk of it is addressed to the Member States, either expressly or implicitly. This is especially so for the rules provided or adopted for the achievement of the internal market: the elimination of public law impediments to the internal market (tariffs, taxes, quotas, immigration, labour markets, professions and trades, currency restrictions) – measures regulating the economy traditionally wielded by the state. Certainly the Treaty is concerned also with private law impediments to the internal market, but addresses these primarily by means of approximation, or harmonisation, of laws, the internal market legislation under Articles 94 or 95, and so (almost) always through the prism of directives, so necessarily the machinery of the state. Many of these measures are of the nature of ‘liberalisation’ of markets and so the progressive dismantling of such fetters to individual freedom stem from national regulation; but this is a political choice on the part of the Community legislator. For his part the individual is expressly a subject of the Treaty only in the context of the competition rules, intended to ensure that operators in the private sector do not gain, or abuse, market power in a manner which frustrates the internal market.

The competition rules are in the Treaty for two reasons. First, it is, for good or ill, a neo-liberal tract. It embraces the free market, implicitly prior to Maastricht and expressly since: ‘[f]or the purposes set out in Article 2, the activities of the Member States and the Community shall . . . [be] conducted in accordance with the principle of an open market economy with free competition’.<sup>35</sup> Since it grew in the midst of Erhardt’s *Wirtschaftswunder*, so much

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<sup>31</sup> Article 2 EC; and, since Maastricht, ‘by establishing . . . an economic and monetary union and by implementing the common policies or activities’ which are then adumbrated.

<sup>32</sup> Article 3(1)(c) EC.

<sup>33</sup> Article 14(2) EC.

<sup>34</sup> *Van Gend en Loos*, n. 1 above.

<sup>35</sup> Article 4(1) EC.

credit for which was given to the competition rules bequeathed Germany by the Americans, it was perhaps inevitable, notwithstanding a clear lack of enthusiasm from the French, and even if it marked, according to Monnet, ‘*une innovation fondamentale en Europe*’.<sup>36</sup> It is the free, unfettered market and its discipline (the invisible hand)<sup>37</sup> which is its own best regulator, maximises consumer welfare and so is a desirable end in itself. To this end, in the extravagant language of Dr Ehlermann, ‘the Community has the most strongly free-market oriented constitution in the world’.<sup>38</sup>

However, there was another reason: it was a necessary corollary to the rest of the Treaty. The rules for the creation of the internal market addressed to the Member States – the public law side of the coin – are only part of the story. Absent specific rules it would be all too easy for private parties to fill the vacuum created with anti-competitive practices which had the effect of reinstating the public barriers dismantled elsewhere in the Treaty. Thus, the individual too had a role to play in the internal market. The competition rules were recognised by the Spaak Report to be a necessary component of economic integration,<sup>39</sup> and we know from the Court of Justice in *Continental Can* that, without them, ‘numerous provisions of the Treaty would be pointless’.<sup>40</sup> More expressly, we know from *Eco Swiss China Time* that ‘according to [*in overestemming met*] Article 3[(1)(g)] of the EC Treaty . . . Article 81 . . . constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community, and, in particular, for the functioning of the internal market’.<sup>41</sup> Put simply, competition law is part and parcel of the internal market; it ‘sails under the flag of market integration’.<sup>42</sup>

So, individuals (insofar as they are undertakings) play an important role, *but* that role is defined and governed by the competition rules. Internal market rules are for the Member States, for public authorities; competition rules are for individuals. At least, this is the traditional view and the traditional

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<sup>36</sup> J. Monnet, *Mémoires* (Paris: Fayard, 1976), p. 413.

<sup>37</sup> Smith, *The Wealth of Nations*, n. 2 above.

<sup>38</sup> C.D. Ehlermann, ‘The contribution of EC competition policy to the single market’ (1992) vol. 29:2 *Common Market Law Review*, 257–82 at 273.

<sup>39</sup> Comité intergouvernementale créé par la Conférence de Messine, Rapport des Chefs de délégation aux Ministres des Affaires Etrangères (Brussels, 21 April 1956), pp. 53ff.

<sup>40</sup> Case 6/72 *Europemballage and Continental Can v Commission* [1973] ECR 215, para. 24.

<sup>41</sup> Case C-126/97 *Eco Swiss China Time v Benetton International* [1999] ECR I-3055, para. 36; see also, Case C-453/99 *Courage v Crehan* [2001] ECR I-6297, para. 20.

<sup>42</sup> B. Rodger, ‘Market integration and the development of European competition policy to meet new demands’ (1994) 2 *Legal Issues of European Integration* 1–26 at 6.

approach. But it is now too simple, and the boundary between the two fields is beginning to break down, allowing a degree of haemorrhaging of principles between them.<sup>43</sup>

For the sake of thoroughness it should be said that the two areas in which competition and the internal market converge most closely are:

- a) dumping. Dumping within the internal market was originally regulated by one (of three) sections within the chapter providing ‘Rules on Competition’;<sup>44</sup> but since dumping becomes economically impossible within a unified market it came to lose its relevance, and the provision was repealed by the Treaty of Amsterdam. Protection from dumped goods (and services) from third countries is an integral part of the cohesion of the internal market, and falls within the ambit of the common commercial policy;<sup>45</sup> and
- b) public procurement, which accounts for a vast amount of economic activity within (some 16 per cent of GDP of) the Community. A series of directives<sup>46</sup> seeks to ensure the free movement of goods and services in response to public projects and, through compulsory (and transparent) tendering, competition in the provision thereof.

However, both dumping and public procurement are *lex specialis*, and will not be further considered.

## THE ‘PUBLICISATION’ OF COMPETITION LAW

Before the individual came to be drawn more directly into the rules of the internal market the movement was in the opposite direction: the application to the Member States of the competition rules. The latter are addressed to ‘undertakings’, essentially in their private law dealings, and it is trite law to say that an entity which is not an undertaking is not subject to and need take no notice of them. However, so broadly is the term defined (the working definition now being that of *Höfner v Macrotron*: ‘every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed’)<sup>47</sup> that it has come increasingly to catch the state in a number of its guises. The Court said in 1987: ‘the fact that a body has or has not, under

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<sup>43</sup> See also the contribution to this volume by Erika Szyszczak.

<sup>44</sup> Article 91 of the EEC Treaty.

<sup>45</sup> See Article 133 EC; Regulation 384/96, OJ 1996 L56/1.

<sup>46</sup> See now, for example, Directive 2004/17, OJ 2004 L134/1; and Directive 2004/18, OJ 2004 L134/114.

<sup>47</sup> Case C-41/90 *Höfner and Elser v Macrotron GmbH* [1991] ECR I-1979, para. 21.

national law, legal personality separate from that of the state is irrelevant in deciding whether it may be regarded as a[n] . . . undertaking'.<sup>48</sup>

So the term embraces *inter alia* post offices,<sup>49</sup> public employment offices embedded in government ministries,<sup>50</sup> sectoral pension funds,<sup>51</sup> public television broadcasting organisations,<sup>52</sup> airports and civil aviation authorities,<sup>53</sup> public transport, telecommunications, ambulances,<sup>54</sup> and a trading body forming part of the financial administration of the Italian state (which has in Italian constitutional law an indivisible legal personality).<sup>55</sup> So widely has it been interpreted that it is only rarely that the Court has found a state entity even touching upon commercial activity *not* to be an undertaking;<sup>56</sup> and this may explain why the Court seems now to be engaged in an exercise of paring back its meaning for fear of trenching upon fraught areas of the organisation of social security provided by the state.<sup>57</sup> These rare cases aside, all are normally state owned and/or operated, certainly regulated, but they are undertakings and so direct addressees of Articles 81 and 82.<sup>58</sup>

There are, of course, two provisions in the competition rules which are

<sup>48</sup> Case 118/85 *Commission v Italy* [1987] ECR 2599, para. 11.

<sup>49</sup> Case C-320/91 *Criminal Proceedings against Corbeau* [1993] ECR I-2533.

<sup>50</sup> *Höfner and Elser*, n. 17; Case C-55/96 *Job Centre Coop* [1997] ECR I-7119.

<sup>51</sup> Case C-67/96 *Albany International v Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I-5751; Joined Cases C-180 etc./98 *Pavlov v Stichting Pensioenfonds Medische Specialisten* [2000] ECR I-6451.

<sup>52</sup> Case 155/73 *Sacchi* [1974] ECR 409; Case C-290/89 *Elliniki Radiophonia Tileorassi v Dimotiki Etairia Pliroforissis* [1991] ECR I-2925.

<sup>53</sup> Case C-82/01 *P Aéroports de Paris v Commission* [2002] ECR I-9297, paras 68–83; Decision 1999/198 (*Ilmailulaitos/Luftfahrtverket*) OJ 1999 L69/24.

<sup>54</sup> Case C-475/99 *Ambulanz Glöckner v Landkreis Südwestpfalz* [2001] ECR I-8089.

<sup>55</sup> Case T-139/98 *Amministrazione Autonoma dei Monopoli di Stato v Commission* [2001] ECR II-3413.

<sup>56</sup> See Case 30/87 *Bodson v Pompes Funèbres des Régions Libérées* [1988] ECR 2479; Joined Cases C-159–60/91 *Poucet et Pistre v Assurance Générales de France* [1993] ECR I-637; Case C-362/92 *SAT Fluggesellschaft v Eurocontrol* [1994] ECR I-43; Case C-343/95 *Diego Cali e Figli v Servizi Ecologici Porto di Genova* [1997] ECR I-1547.

<sup>57</sup> Case T-319/99 *Federación Nacional de Empresas de Instrumentación Científica, Médica, Técnica y Dental (FENIN) v Commission* [2003] ECR II-357, under appeal as Case C-205/03 *P Federación Española de Empresas de Tecnología Sanitaria v Commission*, pending (cf. *BetterCare Group Ltd v Director General of Fair Trading* [2002] CompAR 299, a UK case involving similar questions but which was resolved with a contrary result); Joined Cases C-264 etc./01 *AOK Bundesverband and others v Ichthyol Gesellschaft Cordes and others* [2004] ECR I-2493.

<sup>58</sup> For an exhaustive consideration of the state as undertaking, see S. Storr, *Der Staat als Unternehmer: Öffentliche Unternehmen in der Freiheits- und Gleichheitsdogmatik des nationalen Rechts und des Gemeinschaftsrechts* (Tübingen: Mohr Siebeck, 2001).

addressed to the Member States: (1) the rules on state aids (Articles 87 to 89), which have little relevance here, and (2) Article 86(1), which deals with undertakings but is addressed not to them but to the Member States, and instructs them not to allow or cause, by law, publicly owned undertakings or privately owned service providers to breach any other provision of the Treaty, 'in particular' the competition rules. Article 86 long lay dormant; but since the early 1990s, has sprung to life, and we may be able to borrow from it when looking at the internal market.

Even before then, the Court attributed wider responsibility to Member States in one other particular. Whilst the Member State is bound directly by Articles 81 and 82 only insofar as it is an undertaking, the Court has made it clear that these provisions, in conjunction with Article 10, impose upon the state an obligation not to adopt or maintain in force any measure which would deprive the competition rules of their practical effect. So it is akin to Article 86(1), but broader; in the context of Article 82, the language is closely related to that of Article 86(1):

[w]hilst it is true that Article 86 concerns undertakings . . . the fact nevertheless remains that the Treaty requires the Member States not to take or maintain in force measures which could destroy the effectiveness of that provision . . . .

Consequently any measure adopted by a Member State which maintains in force a statutory provision that creates a situation in which a[n] undertaking cannot avoid infringing Article 86 is incompatible with the rules of the Treaty.<sup>59</sup>

However, the broader application is clearer in the context of Article 81, and is best stated in the *Meng*, *Gebrüder Reiff* and *Ohra* judgments, the three delivered on the same day:

In interpreting Article 3(f), the second paragraph of Article 5 and Article 85 of the Treaty it should be noted that Article 85, read in isolation, relates only to the conduct of undertakings and does not cover measures adopted by Member States by legislation or regulations. However, the Court has consistently held that Article 85, read in conjunction with Article 5 of the Treaty, requires the Member States not to introduce or maintain in force measures, even of a legislative or regulatory nature, which may render ineffective the competition rules applicable to undertakings . . . . [S]uch is the case where a Member State requires or favours the adoption of agreements, decisions or concerted practices contrary to Article 85 or reinforces their effects or deprives its own legislation of its official character by delegating to private traders responsibility for taking economic decisions affecting the economic sphere.<sup>60</sup>

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<sup>59</sup> *Höfner and Elser*, paras 26 and 27.

<sup>60</sup> Case C-2/91 *Criminal Proceedings against Meng* [1993] ECR I-5751, para. 14; Case C-185/91 *Bundesanstalt für den Güterfernverkehr v Gebrüder Reiff* [1993] ECR I-5801, para. 14; and Case C-245/91 *Criminal Proceedings against Ohra Schadeverzekering* [1993] ECR I-5851, para. 10.

This is so not only where legislation compels breaches of Article 81, but also where the state surrenders its proper regulatory functions to the private sector. Given the current headlong enthusiasm in a number of Member States for the privatisation of public services, it is something of which the potential provider/investor ought to be very wary.

## THE 'PRIVATISATION' OF FREE MOVEMENT

The internal market clearly embraces the four freedoms – ‘an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured’.<sup>61</sup> There is significant debate as to what else it includes; or put otherwise, what constitutes its core. It is not assisted by periodic changes to Treaty texts. In the original Treaty, ‘the four freedoms’ fell within Part Two (of six), entitled ‘Foundations of the Community’ and embraced the free movement of goods, persons, services and capital (with special provisions for agriculture and transport). The Maastricht Treaty, intentionally or otherwise, demoted them: they now occupy two (of seventeen) Titles of ‘Community policies’, Title I addressing free movement of goods and Title III addressing free movement of persons, services and capital. This has had the effect of homogenising these ‘policies’ – the four freedoms are no longer ‘foundations’, and enjoy no higher a place or standing in the Treaty scheme than social policy, education, vocational training and youth. Put positively, it could be said to produce a state of affairs in which *all* Community policies are part of, or at least complement, the rules of the internal market. Yet should the Constitutional Treaty be recalled from limbo, they will be formally re-elevated to the status of ‘fundamental freedoms’,<sup>62</sup> no mere policies of the Union (although they will form, with the competition rules, one chapter (of five) within a Title of ‘Internal Policies and Action’), and the free movement of persons leaps ahead of goods in the order in which they are addressed.<sup>63</sup>

Having said that, ‘the four freedoms’ have been *primi inter pares* both before and after Maastricht: the free movement of workers is a ‘fundamental right’<sup>64</sup> and a ‘fundamental freedom’;<sup>65</sup> the free movement of goods is ‘one of the foundations of the Community’,<sup>66</sup> a ‘fundamental freedom’<sup>67</sup> and ‘one of

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<sup>61</sup> Again, Article 14(2) EC.

<sup>62</sup> Treaty establishing a Constitution for Europe, Article I-4(1).

<sup>63</sup> Articles III-133 to III-160.

<sup>64</sup> Case 152/82 *Forcheri v Belgium* [1983] ECR 2323, para. 11.

<sup>65</sup> *Bosman*, para. 78; *Angonese*, para. 35.

<sup>66</sup> Case C-194/94 *CIA Security v Signalson* [1996] ECR I-2201, para. 40.

<sup>67</sup> Case C-265/95 *Commission v France* [1997] ECR I-6959, para. 32; and Case

the fundamental principles of the Community’;<sup>68</sup> and the right of establishment and freedom to provide services are ‘fundamental freedoms’.<sup>69</sup> This is entirely consistent with a Treaty a primary task of which is the creation of the internal market and which serves as ‘the economic constitution of the Community’.<sup>70</sup> These are, therefore, constitutional rights; they may be constitutional rights *plus ultra* – but even if so they do not leave competition law trailing far behind: ‘the rules on free movement and competition . . . constitute the core and best established layer of the [Community] legal order’.<sup>71</sup> But the question here to be considered is whether they also countenance duties for the individual; or put another way, whether the basic provisions on free movement – Articles 39, 43, 49 and 56 – are horizontally directly effective.

There are two preliminary points. First, the obvious starting point is to consider the Treaty texts, to discover, if possible, the stated addressees of the obligations set out; and to be sure, they are addressed *primarily* to the Member States. The original Article 12 provided that ‘Member States shall refrain from introducing between themselves any new customs duties’. Similarly, Article 67, on the free movement of capital (as was), directed that ‘Member States shall progressively abolish between themselves all restrictions on the free movement of capital’, and in language so loose that, uniquely amongst the four freedoms, the chapter had of itself no direct effect.<sup>72</sup> These have both now changed: the post-Amsterdam successor to Article 12 (Article 25 EC) reads ‘[c]ustoms duties on imports and exports shall be prohibited’, and the present Article 56 reads: ‘[a]ll restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited’, which is (vertically) directly effective even as regards capital movements to third countries.<sup>73</sup>

This provides significant clues as to who is, or was, the intended target of

C-112/00 *Eugen Schmidberger Internationale Transporte Planzüge v Austria* [2003] ECR I-5659, para. 59.

<sup>68</sup> *Schmidberger*, para. 51.

<sup>69</sup> Case C-55/94 *Gebhard v Consiglio dell’Ordine degli Avvocati e Procuratore di Milano* [1995] ECR I-4165, para. 37. See extensive consideration of this point in W.H. Roth and P. Oliver, ‘The internal market and the four freedoms’ (2004) vol. 41:2 *Common Market Law Review* 407–41.

<sup>70</sup> M. Poiars Maduro, *We the Court – The European Court of Justice and the European Economic Constitution* (Oxford: Hart Publishing, 1998); and J. Baquero Cruz, *Between Competition and Free Movement: The Economic Constitutional Law of the European Community* (Oxford: Hart Publishing, 2002).

<sup>71</sup> G.C. Rodríguez Iglesias, inaugural address to the FIDE XX Congress, 2002, London; cited in Roth and Oliver, art. cit., n. 69 above, at 410.

<sup>72</sup> Case 203/80 *Criminal Proceedings against Casati* [1981] ECR 2595.

<sup>73</sup> Joined Cases C-163 etc/94 *Criminal Proceedings against Sanz de Lera* [1995] ECR I-4821.

these provisions. But care is advisable, for the Court always looks beyond the immediate text in its interpretation of the Treaty. Consider, for example, the original Article 119: '[e]ach Member State shall . . . ensure . . . the application of the principle that men and women should receive equal pay for equal work'. Clearly, it might be concluded, an obligation addressed to the Member States; but, as we shall see, it goes much wider. The Court said from the beginning, in *van Gend en Loos*, that the Treaty does address obligations to individuals, but when it does so, must do so 'in a clearly defined way'.<sup>74</sup> However, if this is the basic rule, it is sometimes honoured in the breach: can British Gas ever fairly be said to be responsible for the failure of the British state to implement a directive because it enjoys certain statutory privileges under UK law?<sup>75</sup>

Second, a *leitmotif* of the Court's construction of the four freedoms is the convergence, or cross-fertilisation, of the principles applying to each.<sup>76</sup> There are many examples: the uniform application of objective justification reasoning; of proportionality; the transubstantiation of mandatory requirements of *Cassis de Dijon*<sup>77</sup> under Article 28 into imperative reasons (or objective justification) in the general interest under Article 49 (*Insurance cases*)<sup>78</sup> and thence into Article 43 (*Gebhard*); *Keck*<sup>79</sup> reasoning springing up in cases on workers (*Bosman*) and services (*Alpine Investments*).<sup>80</sup> This is inevitable, and probably desirable. But the risk is that dealing with the four freedoms is not always comparing like with like. And where one breaks ranks and leads, will, or ought, the others necessarily to follow?

## Angonese

The breaking of ranks, in the context of obligations for the individual, came, of course, in the free movement of workers, the groundwork in

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<sup>74</sup> *Van Gend en Loos*, p. 12.

<sup>75</sup> Case C-188/89 *Foster v British Gas* [1990] ECR I-3313.

<sup>76</sup> See, for example, P. Behrens, 'Die Konvergenz der wirtschaftlichen Freiheiten im europäischen Gemeinschaftsrecht' (1992) vol. 27:2 *Europarecht* 145–62; W.H. Roth, 'Diskriminierende Regelungen des Warenverkehrs und Rechtfertigung durch die "zwingenden Erfordernisse" des Allgemeininteresses' (2000) 9 *Wettbewerb in Recht und Praxis* 979–85.

<sup>77</sup> Case 120/78 *Rewe-Zentrale v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649.

<sup>78</sup> Case 205/84 *Commission v Germany (Insurance and Co-Insurance)* [1986] ECR 3755.

<sup>79</sup> Joined Cases C-267 and 268/91 *Criminal Proceedings against Keck and Mithouard* [1993] ECR I-6097.

<sup>80</sup> Case C-384/93 *Alpine Investments v Minister van Financiën* [1995] ECR I-1141.



*Walrave*<sup>81</sup> and *Bosman*, and, finally, *Angonese*. The pre-*Angonese* forays have been subsumed within *Angonese* and so have lost some of their shock value; but it is worth noting here that *Walrave* concerned not only the free movement of workers but also the provision of services; so we knew (or thought we knew)<sup>82</sup> from early on that whatever *Walrave* (and *Bosman*) said about regulation by a private body *in a collective manner* applies to both workers and services, although the permitted limitations may be different.

*Bosman* was the first time the Court came to consider genuinely non-discriminatory private measures which impeded the free movement of workers. *Haug-Adrion*<sup>83</sup> in 1984 was almost there, but the Court failed to grasp the nettle; and it was in any event overtaken by *Bosman*. *Bosman* has, of course, a number of elements: the author of M. Bosman's difficulties being a private law body, and one with its seat outwith the Community, but one which 'regulat[ed] gainful employment in a collective manner'<sup>84</sup> and so in this respect on all fours with *Walrave*; the '3 + 2 rule', which was clearly discriminatory and so unlawful; and the transfer fee. *This* was non-discriminatory, Liège would have been liable for it irrespective of M. Bosman's nationality, and if he was moving to Anderlecht, or to Galatasaray. Yet it was caught by Article 39 unless it could be justified by reference to some reason in the general interest. This will be considered below.

This set the stage for *Angonese* and its deceptively quiet revolution. The Court peremptorily brushed aside questions of admissibility of the reference and the application of Regulation 1612/68:<sup>85</sup> the question fell to be considered by reference to Article 39 EC only. The Court noted that the prohibitions in Article 39 were in general terms, and not addressed to the Member States: '[f]reedom of movement for workers shall be secured within the Community. [It] shall entail the abolition of any discrimination based on nationality'. It cited *Walrave* and *Bosman* with approval, and reiterated the *Walrave* concerns that rules governing access to employment may be a function of public or private regulation, and so a risk of inequality of application amongst Member States. It then leapt to *Defrenne II*, noting that Article 141 EC had been held to confer horizontal direct effect, and 'such considerations must, *a fortiori*, be applicable to Article [39 EC], which lays down a fundamental freedom and which constitutes a specific application of the general prohibition of discrim-

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<sup>81</sup> Case 36/74 *Walrave and Koch v Union Cycliste Internationale* [1974] ECR 1405; see also Case 13/76 *Donà v Mantero* [1976] ECR 1333.

<sup>82</sup> See n. 126 below and accompanying text.

<sup>83</sup> Case 251/83 *Haug-Adrion v Frankfurter Versicherungs-AG* [1984] ECR 4277.

<sup>84</sup> *Walrave and Koch*, para. 27; *Bosman*, para. 82.

<sup>85</sup> Regulation 1612/68, OJ 1968 English Special Edition L257/2.

ination contained in Article [12 EC]. In that respect, like Article [141], it is designed to ensure that there is no discrimination on the labour market.’<sup>86</sup> And thence to the bombshell: ‘[c]onsequently, the prohibition of discrimination on grounds of nationality laid down in Article [39] must be regarded as applying to private persons as well’.<sup>87</sup>

Now *Angonese* was coloured with a number of issues, not least the wholly internal rule, and how Sr Angonese managed to spend so many years in Vienna without gaining a qualification.<sup>88</sup> But all that aside, its primary importance lay in, and remains, the horizontal direct effect of, and so burdens placed upon the individual by, Article 39. Where do we go from here?

First, the reasoning of the Court is, to put it at its highest, thin. It boils down to: disharmony between Member States a result of public/private regulation of access to employment is undesirable; Article 141 has horizontal direct effect; the principle ought to apply no less to Article 39; and so it does. The overriding justification seems to be uniform application; *effet utile* is not really canvassed. Now, the Court could have responded in a number of other ways. It could have said *Defrenne* was wrong; Article 141 *does* appear to be addressed to the Member States, and in soft (‘Member States shall ensure the application of the principle’) language, and the judgment (or overreaction) of the Court may well have been coloured by impatience with the abject failure of the Member States (and the Community) to do much at all to honour the commitment. There is disharmony in many areas of Community law, the most obvious example being the application of unimplemented or incorrectly implemented directives, which could have been cured by the Court at a stroke in *Faccini Dori*.<sup>89</sup> But it wasn’t; this, said the Court, would be *contra legem*: it’s not what the Treaty says. *Angonese* now leaves us with significant intrusion into private law (labour law) matters, all private employers now bound to afford Community law standards to all migrant workers, but so long as the wholly internal rule survives, not to home workers. Or at least they must do so if to do otherwise would result in discrimination, for *Angonese* was limited to discriminatory measures. Is it now going to spill over into other of the four freedoms? Advocate-General Lenz said in *Bosman* that ‘there is no sensible reason discernable why free movement of goods ought to be better protected

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<sup>86</sup> *Angonese*, para. 35.

<sup>87</sup> *Ibid.*, para. 36.

<sup>88</sup> For fuller consideration of the judgment see the case comment by R. Lane and N. Nic Shuibhne (2000) vol. 37:5 *Common Market Law Review* 1237–47; and R. Streinz and S. Leible, ‘Die unmittelbare Drittwirkung der Grundfreiheiten: Überlegungen aus Anlass von EuGH – *Angonese*’ (2000) vol. 11:15 *Europäische Zeitschrift für Wirtschaftsrecht* 459–67.

<sup>89</sup> Case C-91/92 *Faccini Dori v Recreb* [1994] ECR I-3325.

than free movement of persons, since both are of fundamental importance for the internal market'.<sup>90</sup> Is he right?

### The Free Movement of Goods

Treaty rules on the free movement of goods fall into three categories: essentially, impediments created by tariff barriers (Article 25); fiscal barriers (Article 90); and non-tariff barriers (Articles 28 to 31). The individual is beyond the reach of Article 90: the taxing power is one wielded by public authorities alone, and the prohibition – ‘No Member State shall impose . . . any internal taxation’ in excess of that imposed upon similar or competing domestic products – survived Amsterdam and survives even the Constitutional Treaty:<sup>91</sup> it is one rightly restricted to the Member States. Article 25 is more problematic. The original Article 12 of the EEC Treaty appears to have been addressed to the Member States: ‘Member States shall refrain from introducing [and from increasing] between themselves any new customs duties on imports or exports’; and it was this construction, and the obligation to ‘refrain from’ increasing tariffs, which caused the anguish, and the split between Advocate-General Roemer and the Court, in *van Gend en Loos*, as to whether it was a directly effective prohibition. Following the Amsterdam spring clean of the Treaty, the prohibition in Article 25 EC is simpler: ‘[c]ustoms duties on imports and exports and charges having equivalent effect shall be prohibited between Member States’. This new provision, like Article 39, is addressed to no one; it simply lays down a prohibition. *Prima facie* it can apply only to Member States, as only Member States are competent to create and impose customs duties. Yet so broad is the meaning of a charge having equivalent effect (‘any pecuniary charge, however small, and whatever its designation and mode of application, which is imposed unilaterally on domestic or foreign goods by reason of the fact that they cross a frontier’)<sup>92</sup> that the application of Article 25 to individuals cannot be ruled out. For example, it is not inconceivable that a producer may wish to discourage parallel trade, and so in a distribution contract seek to do so not by prohibition (which would almost certainly fall within the scope of Article 81)<sup>93</sup> but by a ‘surcharge’ or financial penalty (payable to the producer or to other distributors) should contract goods be sold by the distributor outside the contract territory. If the contract territory is that of a Member State, the surcharge might constitute a ‘pecuniary charge’ that is

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<sup>90</sup> *Bosman*, para. 200 of the Opinion.

<sup>91</sup> Treaty establishing a Constitution for Europe, Article III-170.

<sup>92</sup> Case 24/68 *Commission v Italy (Art Treasures)* [1969] ECR 193, para. 9.

<sup>93</sup> Joined Cases 56 and 58/64 *Consten and Grundig v EEC Commission* [1966] ECR 299.

imposed 'by reason of the fact that [contract goods] cross a frontier'. Such a scheme may well fall foul of Article 81(1), but it may also offend Article 25 which, unlike Article 81, is an absolute prohibition admitting of no exculpation through exemption or *de minimis* defence. However, even presuming the horizontally direct effect of Article 25, such instances are likely to be rare. This is not the case with Article 28.

On their face, Articles 28 and 29 were not addressed only to Member States ('[q]uantitative restrictions . . . and all measures having equivalent effect shall . . . be prohibited between Member States'), although they formed part of what was Chapter 2 of Title I, the rest of which *was* otherwise specifically addressed to the Member States; but these provisions were reorganised by the Amsterdam Treaty, returning Articles 28 and 29 to clearer ambiguity. They may also apply to (semi-)private bodies to which the state has delegated powers normally the preserve of the state, for example the regulation and discipline of a profession.<sup>94</sup> Yet in one respect Article 28 is, and has been since 1971, wholly horizontally directly effective; and that is in the exercise of intellectual property rights. Intellectual property rights are a species of property but they are not 'goods' in Community law, rather they have a character *sui generis* which can have the effect of hindering the free movement of goods (and of other Treaty freedoms);<sup>95</sup> if exercised in a particular manner (once the right is 'exhausted', otherwise it is saved by Article 295), it constitutes a measure having effect equivalent to a quantitative restriction and so a breach of Article 28. Thus, the exercise of a private law right by an individual is capable of falling foul of Article 28.

Why this is so has never been adequately explained or considered. It grew out of *Deutsche Grammophon*<sup>96</sup> in which it was simply presumed, without reasoning or justification, and in fact without being asked,<sup>97</sup> to be a matter falling within Article 28. The Court said that 'the essential purpose of the Treaty, which is to unite national markets into a single market . . . could not be attained if, under [*en vertu de; aufgrund*] the various legal systems of the Member States, nationals [*Privatpersonen*] of those states were able to partition the market and bring about arbitrary discrimination or disguised restrictions on trade between Member States'.<sup>98</sup> True enough, but the means by

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<sup>94</sup> Joined Cases 266 and 267/87 *R. v Royal Pharmaceutical Society of Great Britain ex parte Association of Pharmaceutical Importers* [1989] ECR 1295.

<sup>95</sup> Joined Cases C-92 and 326/92 *Phil Collins v Intrat* [1993] ECR I-487.

<sup>96</sup> Case 78/70 *Deutsche Grammophon v Metro-SB-Großmärkte* [1971] ECR 487.

<sup>97</sup> The questions put by the referring Hamburg court were restricted to interpretation of Articles 5, 85(1) and 86 (now 10, 81(1) and 82) of the Treaty; there was no reference to Article 30 (now Article 28), which the Court took it upon itself to consider.

<sup>98</sup> *Deutsche Grammophon*, para. 12.

which ‘nationals of those states [are] able to partition the market’ is addressed by Articles 81 and 82, not Article 28. The issue was raised in a subsequent case<sup>99</sup> but not satisfactorily considered by the Court, although it fashioned a Delphic judgment in terms of the exercise of an intellectual property right ‘which [the proprietor] enjoys under the legislation of a Member State’.<sup>100</sup> The justification seems to be that it is not the exercise of the private law right that offends Article 28, but rather the necessary reliance upon the national statute which creates it and provides the monopoly right – so bringing into the measure which inhibits the free movement of goods the imprimature and the exercise of state power. Unabashed, the Commission adopted a variation of this tack, proposing that it is not the attempt by the proprietor to exercise the right afforded by national law which infringes Article 28 but the judgment of a national court which gives effect to it.<sup>101</sup> In either case it is sophistry, for all private law rights are created by, and subject to, the legislation (or common law) of a Member State. It is not significantly more disingenuous to say that any conduct of a body corporate falls within the strictures of Article 28, for it too relies upon national legislation for its existence, so that the exercise by it of any private law right – say, the right simply to form a contract – which partitions the internal market ought to fall within Article 28. Which it does not. As the Court of Justice confirmed in 2002 in the context of an arrangement as to the marking of packaging argued to hinder the free movement of goods, ‘that . . . obligation arises out of a private contract between the parties to the main proceedings. Such a contractual provision cannot be regarded as a barrier to trade for the purposes of Article [28 EC] since it was not imposed by a Member State but agreed between individuals.’<sup>102</sup> It is submitted that it is a distortion of Article 28 to stretch the prohibition to embrace the exercise by an individual of a property right; in other words, to confer upon it horizontal direct effect. At least, it is inconsistent with all other existing case-law on Article 28 as it stands hitherto. The question is then whether its reach is further.

It was, at the time, suggested that a breakthrough of sorts was made in *Dansk Supermarked*,<sup>103</sup> but it was a false start; the case involved the application of the Danish law on unfair competition and so relied perhaps over-much upon *Deutsche Grammophon* logic, and is not thought to be good

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<sup>99</sup> Case 15/74 *Centrafarm and de Pijper v Sterling Drug* [1974] ECR 1147.

<sup>100</sup> *Ibid.*, para. 15.

<sup>101</sup> *Ibid.*, Report for the Hearing, Observations submitted by the Commission, Question 1(a).

<sup>102</sup> Case C-159/00 *Saphod Audic v Eco-Emballages* [2002] ECR I-5031, para. 74.

<sup>103</sup> Case 58/80 *Dansk Supermarked v Imerco* [1981] ECR 181.

law.<sup>104</sup> Throughout the 1980s the Court was content that Articles 28 and 29 were addressed to the conduct of the authorities of the state alone, not that of private persons.<sup>105</sup> The first erosion of the principle came later, in *Commission v France*, and then *Schmidberger*.

*Commission v France* (or sometimes the ‘*Strawberries*’ case) involved protests, often violent, waged by French farmers against imported agricultural products: the interception (‘*contrôle*’) of lorries transporting them, destruction of their loads, menaces and violence against drivers, wholesalers and shops selling imported produce; and all over an extended period (more than a decade) and met, it was claimed, with passivity or indifference on the part of the French authorities. According to Advocate-General Lenz, ‘[t]here can be no doubt in this case that the conduct of private individuals in question would constitute an infringement of the principle of the free movement of goods if it could be attributed to the French Republic’.<sup>106</sup> But it couldn’t, or couldn’t readily. This was not the French state, it was rampaging French farmers. However, it was argued, they rampaged with the complicity of the authorities of the French state. To which the Court said:

As an indispensable instrument for the realisation of the market without internal frontiers, Article [28] therefore does not prohibit solely measures emanating from the State which, in themselves, create restrictions on trade between Member States. It also applies where a Member State abstains from adopting the measures required in order to deal with obstacles to the free movement of goods which are not caused by the State.

The fact that a Member State abstains from taking action or, as the case may be, fails to adopt adequate measures to prevent obstacles to the free movement of goods that are created, in particular, by actions of private individuals on its territory aimed at products originating in other Member States is just as likely to obstruct intra-Community trade as is a positive act.

Article [28] therefore requires the Member States not merely themselves to abstain from adopting measures or engaging in conduct liable to constitute an obstacle to trade but also, when read with Article [10] of the Treaty, to take all necessary and appropriate measures to ensure that the fundamental freedom is respected on their territory.<sup>107</sup>

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<sup>104</sup> See W.H. Roth, ‘Drittwirkung und Grundfreiheiten?’, in O. Due and others (eds), *Festschrift für Ulrich Everling* (Baden-Baden: Nomos, 1995), Band II, pp. 1231–47, pp. 1234–46.

<sup>105</sup> See, for example, Joined Cases 177 and 178/82 *Criminal Proceedings against van de Haar* [1984] ECR 1797; Case 311/85 *Vereniging van Vlaamse Reisebureaus v Sociale Dienst van de Plaatselijke en Gewestelijke Overheidsdiensten* [1987] ECR 3801; and Case 65/86 *Bayer v Sillhofer* [1988] ECR 5249.

<sup>106</sup> Case C-265/95 *Commission v France* [1997] ECR I-6959, para. 13 of the Opinion; emphasis in original.

<sup>107</sup> *Ibid.*, paras 30–32.

It went on to consider margin of discretion, and concluded that ‘the French government had manifestly and persistently abstained from adopting appropriate and adequate measures to put an end to the acts of vandalism which jeopardise the free movement on its territory of certain agricultural products originating in other Member States’.<sup>108</sup> Thus, France was in breach of Article 28, in combination with Article 10, not for impeding imports but for failing to prevent the (thuggish) conduct of individuals which did so.<sup>109</sup>

*Schmidberger* was an altogether more decorous affair, involving peaceful protest by environmental campaigners that proceeded with the approval of the Austrian authorities (it being a lawful protest in Austrian law), which temporarily halted heavy motor traffic through the Brenner Pass. It was, it is worth noting, an action in damages (by Schmidberger, a Bavarian operator of heavy good lorries who claimed to have suffered loss as a result) against Austria which came to the Court via Article 234, not enforcement proceedings under Article 226. It probably should have been bounced right back for inadmissibility,<sup>110</sup> but it wasn’t – the Court showing a peculiar and consistent leniency in admissibility of references from Austrian courts; and it yields more interesting fruit than the French case. The (full) Court had recourse to *Dassonville*,<sup>111</sup> and said that Articles 28 and 29 ‘must be understood as being intended to eliminate all barriers, whether direct or indirect, actual or potential, to trade flows in intra-Community trade’.<sup>112</sup> As in *Commission v France*, it referred to the free movement of goods as a fundamental freedom,<sup>113</sup> and had ‘regard to the fundamental role assigned to the free movement of goods in the Community system, in particular for the proper functioning of the internal market’.<sup>114</sup> It found the Austrian refusal to ban the demonstration to be a measure having effect equivalent to a quantitative restriction, so its conduct falling within Article 28 in combination with Article 10; and, like the French case, it inhibited goods from other Member States entering or passing through Austria. The Court trawled through *Commission v France*, easily distinguished the two, found Austria to have acted well within its margin of discretion, and so unlikely to be a breach of Article 28, and certainly not one

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<sup>108</sup> *Ibid.*, para. 65.

<sup>109</sup> The case also led to the adoption of Regulation 2679/98, OJ 1998 L337/8 (the ‘Strawberry Regulation’), intended to enable speedy action by the Commission to prevent repetition of similar breaches of Article 28.

<sup>110</sup> Case C-112/00 *Eugen Schmidberger Internationale Transporte Planzüge v Austria* [2003] ECR I-5659, consideration at paras 16–49 of the Advocate-General’s Opinion and paras 26–45 of the judgment.

<sup>111</sup> Case 8/74 *Procureur du Roi v Dassonville* [1974] ECR 837.

<sup>112</sup> *Schmidberger*, para. 56.

<sup>113</sup> *Ibid.*, para. 59.

<sup>114</sup> *Op. cit.*, para. 60.

sufficiently serious as to give rise to a claim in damages. In this it was very like the House of Lords, which had earlier come to a similar conclusion on the matter of policing protests at English ports from which live veal calves were to be exported, in *International Trader's Ferry*.<sup>115</sup>

Neither *Commission v France* nor *Schmidberger* stands for the proposition that Article 28 imposes obligations upon individuals – or at least, does so directly. Article 28 goes still to the burdens of the Member State; but it includes a duty of the state to ensure that the conduct of individuals does not produce consequences which would have the same effect. Hence, the necessary reference in both cases to Article 10 of the Treaty. There is, here, an analogy with the competition rules and Article 86(1): an obligation for the Member States, not so much to refrain from engaging in what is unlawful Treaty conduct, but to ensure that others do not.

What is interesting about *Schmidberger* is in the nuance, and the mix of principles from other areas of the Treaty, and not just free movement provisions. Advocate-General Jacobs suggested that Article 28 absorb, or adopt, a *de minimis* defence, although it ought not to apply here: '[i]f a *de minimis* rule exists, a blockage such as that in issue constitutes in my view an obstacle to the free movement of goods too substantial to fall within it'.<sup>116</sup> He had tried this before, urging that Article 28 apply to 'substantial restriction' to market access – admitting that 'it would of course amount to introducing a *de minimis* test' into Article 28<sup>117</sup> – but was rebuffed by the Court. *De minimis* is unknown, or unknown yet, in Article 28, at least formally.<sup>118</sup> It is known in Article 81, conduct falling within its prohibition only if it produces anti-competitive effects which are 'appreciable'.<sup>119</sup> Mr Jacobs also might usefully have borrowed from his opinion in *Ambulanz Glöckner*, in which he found that

<sup>115</sup> *R. v Chief Constable of Surrey ex parte International Trader's Ferry Ltd* [1999] 2 AC 418.

<sup>116</sup> *Schmidberger*, para. 67 of the Opinion.

<sup>117</sup> Case C-412/93 *Société d'Importation Edouard Leclerc-Siplec v TF1 Publicité* [1995] ECR I-179, para. 42 of the Opinion.

<sup>118</sup> There are a small number of cases which are difficult to understand unless they are determined, tacitly, upon *de minimis* reasoning; see on this N. Nic Shuibhne, 'Free movement of goods and Article 28 EC: An evolving framework' (2002) vol. 27:4 *European Law Review* 408–25 at 416–17. Recently came the first glimmer of recognition from the Court of Justice of *de minimis* principles applicable to Article 28; see Case C-20/03 *Openbaar Ministerie v Burmanjer and others* [2005] ECR I-4133.

<sup>119</sup> On the development of the principles of appreciability in the context of Article 81 EC, see Case 56/65 *Société Technique Minière v Maschinenbau Ulm* [1966] ECR 235; and Case 5/69 *Völk v Vervaecke* [1969] ECR 295; also, the Commission notice on agreements of minor importance which do not appreciably restrict competition under Article 81(1), OJ 2001 C368/13.



a restriction of ambulance services to a public monopoly was justified by Article 86(2) but only if the monopoly could satisfy demand; otherwise it was not. Although this is of greater nexus with *Commission v France* and *International Trader's Ferry*: it is the responsibility of the state to ensure adequate police so that strawberry importers, or veal exporters, can carry out their business, so it cannot plead limited resources. And most interestingly, to what extent must a Member State ensure the adequacy of the movement of goods? Does Article 28 require the provision by the state of a decent rail service? Could a green government construct a bucolic paradise unspoiled by roads? Could Ireland revert to 'a land whose countryside would be bright with cosy homesteads, whose fields and valleys would be joyous with . . . the romping of sturdy children, the contests of athletic youth, the laughter of happy maidens'<sup>120</sup> without offending the Treaty?

If the obligations of Article 28 are to be extended to individuals, an excellent opportunity to achieve it arose in 2001, courtesy, again, of excitable French farmers. In response to a crisis in the beef market occasioned by incidents of BSE and foot and mouth disease, six French trade associations/unions (four representing producers, two slaughterers), representing 75–80 per cent of turnover across the French meat industry, set about blocking imports of beef and fixing a 'price scale' for their own production. To this end farmers again stopped ('inspected') lorries, blockaded abattoirs, ransacked premises and destroyed consignments of imported beef. The unions were complicit in this, as was the government, the minister for agriculture saying in the *Assemblée nationale*: 'I would like to get downstream undertakings to agree to stop purchasing abroad for a few weeks, or indeed a few months. Of course . . . the state cannot force them to do so. However . . . if such undertakings were to stop importing for two, three or six months, until stocks had run down, it would be an act of good citizenship [*un acte de civisme*].'<sup>121</sup> The Commission intervened under Regulation 17, found that the six associations/unions 'infringed Article 81(1) of the Treaty by concluding . . . an agreement which had the object of suspending imports of beef into France and fixing a minimum price for certain categories of cattle'<sup>122</sup> and fined them a total of almost €17 million.

What the Commission found was a breach of Article 81. What it *might* have found, but didn't, was a breach of Article 28. Just as *Walrave/Bosman* was a bridge from the application of Article 39 purely to the state to full-blooded horizontal direct effect via the collective regulation of employment (and

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<sup>120</sup> É. de Valera, 'The strength of an idea', a speech to the nation broadcast on Radio Éireann, 17 March 1943.

<sup>121</sup> Commission Decision 2003/600 (*French Beef*), OJ 2003 L209/12, para. 33.

<sup>122</sup> *Ibid.*, Article 1.

service) markets, the Commission could have said the unions (being associations of undertakings)<sup>123</sup> engaged in collective conduct – the blacking of imported goods – which, taken together, hindered the access of those goods to the market. This would extend the prohibition of Article 28 (directly, if half way) to the conduct of individuals. But it didn't. The failure to do so does not necessarily mean that the conduct does not fall within the ambit of Article 28; the Commission has (or had) power under Regulation 17 to pursue breaches, by undertakings, of Articles 81 and 82, not their possible breaches of the free movement provisions, though it did helpfully suggest that a remedy for an undertaking visited with menaces and violence was to lodge a complaint to the Commission under Article 3 of Regulation 17.<sup>124</sup> But it is difficult to resist the conclusion that, in not in some way rising to the bait, the Commission considers it to be a bridge too far.

### Other Freedoms

Not very far adrift of the free movement of workers is the chapter on services. Like Article 39, Article 49 is not, and never was, addressed to the Member States ('restrictions on freedom to provide services shall be prohibited'). Like workers, it may apply (as the chapter of workers always does) to individuals properly so-called, to natural persons. *Walrave*, it may be recalled, applied equally to workers and services, and Advocate-General Warner was able to say that Articles 39 and 49 'are, in every material respect, parallel'.<sup>125</sup>

But if so, here is a strange thing. In 2002 (and so two years after *Angonese* and some seven years after *Bosman*), two banned swimmers lodged a complaint under Article 3 of Regulation 17 claiming that the doping control rules adopted by the International Olympic Committee (IOC) and the Fédération Internationale de Natation (FINA) infringed Articles 81 and 82, but which raised ancillary arguments relating to infringements of Article 49. The Commission refused to pursue the complaint in the matter of the competition rules, and responded in respect of Article 49:

The complaint contains no details which could justify a finding that there exists an infringement of Article 49 of the Treaty by a Member State or an associated state. Indeed, there is no evidence of the responsibility of any authority of a Member State for the adoption of measures which could prove contrary to the principle of the free movement of services.<sup>126</sup>

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<sup>123</sup> Op. cit., paras 104–17.

<sup>124</sup> Op. cit., para. 121.

<sup>125</sup> *Walrave*, Opinion of Advocate-General Warner, p. 1425.

<sup>126</sup> Case COMP/38.158 – *Meca-Medina and Majcen/CIO*, decision of 1 August 2002, unpublished, para. 71; translation by the author. The decision was challenged,

This is very stark, and very odd, for surely the IOC and FINA are no less responsible than are the Union Cycliste Internationale (*Walrave*), the Ligue Francophone de Judo (*Deliège*)<sup>127</sup> and the Fédération Royal Belge des Sociétés de Basket-ball (*Lehtonen*),<sup>128</sup> the latter two reaffirming *Walrave* that ‘the Community provisions on the free movement of persons and services not only apply to the action of public authorities but extend also to rules of any other nature aimed at regulating gainful employment and the provision of services in a collective manner’.<sup>129</sup> The Commission found Article 81 not to be joined by application of *Wouters* principles.<sup>130</sup> It might, at a stretch, have extended them to Article 49: that the IOC and FINA were responsible for the good government of the sport, unrelated to any aspect of the freedom of the individual to engage in it. But it did not do so, certainly not expressly. The Commission is in all likelihood wrong about the applicability of Article 49 (although doubtless the conduct of the IOC and FINA fall within an imperative reason in the general interest). But it certainly appears not to be enthusiastic to extend Article 49 directly to the conduct of individuals.

If not services, then even less likely establishment. Like workers and services, the prohibitions of Article 43 are not, and were not, addressed to the Member States: ‘restrictions on the freedom of establishment’ shall be abolished (pre-Amsterdam)/prohibited (post-Amsterdam). However, the whole ethos of Article 43 is the dismantling and repression of the (extensive) public barriers to establishment, and it would be rare that the conduct of individuals hinders the right. There are exceptions, an obvious one being, say, the refusal of a commercial landlord to let premises for the establishment and operation of a business by a company, or individuals, from abroad. This is not hugely adrift of *Angonese*, and might invite the same reasoning. But if so, presumably the landlord would be afforded a wide amplitude to argue objective justification.

The slowest to start, probably the most fully achieved, of the four freedoms is capital, and here there is room for individual duties. There are a number of cases in which banks have been censured for breaching the competition

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unsuccessfully, in Case T-313/02 *Meca-Medina and Majcen v Commission*, judgment of 30 September 2004, not yet reported, but with no direct consideration of this issue; under appeal as Case C-519/04P *Meca-Medina and Majcen v Commission*, pending. See also Case COMP/37.124 – FIFA rules on players’ agents, decision of 16 April 2002, unpublished.

<sup>127</sup> Joined Cases C-51/96 and 191/97 *Deliège v Ligue francophone de judo* [2000] ECR I-2549.

<sup>128</sup> Case C-176/96 *Lehtonen and Castors Canada Dry Namur-Braine ASBL v Fédération Royal Belge des Sociétés de Basket-ball ASBL (FRBSB)* [2000] ECR I-2681.

<sup>129</sup> *Deliège*, para. 47; *Lehtonen*, para. 35.

<sup>130</sup> Case C-309/99 *Wouters v Algemene Raad van de Nederlandse Orde van Advokaten* [2002] ECR I-1577.

rules;<sup>131</sup> these have been restricted to Article 81. However, let us say a UK bank, upon a request to do so, refuses to open a deposit account in Euros – or for that matter, in Estonian *krooni*. There may be good reason for not doing so, but is it not ‘a restriction on the movement of capital between Member States’?<sup>132</sup> If so, Article 56 may come to have significant bite.

## THE RESULTS

There are a number of issues here to be drawn together. The first is that of the horizontal direct effect of the Treaty provisions on free movement taken on their own. Were the Court to take the plunge, the repercussions could be profound. To illustrate, a few examples, or projections, will suffice. We know that Member States breach Article 28 if they require retailers to indicate the origin of the goods they sell, and the breach cannot be justified by reference to consumer protection.<sup>133</sup> This arose prior to the development of the ‘selling arrangements’ analysis of *Keck*, but as the Court found it could go to the product characteristics of goods and not just the context in which they were sold, it would probably survive it. If Article 28 bore burdens for the individual, would a retailer (even a single retailer, there being, yet, no *de minimis* defence) choosing to indicate the national origin of its wares, so dissuading the customer from buying imported goods (as the Court found to be the result in *Marks of Origin* on the basis of no evidence), infringe it? Would a cheesemonger (wherever situated) who specialised in French cheeses and so failed to stock cheddar, gorgonzola and halloumi offend Article 28? Would a bookseller who elects to specialise in the works of Shakespeare do so because he does not stock those of Racine or of Æschylus? Taken a logical step further, could the ‘fundamental right’ of free movement of goods, usually seen in the context of the rights of the market operator to carry on the business of producing and selling goods free of interference, extend to the demand side of the market, and a fundamental right of the consumer to his or her cheddar or Racine, or any (imported) product of his or her choice, and so the power to compel a shopkeeper (by invoking a direct effect of Article 28) to stock and sell it?

Clearly not. Or it might be safer to say, probably not. This is to misunderstand, and blur, the distinction between impediments to market access (in a *Keck* sense) and the autonomy of the individual, or undertaking, which is the

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<sup>131</sup> See, for example, Decision 2003/25 (*German Banks*), OJ 2003 L15/1; Decision 2004/138 (*Austrian Banks – Lombard Club*), OJ 2004 L56/1.

<sup>132</sup> Article 56 EC.

<sup>133</sup> Case 207/83 *Commission v United Kingdom (Marks of Origin)* [1985] ECR 1191.

motive force of the market. It goes to the heart of the free market and the competition rules: private parties may suffer limitations to their liberty, but exceptionally only (and in the Treaty context, under Articles 81 and 82). Otherwise they are to be afforded a free hand; to place further fetters upon that liberty would defeat their proper role and contribution to the internal market.

Yet this is exactly what the Court has done for workers: a fettering of the liberty of the individual insofar as it inhibits the free movement of others. Maybe it is a function of the status in Community law of the individual (properly so-called), for workers are always natural persons; and notwithstanding the austerity of Treaty texts, the Court has long held him or her to merit greater esteem than a mere provider of labour. The case-law leads inevitably to the conclusion that discrimination against the individual is graver than discrimination against a good or a service (as, also necessarily, is discrimination between the sexes, at least insofar as it falls within Article 141). This can only be enhanced by his or her status as a citizen of the Union, one enjoying the rights of the Charter which may, if the Constitution is approved, for the first time have constitutional value, and by its re-jigging of workers to the front of the queue, both in the ordering of the internal market ('The internal market shall comprise an area without internal frontiers in which the free movement of persons, services, goods and capital is ensured . . .')<sup>134</sup> and workers taking pride of place, being the first of the freedoms and simplified to '[w]orkers shall have the right to move freely within the Union'.<sup>135</sup> But if the rights of the individual are so extensive – to reach so deeply as to prohibit the liberty of private persons to discriminate – under the chapter on workers, it is difficult to see how it can be sustained and not extended to natural persons providing or receiving services or seeking to exercise a right of establishment. And perhaps then beyond, to individuals invoking rights under the three 1990 residence directives<sup>136</sup> or even to rights of citizenship independently of any other free movement provisions of the Treaty.<sup>137</sup>

There is another fallacy in the extension, horizontally, of the free movement provisions. The breadth of Articles 28, 39, 43 and 49 is tempered by their derogation clauses: Member States are entitled – they have a duty – to protect the interests of the state, its public policy, public security and public health, even,

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<sup>134</sup> Treaty establishing a Constitution for Europe, Article III-130(2).

<sup>135</sup> Article III-133(1).

<sup>136</sup> Directive 90/364, OJ 1990 L180/26 (general right of residence); Directive 90/365, OJ 1990 L180/28 (retired persons); Directive 93/96, OJ 1993 L317/59 (students).

<sup>137</sup> That is, the line of authority starting with Case C-85/96 *Martínez Sala v Freistaat Bayern* [1996] ECR I-2691; and Case C-184/99 *Grzyłczyk v Centre public d'aide sociale d'Ottignies-Louvaine-la-Neuve* [2001] ECR I-6193.

if necessary, by restricting a fundamental Treaty right (as was the case in *Schmidberger*). This is part of the balance struck by the Treaty between Community objectives and the legitimate interests of the state. The Court says the balance is unaffected regardless of whether an inhibition to free movement is a function of state or private measure; that an individual may likewise plead justification for its conduct. In *Bosman* it said that '[t]here is nothing to preclude individuals from relying on justifications on grounds of public policy, public security or public health. Neither the scope nor the content of those grounds of justification is in any way affected by the public or private nature of the rules in question.'<sup>138</sup> But this is nonsense. Individuals have neither the power nor the duty to protect public policy; they act in their self interest. This lies at the heart of competition law and policy, recalling, once again, the invisible hand: '[i]t is not from the benevolence of the butcher, the brewer or the baker that we expect our dinner, but from their regard to their own interest'.<sup>139</sup> It is the pursuit of self interest through the autonomy of the individual that he or she best serves the interests of the Community.<sup>140</sup> This is the system by which we elect to live. And the pursuit of this self-interest can be vigorous, and destructive to others (within the law), without need of justification.

This brings us back to the relationship between, and the compatibility of, the rules on free movement and the competition rules, in respect of which there is an internal tension within the Treaty. For the moment there is clear blue water between Article 39 and the other free movement provisions, into which Article 28 has only dipped its toe. But there is a wider gulf between the free movement provisions and the competition rules, which although complementary and capable of informing each other, are not entirely harmonious. The latter have been horizontally directly effective since the Treaty became effective; that is their purpose. But if the former become horizontally directly effective, it would result in chaos for, and emasculation of, Articles 81 and 82.

On their face, the competition rules strike very broadly at distortions to competition. However, there are limits. Articles 81 and 82 apply only to 'undertakings'. Whilst the term admits of a very wide meaning – including the state in some of its guises – an entity which is not an undertaking need pay no heed to the competition rules. The finding by the Court of First Instance in *FENIN*<sup>141</sup> that an end-user is not an undertaking, even if a monopsony with the economic might of the Spanish *Sistema nacional de salud*, is not only peculiar, it removes from the ambit of Articles 81 and 82 a significant swathe

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<sup>138</sup> *Bosman*, para. 86.

<sup>139</sup> Smith, *op. cit.*, n. 2 above, Bk I, Chapter II, para. 1.2.2.

<sup>140</sup> See J. Baquero Cruz, 'Free movement and private autonomy' (1999) vol. 24:6 *European Law Review* 603–20.

<sup>141</sup> *FENIN*, n. 57 above.

of economic activity. The application of Article 82 is limited to situations in which market dominance exists (including, recently, collective dominance); absent a dominant position, it is silent. Article 81 applies only to distortions to competition the product of agreements, decisions of associations of undertakings or concerted practices. These too are very elastic, but not limitlessly so: Bayer AG clearly distorted competition, and admitted as much, but because its conduct could not be characterised to be a function of an ‘agreement’, it did nothing wrong<sup>142</sup> – or, more accurately, nothing proscribed. Absent an agreement (or collusion which would constitute a concerted practice), nor would rampaging French farmers be caught by Article 81.

The competition rules are also enforced in a manner differently from the free movement provisions: they are all directly effective (at least since May 2004),<sup>143</sup> but the competition rules are also enforced by the Commission and by national administrative authorities. If a Member State breaches Articles 28, 39, 43 or 49, it can be, and often is, put right by Article 226 proceedings. However, the Commission cannot raise an action under Article 226 against a delinquent individual. Should, for example, the *Cassa di Risparmio di Bolzano* refuse to employ a fully qualified Austrian because the head of personnel doesn’t much care for Austrians, there is nothing, under the present Treaty, the Commission could do about it, unless it sought to impute to the Republic the conduct of one bigoted provincial bank manager. Otherwise, enforcement would be a matter solely for national judicial remedies.

Most important, the prohibition of Article 81 in particular is not absolute. Even a hardcore restraint escapes if it produces anti-competitive effects which are not ‘appreciable’.<sup>144</sup> If the effects are appreciable they may still be excused by the application of the (now directly effective) exemption provisions of Article 81(3). The prohibitions of the free movement provisions are not only very wide (Article 28, for example, infused with *Dassonville*: all trading rules which directly or indirectly, actually or potentially, inhibit the movement of goods); notwithstanding the best efforts of Advocate-General Jacobs, it admits of no *de minimis* rule. Now, the *de minimis* exclusion and ‘rule of reason’ exemption provisions are part of Article 81 for a reason. Some conduct of individuals is nominally anti-competitive, yet produces results beneficial to the internal market – for example, exclusive dealing agreements which limit downstream competition but promote market interpenetration. It is a supple-

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<sup>142</sup> Joined Cases C-2 and 3/01 P *Bundesverband der Arzneimittel-Importeure v Bayer and Commission* [2004] ECR I-23.

<sup>143</sup> On 1 May 2004, Regulation 1/2003 (OJ 2004 L1/1) entered into force, amending the previous administrative system of exemption under Article 81(3) to one of (directly effective) *exception légale*.

<sup>144</sup> See n. 119 above and accompanying text.

ness which is a part of the competition rules but not of the internal market rules.

The two are therefore mutually incompatible to a degree, and if their application were to be extended (by finding individuals directly subject to the latter), the internal cohesion of the Treaty would be jeopardised. It has already been jeopardised by *Angonese*. The competition rules have been applied hitherto primarily to the production and distribution of goods, and latterly also to services; they have had little play in the free movement of workers – limited, effectively, to the discussion of Advocate-General Lenz in *Bosman* – and so the opportunity for mutual antagonism is limited. However, the prohibition recognised in *Angonese* is absolute (subject only to Article 39(3) exceptions or, if non-discriminatory, Advocate-General Lenz’s reasons in the general interest). There was no market analysis, no consideration of the place or the strength of the *Cassa* in a market, no appreciability test, no thought given to whether Sr Angonese might easily find other outlets for his talents. These are Article 81, not Article 39, considerations; and ironically, would not apply here at all, for a worker is not an undertaking in matters of his or her contract of employment.<sup>145</sup> Under Article 39, Sr Angonese met with a hindrance to his right as a worker (assuming he could plead the equivalence of such linguistic qualifications as he possessed); end of analysis. Unless the Court goes back on *Angonese*, we shall have to live with this now. However, should the principle be extended to goods (and services), the dangers would be magnified several-fold. Take, for example, a distribution or licensing contract which includes an absolute export ban; it would breach Article 81 (unless inappreciable) and Article 29 (absolutely). Yet, say rather it is a partial export ban (an ‘open’ exclusive contract); it may, in circumstances, escape the prohibition of Article 81(1) altogether, without need of recourse to Article 81(3);<sup>146</sup> but it will still be caught by Article 29. Thus, we have an agreement between individuals which, by application of competition principles, produces a state of affairs which serves the ends of the internal market, but is impaled upon on the strict discipline of the un-supple free movement rules.

Where then does this leave us? The individual is a clear beneficiary of the rules of the internal market, and, because of direct effect, has a pivotal role to play in promoting and safeguarding its development: all that is required of him is that he pursue his own self-interest with vigour. He is an addressee of

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<sup>145</sup> Case C-67/96 *Albany International v Stichting Bedrijfspensioenfonds Textielindustrie* [1999] ECR I-5751; and Case C-22/98 *Criminal Proceedings against Becu* [1999] ECR I-5665.

<sup>146</sup> See, for example, Case 56/65 *Société Technique Minière v Maschinenbau Ulm* [1966] ECR 235; and Case 258/78 *Nungesser v Commission (Maize Seeds)* [1982] ECR 2015.



burdens under the Treaty primarily under the competition rules. Here there are fetters placed upon his individual freedom, but they are not great, and to all but the most extreme devotees of the free market, they are justified. This is the limit of the regulation to which he is made subject by the law; otherwise it is the discipline of the market (which is to be kept untainted by these rules) which imposes the greatest burdens upon him, and within which he is, again, expected to contribute most by the vigorous pursuit of self-interest. The rules on free movement have a different purpose. That is why they are addressed primarily to the Member States, to the public law side of the internal market. The two are complementary, but their target, design and principles are different, and they cannot co-exist in all respects comfortably. We have, nevertheless, seen the two fields edging closer together, the most remarkable synaptic leap being, of course, the horizontal direct effect of Article 39, of which much more needs to be learned, both in and for itself and for its properties of infection. Elsewhere the distinction survives more or less intact, the two continuing to be essentially, but not entirely, watertight. It cannot be said with certainty that they will remain so.

# 10. The external dimension of the internal market and the individual

**Panos Koutrakos**

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## INTRODUCTION

Within the context of the single market, the individual is at the very centre of the implementation of Community law by carrying out a two-fold function. On the one hand, they have been the recipients of rights conferred upon them by EC law: from *van Gend en Loos*<sup>1</sup> to *van Duyn*<sup>2</sup> to *Ratti*,<sup>3</sup> they have been granted what would subsequently be described as a minimum level of protection<sup>4</sup> and become agents of the decentralised enforcement of the law of the single market. On the other hand, that enhanced legal position has been instrumentalised by the Court of Justice and enabled it to strike down national practices which were not only economically but also politically protectionist.<sup>5</sup> These intrinsically intertwined functions have rendered individuals not only passive recipients of rights, but also active participants in the establishment and management of the internal market. In doing so, they have contributed to the definition of the fundamental nature of the Community legal order.

Within the context of EC external relations, however, the definition of the legal position of individuals gives rise to a new set of questions. The legal personality of the EC<sup>6</sup> and the competence to negotiate and conclude international agreements, both autonomously and along with the Member States,

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<sup>1</sup> Case 26/62 *van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 1.

<sup>2</sup> Case 41/74 *van Duyn v Home Office* [1974] ECR 1337.

<sup>3</sup> Case 148/78 *Criminal Proceedings against Ratti* [1979] ECR 1629.

<sup>4</sup> Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur SA v Germany* and *R. v Secretary of State for Transport, ex parte Factortame Ltd and others* [1996] ECR I-1029.

<sup>5</sup> See A. Menon and S. Weatherill, 'Legitimacy, accountability, and delegation in the European Union', in A. Arnall and D. Wincott (eds), *Accountability and Legitimacy in the European Union* (Oxford: Oxford University Press, 2002), pp. 113-31.

<sup>6</sup> Article 281 EC.

brings the issue of the interpretation and application of international rules to the centre of the Community legal order. These rules constitute the outcome of negotiation between the Community (and possibly national) executive and third parties, and the method of their enforcement may vary. The aim of this chapter is to: first, outline ways in which individuals may become involved in the enforcement of rules which constitute the external dimension of the internal market; second, to ascertain how the construction of the legal position of the individual may differ from that underpinning the enforcement of the single market rules; and finally, to place the approach of the Court of Justice within the more general framework of the principles underpinning the system of EC external relations.

## THE INDIVIDUAL AND THE EFFECTS OF WTO RULES

The legal position of the individual has been at the centre of academic debate in relation to the effects of the agreements concluded under the framework of the World Trade Organization (WTO). It is recalled that back in the 1970s, the Court had rejected the direct effect of the precursor to the WTO Agreements, that is the General Agreement on Tariffs and Trade (GATT). Having examined the spirit, the general scheme and the terms of the Agreement, it reached the conclusion in *International Fruit Company* that it was ‘not capable of conferring on citizens of the Community rights which they can invoke before the courts’.<sup>7</sup> The main reason for this was the ‘great flexibility’ of the GATT provisions, ‘in particular those conferring the possibility of derogation, the measures to be taken when confronted with exceptional difficulties and the settlement of conflicts between the contracting parties’.<sup>8</sup> This approach to the nature of GATT was applied by the Court to challenges brought by private applicants against both EC secondary legislation<sup>9</sup> and national legislation.<sup>10</sup>

This dual bite of the notion of direct effect might appear to transcend the fundamental quality underpinning its application on the internal plane, namely

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<sup>7</sup> Joined Cases 21 to 24/72 *International Fruit Company NV and Others v Produktschap voor Groenten en Fruit* [1972] ECR 1219, para. 27.

<sup>8</sup> *Ibid.*, para. 21.

<sup>9</sup> See Case 9/73 *Carl Schlueter v Hauptsollamt Loerrach* [1973] ECR 1135, where reliance was made upon a bilateral agreement with Switzerland concluded in 1969 in accordance with Article XXVIII GATT 1947.

<sup>10</sup> See Case 266/81 *SIOT v Ministero delle Finanze* [1973] ECR 731; Joined Cases 267/81, 268/81 and 269/81 *Amministrazione delle Finanze dello Stato v Società Petrolifera Italiana SpA (SPI) and SpA Michelin Italiana (SAMI)* [1983] ECR 801; and Case C-469/93 *Amministrazione delle Finanze dello Stato v Chiquita Italia* [1995] ECR I-4533.

a tool which would enable the individual not to be confined to the legal machinery provided under national law and, instead, rely upon that provided within the context of an additional legal order. However, the Court's approach illustrates with stark clarity the dual function it is called upon to carry out: on the one hand, to supervise the interpretation and application of Community law in the national legal orders and, on the other hand, to supervise the application of international rules within the context of the Community legal order which is, in turn, intrinsically intertwined with the national legal orders. Placed at the intersection of Community law, international law and national law, the Court of Justice is called upon to carry out a constitutional function while wearing two hats: the one requires that it acts as an 'external' court, which facilitates the penetration of national law by supranational law; and the other requires that it acts as an 'internal' court, which safeguards the integrity of supranational law by controlling its penetration by international law.

While this is not an easy task, the Court went to some lengths to ensure that it is being carried out efficiently. For instance, it developed what has been called its 'succession theory':<sup>11</sup> as the Community has been endowed with exclusive competence pursuant to Article 133 EC over the areas covered by GATT, 'the Member States showed their wish to bind it by the obligations entered into under the General Agreement'<sup>12</sup> and, therefore, it 'has assumed the powers previously exercised by Member States in the area governed by the General Agreement' the provisions of which 'have the effect of binding the Community'.<sup>13</sup> This position subsequently allowed the Court to deny individuals the right to invoke GATT provisions against national measures adopted even prior to the introduction of the Common Customs Tariff.<sup>14</sup>

The adoption of the WTO Agreements in 1994 following the Marrakesh Round brought the issue of direct effect back to the centre of EC external relations law. The reason for this was the considerable legalisation of this new framework for multilateral trade negotiations. This was illustrated at various instances, most notably in the dispute settlement rules.<sup>15</sup> While the issue of the effect of the new multilateral framework was raised in a number of annulment actions brought by private applicants, the Court conspicuously ignored it for a

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<sup>11</sup> J. Klabbers, 'The *Bustani* case before the ILOAT: Constitutionalism in disguise?' (2004) vol. 53:2 *International and Comparative Law Quarterly*, 455–64 at 456.

<sup>12</sup> *International Fruit Company*, para. 15.

<sup>13</sup> *Ibid.*, para. 18.

<sup>14</sup> See again, the judgment in *SPI* and *SAMI*.

<sup>15</sup> See A.F. Lowenfeld, *International Economic Law* (Oxford: Oxford University Press, 2003), p. 135 et seq.

period of time.<sup>16</sup> However, when asked to interpret the Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) in *Parfums Dior*, it was made clear that, as set out in an annex to the WTO Agreement, the provisions of TRIPS 'are not such as to create rights upon which individuals may rely directly before the courts by virtue of Community law'.<sup>17</sup>

This conclusion was based on the judgment delivered in the *Portuguese Textiles* case, where Portugal challenged a Council Decision concerning the conclusion of Memoranda of Understanding between the EC and Pakistan and India on arrangements in the area of market access for textile products.<sup>18</sup> In particular, it was argued that, in adopting the contested decision, the Council had violated a number of WTO Agreements, namely GATT 1994, the Agreement on Textiles and Clothing, and the Agreement on Import Licensing Procedures. The Court began its analysis by reaffirming two general points: on the one hand, it was for the contracting parties to every agreement to determine whether that agreement should have direct effect (it was only in the absence of such a statement that it was left to the courts to determine the effect of the agreement); on the other hand, whilst there should be *bona fide* performance of every agreement under international law, each contracting party is free to determine the legal means by which the commitments entered into should be fully executed in its legal system provided that such means are not specific in the agreement itself.

As for the WTO Agreements themselves, the Court did accept that they differed 'significantly' from the rules laid down in GATT 1947, with particular emphasis on the tighter regime provided in the system of safeguards and the dispute settlement procedure. However, after this briefest of statements, the Court stated that 'the WTO agreements, interpreted in the light of their subject-matter and purpose, do not determine the appropriate legal means of ensuring that they are applied in good faith in the legal order of the contracting parties'<sup>19</sup> as the system set out in the Dispute Settlement Understanding 'accords considerable importance to negotiation between the parties'.<sup>20</sup>

This is the first argument pursuant to which the Court denied the WTO

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<sup>16</sup> Joined Cases C-364 to 365/95 *T. Port GmbH & Co. v Hauptzollamt Hamburg-Jonas (T. Port III)* [1998] ECR I-1023 and Case C-183/95 *Affish BV v Rijksdienst voor de keuring van Vee en Vlees* [1997] ECR I-4315; Advocates-General Elmer and Cosmas respectively asked the Court to rule that GATT 1994 did not confer rights enforceable by individuals before national courts.

<sup>17</sup> Joined Cases 300/98 and 392/98 *Parfums Christian Dior SA and others v Tuk Consultancy BV and Assco Gerueste GmbH, Rob van Dijk v Wilhelm Layher GmbH and Co. Kg and Layher BV* [2000] ECR I-11307, para. 44.

<sup>18</sup> Case C-149/96 *Portugal v Council (Portuguese Textiles)* [1999] ECR I-8395.

<sup>19</sup> *Ibid.*, para. 41.

<sup>20</sup> *Ibid.*, para. 36.

Agreements direct effect, substantiated with reference to a number of specific provisions of that system. To that effect, the Court pointed out that, whereas the aim of the dispute settlement system was to ensure the withdrawal of a national measure found to have violated WTO rules, that withdrawal might be impracticable, in which case compensation may be granted on an interim basis.<sup>21</sup> While compensation is deemed a temporary measure in cases where the recommendations and rulings of the dispute settlement body are not implemented within reasonable time, the party violating WTO law may merely enter into negotiations with any party that has invoked the dispute settlement procedures in order to agree on mutually acceptable compensation. It was for that reason that the Court concluded that ‘to require the judicial organs to refrain from applying the rules of domestic law which are inconsistent with the WTO Agreements would have the consequence of depriving the legislative or executive organs of the contracting parties of the possibility afforded by Article 22 [DSU] of entering into negotiated arrangements even on a temporary basis’.<sup>22</sup>

The second argument put forward by the Court was based on the distinct nature of the system set out by the WTO Agreements, with particular emphasis on their implementation on the basis of the principle of negotiations between the contracting States – with a view to entering into reciprocal and mutually advantageous arrangements. In doing so, the Court expressly distinguished that framework from the typology of agreements concluded by the Community in order to provide either for an asymmetry of obligations or to create a special legal framework of integration with the Community.

The third argument may be called a balance-of-power argument, and is based on the approach to the issue of direct effect taken by some of the most important commercial partners of the Community. While in the case of any other international agreement a divergent approach to direct effect would not be problematic, the distinct nature of the WTO Agreements meant that the lack of reciprocity in their effect may lead to non-uniform application of the WTO rules. The Court then reasoned that ‘[t]o accept that the role of ensuring that those rules comply with Community law devolves directly on the Community judicature would deprive the legislative or executive organs of the Community of the scope for manoeuvre enjoyed by their counterparts in the Community’s trading partners’.<sup>23</sup>

It was for the above reasons that ‘having regard to their nature and structure, the WTO agreements are not in principle among the rules in the light of which the Court is to review the legality of measures adopted by the

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<sup>21</sup> Article 3(7) Dispute Settlement Understanding (DSU).

<sup>22</sup> *Portuguese Textiles*, para. 40.

<sup>23</sup> *Ibid.*, para. 46.

Community institutions'.<sup>24</sup> This conclusion has since been repeated in relation to a number of agreements concluded under the WTO umbrella, such as GATT 1994,<sup>25</sup> the Agreement on Technical Barriers to Trade,<sup>26</sup> and the Agreement on Trade-Related Aspects of Intellectual Property Rights.<sup>27</sup>

The approach of the Court of Justice to the right of individuals to invoke international trade rules was criticised quite early on. Even prior to the adoption of the WTO Agreements, the emphasis on the incomplete legal nature of GATT was seen as legally indefensible.<sup>28</sup> This argument was levelled against the Court with more force following the tighter legal regime provided within the WTO framework. This process of juridification of WTO law<sup>29</sup> has raised various objections to the exclusion of individuals, in principle, from the process of judicial adjudication pursuant to WTO rules. One such argument relies upon the construction of international economic law as a legal process with distinct constitutional features in which the European Union (EU) ought to assume a leading role: it ought to promote a global democratic framework where individuals would be active participants with specific legal rights conferred upon them, which would be enforceable before both national and transnational judicial bodies.<sup>30</sup>

The perceived constitutionalisation of international economic law<sup>31</sup> has been invoked in order to support two interrelated arguments. The first approaches the direct effect of WTO rules from an internal point of view and suggests that it is necessary in order to enhance the substantive and procedural rights of individuals. In that respect, the development of WTO law has been

<sup>24</sup> Op. cit., n. 22, para. 47.

<sup>25</sup> Case C-307/99 *OGT v Hauptzollamt Hamburg-St Annen* [2001] ECR I-3159.

<sup>26</sup> Joined Cases C-27 and C-122/00 *Omega Air Ltd and others* [2002] ECR I-2569.

<sup>27</sup> *Parfums Dior*; Case C-89/99 *Schieving-Nijstad vof and others v Robert Groeneveld* [2001] ECR I-5851.

<sup>28</sup> See E.U. Petersmann, 'The EEC as a GATT member – Legal conflicts between GATT law and European Community law', in M. Hilf, F.G. Jacobs and E.U. Petersmann (eds), *The European Community and GATT* (The Hague: Kluwer Law, 1989), pp. 23–71, p. 58–89.

<sup>29</sup> See J.H.H. Weiler, 'The rule of lawyers and the ethos of diplomats: Reflections on WTO dispute settlement', in R.B. Porter, P. Sauve, A. Subramanian and A.B. Zampetti (eds), *Efficiency, Equity, Legitimacy: The Multilateral Trading System at the Millennium* (Washington: Brookings Institution Press, 2001), pp. 334–50.

<sup>30</sup> See E.U. Petersmann, 'European and international constitutional law: Time for promoting "cosmopolitan democracy" in the WTO', in G. de Búrca and J. Scott (eds), *The EU and the WTO: Legal and Constitutional Issues* (Oxford: Hart Publishing, 2001), pp. 81–110.

<sup>31</sup> For another construction of it, see N. Walker, 'The EU and the WTO: Constitutionalism in a new key', in de Búrca and Scott (eds), *ibid.*, pp. 31–57.

viewed along the lines of the development of the law of the single market: the empowerment of individuals is seen as central to the former in the same manner as the success of the latter has been underpinned by the active participation of private citizens though the conferment of legally enforceable rights. In other words, it has been claimed that ‘this enlargement of “individual sovereignty” and the empowerment of EU citizens vis-à-vis EU member states has . . . not been applied to the EU’s external relations’.<sup>32</sup> The second thesis advanced by the ‘WTO constitutionalisation approach’ is based on an external point of view and is based on the role of the European Court of Justice (ECJ). It suggests that, by strengthening the enforcement mechanisms provided under the WTO umbrella, the Community judiciary would become central to the constitutionalising process.<sup>33</sup>

A detailed assessment of the specific characteristics of the WTO framework and their interpretation by the Court is beyond the scope of this chapter.<sup>34</sup> The process of juridification of international economic law, as illustrated by the reform of the WTO rules, is in no doubt. Indeed, it is acknowledged by the Court of Justice, both expressly and impliedly, by the shift in its reasoning in *Portuguese Textiles*. However, to argue for an extension of the direct effect logic as applied within the Community legal order to the rules laid down in the WTO framework is tantamount to ignoring the

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<sup>32</sup> E.U. Petersmann, ‘From state sovereignty to the “sovereignty of citizens” in the international relations law of the EU?’, in N. Walker (ed.), *Sovereignty in Transition* (Oxford: Hart Publishing, 2003), p. 154.

<sup>33</sup> See generally, K.J. Kuilwijk, *The European Court of Justice and the GATT Dilemma* (Beuningen: Centre for Critical Legal Studies, 1996).

<sup>34</sup> From the voluminous literature on the subject, see the detailed analysis of the wording, context and purpose of DSU and WTO in J. Jackson, ‘International law status of WTO Dispute Settlement Reports: Obligation to comply or option to “buy out”?’ (2004) vol. 98:1 *American Journal of International Law* 109–25 and P. Koutrakos, *EU International Relations Law* (Oxford: Hart Publishing, 2006), pp. 265–99. Also S. Peers, ‘Fundamental rights or political whim? WTO law and the European Court of Justice’, in de Búrca and Scott (eds), op. cit., n. 30 above, pp. 111–30; J.H.J. Bourgeois, ‘The European Court of Justice and the WTO: Problems and challenges’, in J.H.H. Weiler (ed.), *The EU, the WTO and the NAFTA: Towards a Common Law of International Trade* (Oxford: Oxford University Press, 2000), pp. 71–123; F. Snyder, ‘The gatekeepers: the European Courts and WTO law’ (2003) vol. 40:2 *Common Market Law Review* 313–67; P. Eeckhout, ‘The domestic legal status of the WTO Agreement: Interconnecting legal systems’ (1997) vol. 34:1 *Common Market Law Review* 11–58, and ‘Judicial enforcement of WTO law in the European Union: Some further reflections’ (2002) vol. 5:1 *Journal of International Economic Law* 91–110; J. Trachtman, ‘Bananas, direct effect and compliance’ (1999) vol. 10:4 *European Journal of International Law* 655–78; and S. Griller, ‘Judicial enforceability of WTO law in the European Union: Annotation to Case C-149/96 *Portugal v Council*’ (2000) vol. 3:3 *Journal of International Economic Law* 441–72.



specific features of the latter and suggesting a parallelism which is supported in neither legal nor practical terms.<sup>35</sup> There is one choice underpinning the dispute settlement system of the WTO and that is to strive for negotiation. Merely one illustration of this is provided by the absence of any remedy regarding financial compensation for past losses or interest. This indicates that the juridification of the WTO system, far from amounting to the establishment of a rules-oriented structure, constitutes a process which evolves around, rather than beyond, the political will of the contracting parties.<sup>36</sup> As has been pointed out, ‘remedies . . . in an integration system between unequal players like the WTO are there to “equalise” inequalities and to ensure, to paraphrase Henkin, that all players at all times will respect all of their obligations’, on which account ‘the WTO remedies fail’.<sup>37</sup> The defining limits of the WTO system are, as pointed out by the Court of Justice in *Portuguese Textiles*, also borne out in the light of current practice.<sup>38</sup> Even after years of judicial proceedings involving the Community bananas import regime, the policy of seeking to strike a deal with the Commission never abandoned the US administration.<sup>39</sup>

In light of the above, the dispute settlement procedures provided under the WTO framework have cogently been described as assuming ‘the role of shaping a new bargaining environment by attributing costs to the continuing violation of contract’.<sup>40</sup> Within such a legal environment, the judicial acknowledgment of the discretion that the Community executive should be allowed ought not to be seen merely as an illustration of judicial restraint; instead, it shows that the Court of Justice is receptive to the specific dynamics

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<sup>35</sup> As Howse and Nicolaidis point out, ‘constitutionalization was made acceptable in Europe by characteristics whose functional equivalent cannot be obtained at the WTO level, including the complex relationship between constitutional politics and legislative politics in the European Union’: see R. Howse and K. Nicolaidis, ‘Legitimacy and global governance: Why constitutionalizing the WTO is a step too far’, in Porter, Sauve, Subramanian and Zampeti (eds), *op. cit.*, n. 29 above, pp. 227–52, p. 238.

<sup>36</sup> See R. Hudec, ‘The new WTO dispute settlement procedure: An overview of the first three years’ (1999) vol. 8:1 *Minnesota Journal of Global Trade*, 1–53 at 10–15. See the overview by P.T. Stoll and A. Steinmann, ‘WTO dispute settlement: The implementation stage’ (1999) 3 *Max Planck Yearbook of United Nations Law* 407–37.

<sup>37</sup> P.C. Mavroidis, ‘Remedies in the WTO legal system: Between a rock and a hard place’ (2000) vol. 11:4 *European Journal of International Law*, 763–813 at 811.

<sup>38</sup> See the statements of Commissioner Lamy in *Financial Times*, 26 February 2004, p. 10 regarding the foreign sales corporation tax imposed by the US administration: the Commission was notably keen to avoid the imposition of trade sanctions in order to ensure compliance with the WTO rules.

<sup>39</sup> See H. Hauser and A. Roitinger, ‘Renegotiation in transatlantic trade disputes’, in E.U. Petersmann and M.A. Pollack (eds), *Transatlantic Economic Disputes: The EU, the US and the WTO* (Oxford: Oxford University Press, 2004), pp. 487–506.

<sup>40</sup> *Ibid.*, p. 506.

that underlie the international economic arena and the way they vary depending on the nature of the specific framework of co-operation under review.<sup>41</sup> At this juncture, it is suffice to make two observations. First, the endowment of WTO rules with direct effect would entail a shift in the balance of powers not only within the Community legal order but also the WTO framework itself, a development hardly envisaged by its contracting parties.<sup>42</sup> Secondly, while referring to the express will of the Member States as to the effects of WTO law, the formula used by the Court in *Portuguese Textiles* was such as to make it impossible to assume the weight that it had attached to it. It is recalled that, in the Preamble to Decision 94/800, the Council had stated that ‘by its nature, the Agreement establishing the World Trade Organization, including the Annexes thereto, is not susceptible to being directly invoked in Community or Member States courts’.<sup>43</sup> Having elaborated on the reasons why the WTO Agreements should not determine the legality of EC measures, the Court merely pointed out that that interpretation corresponded to the content of Decision 94/800.

## THE INDIVIDUAL AND THE EFFECTS OF INTERNATIONAL AGREEMENTS

It is argued above that the process of legalisation of the WTO framework does not seriously question the reluctance of the Court of Justice to involve individuals directly in the process of the application of those rules in the Community legal order. However, even for other international agreements concluded by the Community, the Court has been accused of being reluctant to rely upon the notion of direct effect, hence significantly undermining the legal position of individuals in the area of external relations.<sup>44</sup> This position

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<sup>41</sup> It is interesting that a WTO Panel Report has noted that ‘neither the GATT nor the WTO has so far been interpreted by GATT/WTO institutions as a legal order producing direct effect. Following this approach, the GATT/WTO did not create a new legal order the subjects of which comprise both contracting parties or Members and their nationals’: *US Sections 301–310 of the Trade Act of 1974*, Panel Report of 8 November 1999, WT/DS 152, para. 7.78.

<sup>42</sup> See the arguments put forward in C.D. Ehlermann, ‘Six years on the bench of the “World Trade Court”: Some personal experiences as a member of the Appellate Body of the World Trade Organization’ (2002) vol. 36:4 *Journal of World Trade* 605–39 at 637.

<sup>43</sup> OJ 1994 L336/1.

<sup>44</sup> See G. Gaza, ‘Trends in judicial activism and judicial self-restraint relating to Community agreements’ in E. Cannizzaro (ed.), *The European Union as an Actor in International Relations* (The Hague: Kluwer Law, 2002), pp. 118–34, pp. 128–30.

appears to be supported by the two-tier test adopted by the Court in order to allow individuals to invoke international agreements: the relevant provision of such an agreement should be clear, unconditional and non-dependent on further implementing measure *and* the agreement itself should be capable of conferring rights on individuals in the light of its nature and structure.<sup>45</sup> While this might appear to impose an additional burden on the ability of individuals to rely upon international rules binding upon the Community in order to challenge Community law, such a claim is unjustified on various grounds.

First, in theoretical terms, this two-tier test illustrates a pragmatic understanding of the acutely political nature of international negotiations, the legal outcome of which is expressed in various forms of an inherently indeterminate nature. The legalisation of international economic law, for instance, typifies that of an incrementally developed structure: whilst the outcome of the slow evolution of the sophisticated ways in which international economic relations may be carried out,<sup>46</sup> it constitutes in itself an inherently dynamic and incomplete process regularly reviewed at political level. This framework, where politics and law are intrinsically intertwined, appears fundamentally inhospitable to the development of legal principles such as those read by the Court of Justice into the EC Treaty and transformed into the constitutionalising foundations of the Community legal order. While Pescatore's oft repeated argument about the Court's '*certainne idée de l'Europe*'<sup>47</sup> might not be universally shared, it is suggested that, in the classic authorities introducing supremacy and direct effect into our legal vocabulary, one may find a vision for the foundations of the emerging legal order expressed both with conviction and coherence.<sup>48</sup> Extremely cautious though one may be of 'visions' of any type, that developed by the Court has a specific appeal insofar as the legal position of individuals underpins the genesis and development of the constitutional foun-

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<sup>45</sup> *International Fruit Company*, para. 20; see also Case 104/81 *Hauptzollamt Mainz v C.A. Kupferberg & Cie KG a.A.* [1982] ECR 3641. The Court now puts it as follows: 'a provision in an agreement concluded by the Community with a non-member country must be regarded as being directly applicable when, regard being had to its wording and to the purpose and nature of the agreement, the provision contains a clear and precise obligation which is not subject, in its implementation or effects, to the adoption of any subsequent measure': Case C-171/01 *Gemeinsam Zajedno* [2003] ECR I-4301 (relating to Article 10(1) of Decision No 1/80 of the EEC-Turkey Association Council), para. 54.

<sup>46</sup> See, for instance, the conclusion of international agreements with a regulatory dimension to which the Court referred in *Opinion 1/78*, [1979] ECR 2871.

<sup>47</sup> P. Pescatore, 'The doctrine of "direct effect": An infant disease of Community law?' (1983) 8 *European Law Review*, 155-77 at 157.

<sup>48</sup> For a critique of the line of reasoning underpinning the relevant judgments from a jurisprudential point of view, see P. Eleftheriadis, 'The direct effect of Community law: Conceptual issues' (1996) 16 *Yearbook of European Law* 205-21.

dations of the emerging legal order. This could not be the case in relation to the emerging international legal order and the approach developed by the Court recognises it.

Secondly, the criticism levelled against the Court regarding the legal position of individuals appears unwarranted in the light of its overall approach to the effects of international agreements in the Community legal order. Instead of being confined to actions brought by individuals, the assessment of the general nature and context of an agreement as a prerequisite to its potential to challenge the legality of EC law is also apparent in actions brought by Member States. Indeed, *Portuguese Textiles* was such a case. The approach of the Court is not surprising: in *Germany v Council*,<sup>49</sup> the subject matter of the action was the compatibility of the Community regime on imports of bananas with a number of substantive and procedural rules and general principles of EC law, the Lomé Convention, and the rules laid down in GATT and the Banana Protocol. The saga of the *Bananas* litigation has been analysed often and well.<sup>50</sup> For the purpose of this chapter, it is suffice to point out that the Court transposed the *rationale* preventing individuals from invoking GATT rules before national courts to the legal position of Member States seeking to challenge EC rules before the Court of Justice. Having repeated the line of reasoning already put forward in *International Fruit Company*, *Schlueter*, *SIOT* and *SPI and SAMI*, the Court concluded in *Germany v Council* that ‘the special features [of GATT] show that the GATT rules are not unconditional and that an obligation to recognise them as rules of international law which are directly applicable in the domestic legal systems of the contracting parties cannot be based on the spirit, general scheme or terms of GATT’.<sup>51</sup> This conclusion, later reaffirmed in the Court’s case-law,<sup>52</sup> reiterates that the construction of the effect of an international agreement under Community law is in direct correlation to the nature and spirit of the agreement. The Court’s willingness to make the latter the starting point for its analysis in any action brought before it illustrates acute awareness of the constitutional and political implications

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<sup>49</sup> Case C-280/93 *Germany v Council* [1994] ECR I-4973.

<sup>50</sup> See S. Peers, ‘Banana split: WTO law and preferential agreements in the EC legal order’ (1999) vol. 4:2 *European Foreign Affairs Review* 195–214, and ‘WTO dispute settlement and Community law’ (2001) vol. 26:6 *European Law Review* 605–15; Trachtman, op. cit., n. 34 above; M. Weisberger, ‘The application of *Portugal v Council*: The Banana cases’ (2002) vol. 12:1 *Duke Journal of Comparative and International Law* 153–77; P. Cadot and D. Webber, ‘Banana splits and slipping over banana skins: The European and Trans-Atlantic politics of bananas’ (2001) European University Institute Working Papers, RSC 2001/03, available at <http://webdb.iue.it/FMPPro>.

<sup>51</sup> *Germany v Council*, para. 110.

<sup>52</sup> Case C-352/96 *Italy v Council* [1998] ECR I-6937.

that the broad effect of international agreements may carry. For the purpose of this chapter, it is suffice to point out that the approach of the Court in that respect is characterised by internal coherence and, being applied to actions brought by private applicants and Member States alike, in no way singles out the former for stricter legal treatment.

Thirdly, the two-tier test developed by the Court has, in fact, deprived only a specific legal framework of direct effect as a matter of principle. Indeed, the WTO agreements constitute an exceptional case of denying direct effect on the basis of the nature of the agreement<sup>53</sup> whereas a wide range of agreements negotiated and concluded by the Community are, in fact, assessed on the basis of the specific provision invoked by private applicants. Such instruments include the Europe Agreements concluded with the Central and Eastern European Countries,<sup>54</sup> Free Trade Agreements,<sup>55</sup> Co-operation Agreements,<sup>56</sup> and the Agreement with the Caribbean, African and Pacific countries.<sup>57</sup>

Furthermore, the material scope of the principle has been interpreted in quite wide terms: it applies to decisions of bodies set out by agreements concluded between the Community and a third country;<sup>58</sup> the fact that the procedures necessary for the application of rights conferred by such decisions cannot prevent them from being invoked by individuals.<sup>59</sup> Neither was direct effect ruled out simply because of the existence of safeguard clauses in the relevant agreement<sup>60</sup> nor by the fact that that agreement, in addition to conferring rights on individuals, also imposed certain limits.<sup>61</sup> All in all, while not adopting Pescatore's thesis that direct effect be deemed the ordinary state of the law,<sup>62</sup> the Court's approach has been far from unsympathetic in

<sup>53</sup> See P. Eeckhout, *The External Relations of EU* (Oxford: Oxford University Press, 2004), pp. 288 et seq.

<sup>54</sup> See, for instance, the Agreement with Poland, considered in Case C-162/00 *Land Nordrhein-Westfalen v Pokrzeptowicz-Meyer* [2002] ECR I-1049.

<sup>55</sup> See, for instance, the Agreement with Spain, considered in Case 225/78 *Procureur de la République de Besançon v Bouhelier* [1979] ECR 3151, para. 10.

<sup>56</sup> See, for instance, the Agreement with Algeria: Case C-103/94 *Krid v CNAVTS* [1995] ECR I-719, paras 21–23.

<sup>57</sup> See, in respect of the Yaoundé Convention, Case 87/75 *Bresciani v Amministrazione delle Finanze dello Stato* [1976] ECR 129.

<sup>58</sup> Case C-192/89 *S.Z. Sevince v Staatssecretaris van Justitie* [1990] ECR I-3461. See B. Martenczuk, 'Decisions of bodies established by international agreements and the Community legal order', in V. Kronenberger (ed.), *The European Union and the International Legal Order: Discord or Harmony?* (The Hague: T.M.C. Asser Press, 2001), pp. 141–63.

<sup>59</sup> See again, *Sevince*.

<sup>60</sup> See again, *Kupferberg*.

<sup>61</sup> See Case C-18/90 *Office National de l'Emploi v Kziber* [1991] ECR I-199.

<sup>62</sup> Pescatore, op. cit., n. 47 above.

principle to the right of individuals to invoke international rules before domestic courts.

Finally, it is worth pointing out that the assessment of the nature and purpose of international agreements concluded by the Community is relevant to the interpretation of the substantive content of their provisions once their ability to be invoked has been confirmed. This is illustrated in the Court's approach to actions where the provision of an agreement concluded by the Community and relied upon by a private applicant before a national court is worded in terms similar to those of EC Treaty provisions. Such similarity has been held not to be sufficient to justify the automatic application of EC principles without regard being had to the purpose of the agreement in question.<sup>63</sup>

## THE INDIVIDUAL AND THE DISTINCT FEATURES OF THE DEVELOPMENT OF EC EXTERNAL RELATIONS

It has been suggested so far that, within the context of the external dimension of the internal market, the legal position of the individual might appear to be marginalised for two reasons: on the one hand, the constitutionalising features of transnational economic law have been exaggerated and, on the other hand, the individual has not been central to the enforcement of international law. There is another reason on the basis of which the process of 'privatisation of internal market law'<sup>64</sup> is far from applicable in the area of EC external relations, namely the distinct features of the evolving construction of the latter by the Court of Justice.

This is illustrated by the development of the Common Commercial Policy (CCP), one of the few areas over which the competence of the Community to act externally had been expressly provided.<sup>65</sup> Its EC Treaty basis was, typically, unhelpful as to its legal delineation by merely containing a non-exhaustive

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<sup>63</sup> See, for instance, Case 270/80 *Polydor Ltd and RSO Records Inc v Harlequin Records Shops Ltd and Simons Records Ltd* [1982] ECR 329 relating to the Free Trade Agreement with Portugal and its provision on measures on an equivalent effect to quantitative restrictions in the area of copyright; Case C-163/90 *Administration des Douanes et Droits Indirects v Legros and others* [1992] ECR 4625 on the Free Trade Agreement with Sweden and its prohibition on charges of an equivalent effect to customs duties. See the assessment by Eeckhout, *op. cit.*, n. 53 above, pp. 269–70.

<sup>64</sup> See the contribution to this volume by Robert Lane (Chapter 9).

<sup>65</sup> Under Article 133(1) EC, the 'common commercial policy shall be based on uniform principles. Particularly in regard to changes in tariff rates, the conclusion of tariff and agreements, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies'.

enumeration of activities and providing that they ought to be carried out on the basis of uniform principles. The Court was keen to emphasise the link between the CCP and the internal market. When asked to rule on the compatibility with the EC Treaty of an OECD agreement on credit for local costs related to exports, the Court pointed out the link between the CCP and the common market: ‘such a policy is conceived . . . in the context of the operation of the Common Market, for the defence of the common interests of the Community, within which the particular interests of the Member States must endeavour to adapt to each other’.<sup>66</sup> In order to be able to carry out this policy, the Community institutions were granted the power to adopt both autonomous and contractual measures on the basis of a wide interpretation of Article 133 EC justified by ‘the proper functioning of the customs union’.<sup>67</sup>

At those times of legislative stagnation, the link between the internal market and the construction of the CCP was essential for two reasons: first, to ensure that the qualified majority voting provided under Article 133 EC would not dissuade Member States from relying upon it, hence impairing the effectiveness of the policy; and secondly, to provide a solid foundation for the exclusive nature of the Community’s competence in that area. In *Opinion 1/75*, the Court pointed out that ‘quite clearly, . . . this conception [of CCP] is incompatible with the freedom to which the Member States could lay claim by invoking a concurrent power, so as to ensure that their own interests were separately satisfied in external relations, at the risk of compromising the effective defence of the common interests of the Community’, for that would ‘distort the institutional framework, call into question the mutual trust within the Community and prevent the latter from fulfilling its task in the defence of the common interest’.<sup>68</sup>

Viewed as a necessary adjunct to the Common Market,<sup>69</sup> the exclusive competence of the Community appeared not only justified but also in need of being construed in wide terms. Indeed, in the area of the CCP, any policy unilaterally determined by a Member State is presumed to be illegal unless specifically authorised pursuant to EC law.<sup>70</sup> Furthermore, the articulation of

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<sup>66</sup> *Opinion 1/75 (re: Understanding on a Local Cost Standard)* [1975] ECR 1355, pp. 1363–4.

<sup>67</sup> Case 8/73 *Hauptzollamt Bremerhaven v Massey-Ferguson GmbH* [1973] ECR 897, para. 4.

<sup>68</sup> *Opinion 1/75*, n. 66 above, p. 1365.

<sup>69</sup> On the link between the internal market and its external dimension as reflected in substantive terms, see M. Cremona, ‘The External Dimension of the Single Market: Building (on) the Foundations’ in C. Barnard and J. Scott (eds), *The Law of the Single European Market: Unpacking the Premises* (Oxford: Hart Publishing, 2002), p. 351.

<sup>70</sup> See Case 41/76 *Criël, née Donckerwolcke and Schou v Procureur de la République au Tribunal de Grande Instance de Lille and Director General of Customs* [1976] ECR 1921.

this link with the internal market enabled the Court to further strengthen the Community's external commercial policy by indicating that its scope was not static. Instead, the concept of commercial policy was seen as 'having the same content whether it is applied in the context of the international action of a State or to that of the Community'<sup>71</sup> whereas, in order 'to carry on any worthwhile common commercial policy', the Community should be 'in a position to avail itself also of more elaborate means devised with a view to furthering the development of international trade'.<sup>72</sup>

While delivered in response to persistent arguments by the Council and various Member States for a very restrictive construction of the CCP, such statements led the Commission to articulate a maximalistic approach to Article 133 EC which, in effect, would assimilate it to a set of rules underpinning the EC external economic relations *in toto*.<sup>73</sup> The Court rejected such claims when asked to rule on the conclusion of the WTO Agreements<sup>74</sup> and, more recently, that of the Cartagena Protocol on Biosafety.<sup>75</sup>

The link with the internal market did not prove sufficient to bring the individual to the centre of EC external relations. This was due to its very specific function described above, i.e. to bolster the normative foundations of CCP; to empower individuals to assume a central role in the enforcement of law in that area would risk upsetting the sensitive balance between the autonomous nature of EC action and the position of states as fully sovereign subjects of international law. This was also apparent in other areas of the external dimension of the internal market. Having acknowledged the power of the Community to act on the international plane even in the absence of an express provision in the EC Treaty,<sup>76</sup> the Court had to define the circumstances in which such competence arose and the conditions under which it would become exclusive. This was not an easy task as, in the area of implied competence, the determination of exclusivity was deemed to be linked to the exercise of the internal competence.<sup>77</sup>

An analysis of the Court's case-law on the implied competence of the Community in EC external relations is beyond the scope of this chapter.<sup>78</sup>

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<sup>71</sup> *Opinion 1/75*, n. 66 above, p. 1362.

<sup>72</sup> *Opinion 1/78*, para. 44.

<sup>73</sup> See P. Koutrakos, "'I need to hear you say it": Revisiting the scope of the EC Common Commercial Policy' (2003) 22 *Yearbook of European Law* 407–33.

<sup>74</sup> *Opinion 1/94* [1994] ECR I-5267.

<sup>75</sup> *Opinion 2/00* [2001] ECR I-9713.

<sup>76</sup> *Case 22/70 Commission v Council (ERTA)* [1971] ECR 263.

<sup>77</sup> *Opinion 2/91 (re: ILO Convention No. 170)* [1993] ECR I-1061.

<sup>78</sup> See A. Dashwood and J. Heliskoski, 'The classic authorities revisited', in A. Dashwood and C. Hillion (eds), *The General Law of EC External Relations* (London: Sweet and Maxwell, 2000), pp. 3–19; Koutrakos, *op. cit.*, n. 34, Chapter 3; Eeckhout,



Instead, it is suffice to make the following three points. First, it has been accepted that the co-existence of Member States and the Community in the negotiation, conclusion and implementation of international agreements is the rule rather than the exception. In practical terms, this has become possible pursuant to the formula of mixity, which enables the involvement of Member States and the Community in areas which fall within the competence of both.<sup>79</sup> This formula has facilitated the external action of the Community in a wide range of areas.<sup>80</sup> Secondly, while the Commission has often argued for a wide interpretation of the Community's exclusive competence on the basis of the practical difficulties to which mixity may give rise, such claims have consistently been rejected by the Court. In *Opinion 1/94*, it was accepted that such concerns were 'quite legitimate'; however, the Court agreed with the Council that 'resolution of the issue of the allocation of competence cannot depend on problems which may possibly arise in administration of the agreements'.<sup>81</sup> Similarly, it was pointed out in *Opinion 2/00* that 'whatever their scale, the practical difficulties associated with the implementation of mixed agreements . . . cannot be accepted as relevant when selecting the legal basis for a Community measure'.<sup>82</sup> Thirdly, the Court has consistently avoided the precise delineation of competences within the framework of mixed agreements.<sup>83</sup> It is noteworthy that, as early as 1978, it had opined as follows:

it is not necessary to set out and determine, as regards other parties to the Convention, the division of powers . . . between the Community and the Member States, particularly as it may change in the course of time. It is sufficient to state to the other contracting parties that the matter gives rise to a division of powers within the Community, it being understood that the exact nature of that division is a domestic question in which third parties have no need to intervene.<sup>84</sup>

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op. cit., n. 53 above, Chapters 3–4; and I. Macleod, I.D. Hendry and S. Hyett, *The External Relations of the European Communities* (Oxford: Clarendon Press, 1996), Chapter 3.

<sup>79</sup> See D. O'Keeffe and H. Schermers (eds), *Mixed Agreements* (The Hague: Kluwer Law, 1993), and J.L. Dewost and M.A. Gaiffe (eds), *La Communauté Européenne et les Accords Mixtes: Quelles Perspectives?* (Bruxelles: Presses Interuniversitaires Européennes, 1997).

<sup>80</sup> See A. Rosas, 'Mixed Union – mixed agreements', in M. Koskeniemi (ed.), *International Law Aspects of the European Union* (The Hague: Kluwer Law, 1998), pp. 125–48.

<sup>81</sup> *Opinion 1/94*, para. 107.

<sup>82</sup> *Opinion 2/00*, para. 41.

<sup>83</sup> See, for instance, its rulings in *Opinion 1/94* and Case C-53/96 *Hermès International v FHT Marketing* [1998] ECR I-3603.

<sup>84</sup> *Ruling 1/78 (re: Draft Convention of the International Atomic Energy Agency on the Physical Protection of Nuclear Materials, Facilities and Transport)* [1978] ECR 2151, para. 35. Similarly, see *Hermès*, para. 25. On the other hand, when the

Instead, once it has established the shared nature of the external competence involved, it moves on to stress the duty of co-operation which binds both the Community institutions and the Member States in the process of negotiation, conclusion and implementation of international agreements. This principle, introduced quite early on<sup>85</sup> and given prominence in *Opinion 1/94*<sup>86</sup> and *Opinion 2/00*,<sup>87</sup> aimed at ensuring that the unity of the international representation of the Community would not be endangered by the simultaneous participation of the Member States.

This overview indicates the challenges that faced the Court of Justice in its effort to ensure the unity of international representation of the Community without undermining its capacity to accommodate diversity. The duty of co-operation is one illustration of this multifaceted process; the Court's construction of its jurisdiction to interpret mixed agreements provides another. In an astonishing illustration of how policy may be determined and carried out on a pragmatic basis in the multifaceted system of EC external relations, this question was only addressed directly by the Court very recently. When originally called upon under the procedure laid down in Article 234 EC to interpret the Association Agreement with Turkey and its Additional Protocol on free movement of workers in *Demirel*,<sup>88</sup> the Court's jurisdiction to interpret that part of the Agreement had been challenged on the basis that the scope of that particular part of the Agreement fell within the exercise of national powers. While it rejected that argument with considerable force, the Court did not engage in a detailed analysis of how it understood its jurisdiction to interpret all parts of all types of agreements concluded both by the Community and the Member States. Subsequently, the question of the interpretation of a procedural provision of TRIPS was referred to the Court.<sup>89</sup> While Article 50(6) TRIPS was to apply to national trademarks, the Court held that it had jurisdiction to interpret it: as the Community was a party to TRIPS and had already adopted trademarks legislation for whose violation national courts would have to apply Article 50(6) TRIPS, the latter would have to be interpreted in a uniform manner which

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Community is required to declare the scope of its competence over specific provisions of an agreement, the Court does exercise its jurisdiction and determines the provisions of the agreement over which the Community is exclusively competent: see Case C-29/99 *Commission v Council (re: Nuclear Safety Convention)* [2002] ECR I-11221.

<sup>85</sup> See the duty outlined in Joined Cases 3, 4 and 6/76 *Cornelis Kramer and others* [1976] ECR 1279. For the duty of co-operation, see *Opinion 2/91*, paras 36–38.

<sup>86</sup> *Opinion 1/94*, paras 106–10.

<sup>87</sup> *Opinion 2/00*, para. 18. Another layer, involving the relationship between the Court of Justice and national courts, was added in *Parfums Dior*.

<sup>88</sup> Case 12/86 *Demirel v Stadt Schwäbisch Gmünd* [1987] ECR 3719.

<sup>89</sup> See again, the judgment in *Hermès*.

could only be ensured by the Court of Justice.<sup>90</sup> The broad construction of its jurisdiction was subsequently repeated in *Parfums Dior* and *Schieving-Nijstad*.

The Court's reliance upon the requirement of uniform interpretation of international agreements which fall within the competence of both the Community and the Member States, in the absence of any allocation of obligations between them, is relevant to the legal position of the individual in various ways. First, it is coupled with a distinct emphasis on the duty of co-operation broadly understood. While reliance upon it had become increasingly prominent in its rulings on the nature and exercise of joint competence by the Community and national institutions, the Court added another layer in the judgments addressing the limits of its jurisdiction by mapping out a considerable role for national courts. In *Schieving-Nijstad*, for instance, a number of issues regarding the balance between the competing rights and obligations of the trademark holder and the defendant were left for the national court to decide; this also applied to a number of specific aspects of the interim protection system laid down in Article 50 TRIPS, such as the point in time at which the period prescribed in Article 50(6) TRIPS would have to start.<sup>91</sup> This might appear to be the role naturally assumed by a referring court under the preliminary reference procedure within the context of the interpretation of mixed agreements. However, it has an added significance here insofar as the more pronounced the role of national courts is, the more decentralised and multilayered the nature of the management of EC external relations becomes. It is noteworthy that, while interpreting its jurisdiction in broad terms, the Court did not interpret it so broadly as to include the issue of the effect of Article 50(6) TRIPS within the national legal order. Instead, it stated that 'in a field in respect of which the Community has not yet legislated . . . Community law neither requires nor forbids that the legal order of a Member State should accord to individuals the right to rely directly on the rule laid down by Article 50(6) of TRIPS or that it should oblige the courts to apply that rule of their own motion'.<sup>92</sup>

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<sup>90</sup> See A. Dashwood, 'Preliminary rulings on the interpretation of mixed agreements', in D. O'Keefe and A. Bavasso (eds), *Judicial Review in EU Law. Liber Amicorum in Honour of Lord Slynn of Hadley*, vol. I (The Hague: Kluwer Law, 2000), pp. 167–75 and J. Heliskoski, 'The jurisdiction of the European Court of Justice to give preliminary rulings on the interpretation of mixed agreements' (2000) vol. 69:4 *Nordic Journal of International Law* 395–412.

<sup>91</sup> In doing so, the Court made it clear that such period would have to be 'reasonable having regard to the circumstances of each case and taking into account the balance to be struck between the competing rights and obligations of the intellectual property right holder and of the defendant' (para. 65).

<sup>92</sup> *Parfums Dior*, para. 48.

The increasingly central role of national courts is also significant from the more general perspective of the management of the EC external relations. Viewed in that context, that role and the co-operation between national courts and the Court of Justice may develop into a part of a two-fold mechanism, instrumentalised by the Court to strike the balance between the ability of the Community to act on the international plane and the power of the Member States to exercise their sovereignty as subjects of international law – the other part of that mechanism being the increasing emphasis on the principle of co-operation to which the EC and national institutions should adhere in the process of the negotiation, conclusion and implementation of mixed agreements.<sup>93</sup> The above two aspects of the position of national courts contribute to the establishment of a multilayered system of intrinsically linked principles which is developed in order to manage mixity without compromising the unitary representation of the Community. To that effect, the comment by Advocate-General Tesauro in *Hermès* is worth citing in full:

The Community legal system is characterised by the simultaneous application of provisions of various origins, international, Community and national; but it nevertheless seeks to function and to represent itself to the outside world as a unified system. That is, one might say, the inherent nature of the system which, while guaranteeing the maintenance of the realities of States and of individual interests of all kinds, also seeks to achieve a unified *modus operandi*. Its steadfast adherence to that aim, which the Court itself has described as an obligation of solidarity, is certainly lent considerable weight by the judicial review mechanism which is defined in the Treaty and relies upon the simultaneous support of the Community courts and the national courts.<sup>94</sup>

## THE INDIVIDUAL AND ALTERNATIVE WAYS OF ENFORCEMENT OF INTERNATIONAL RULES

To seek to construe the legal position of the individual in EC external relations in terms identical to those which have rendered it at the very core of the genesis and development of the internal market is tantamount to asking an impossible question: the special challenges raised by the enforcement of international rules and the distinct characteristics of the incremental development of EC external relations shape an entirely different legal context within which the Court of Justice may define the legal position of individuals. However, the claim that the latter is considerably undermined in the area of EC external

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<sup>93</sup> See P. Koutrakos, 'The interpretation of mixed agreements under the preliminary reference procedure' (2002) vol. 7:1 *European Foreign Affairs Review* 25–52.

<sup>94</sup> *Hermès*, para. 20 of the Opinion.

relations is exaggerated. This conclusion is supported by the imaginative use of the notion of direct effect in the enforcement of a wide variety of agreements concluded by and binding upon the Community. It is also supported by the alternative mechanisms of enforcement of international rules introduced by the Court of Justice. After all, the conclusion that a provision contained in an international agreement is not capable of conferring rights upon individuals does not necessarily mean that it is irrelevant to its application within the Community legal order.

First, a duty of consistent interpretation has been developed according to which a provision of secondary Community law should be interpreted in a manner which is consistent with international agreements as far as possible.<sup>95</sup> Following from the superior status that international agreements enjoy over secondary legislation, this principle aims at ensuring that the effective control of legality of Community legislation in the light of the international obligations assumed by the Community is not confined to the ability of the individuals to rely upon those rules. It is noteworthy that the principle of indirect effect of directives was developed precisely in order to counterbalance the limitations imposed on their direct effect.<sup>96</sup>

Secondly, a provision of an international agreement may be invoked in an action by a private applicant against an EC measure if the latter was adopted in order to implement the former; in that case, the fact that the agreement in question is not capable of conferring rights upon individuals is irrelevant.<sup>97</sup> This exception was introduced in relation to the GATT Anti-dumping Code to which reference was made in the preamble to the EC Basic Anti-dumping Regulation. This exception has been relied upon not only by individuals<sup>98</sup> but also Member States.<sup>99</sup> Thirdly, specific provisions in the WTO Agreements may constitute a ground of review of a Community measure in cases where the latter expressly refers to the former.<sup>100</sup>

The above overview indicates that the direct effect of international legal

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<sup>95</sup> Case C-61/94 *Commission v Germany* [1996] ECR I-3989; *Hermès*.

<sup>96</sup> Case C-106/89 *Marleasing SA v La Comercial Internacional de Alimentación SA* [1990] ECR I-4135. See G. Betlem, 'The doctrine of consistent interpretation: Managing legal uncertainty' (2002) vol. 22:3 *Oxford Journal of Legal Studies* 397–418.

<sup>97</sup> Case C-69/89 *Nakajima v Council* [1991] ECR I-2069.

<sup>98</sup> See, for instance, Case C-105/90 *Goldstar Co. Ltd v Council* [1992] ECR I-677; Case T-162/94 *NMB France Sarl, NMB Minebea GmbH, NMB UK Ltd and NMB Italia Srl v Commission* [1996] ECR II-427.

<sup>99</sup> See Case C-352/96 *Italy v Council (re: Tariff Quotas on Imports of Rice)* [1998] ECR I-6937 with regard to GATT 1994; Case C-150/95 *Portugal v Council (re: Oilseeds)* [1997] ECR I-5863 in which area figures contained in an annex to the Blair House Agreement were mentioned in the challenged Regulation.

<sup>100</sup> Case 70/87 *Fediol v Commission* [1989] ECR 1781.

rules is not the only way in which individuals may claim a high level of protection before courts. After all, to sanction the direct effect of an international rule by no means ensures its application by a court in favour of the individual. Whilst some of the above principles have been introduced precisely in order to counterbalance the absence of direct effect, their application may have positive implications beyond the specific area of external relations. In the area of anti-dumping law, for instance, which falls within the scope of the *Nakajima* exception, *locus standi* of individuals has been interpreted in a considerably more liberal manner than in other areas of internal market law.<sup>101</sup> It is noteworthy that the so-called *Nakajima* and *Fediol* ‘exceptions’ are not, strictly speaking, exceptions insofar as the Court has stressed that the underlying right of private parties to challenge EC measures does not amount to the direct effect of the international provision pursuant to which they challenge the legality of those measures. Instead, they are exceptional in the sense that they dissociate the requirement of direct effect from the review of legality of Community legislation. It is interesting that, in the area of the enforcement of the law of the single market, when the construction of the direct effect of directives has reached its limits, the Court has sought to introduce alternative ways in which directives would affect the legal position of individuals while stressing that those ways would not amount to direct effect, the so-called ‘incidental’ or ‘triangular’ effect being a case in point.<sup>102</sup>

Another area in which the Court has shown ingenuity in allowing individuals to challenge Community measures is the application of rules of customary international law. In *Racke*,<sup>103</sup> where it was confronted with the suspension of trade concessions provided for by the Co-operation Agreement with Yugoslavia (which was related to its suspension and termination after the

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<sup>101</sup> See, for instance, Joined Cases 239 and 275/82 *Allied Corporation v Commission* [1984] ECR 1005 and Case C-358/89 *Extramet Industrie SA v Council* [1991] ECR I-2501. For a comment, see A. Arnulf, ‘Challenging EC anti-dumping regulations: The problem of admissibility’ (1992) vol. 13:2 *European Competition Law Review* 73–81 and R. Greaves, ‘*Locus standi* under Article 173 EEC when seeking annulment of a regulation’ (1986) vol. 11:2 *European Law Review* 119–33.

<sup>102</sup> See the controversial judgment in Case C-443/98 *Unilever Italia SA v Central Food SpA* [2000] ECR I-7535, and the criticism in M. Dougan, ‘The “disguised” vertical direct effect of directives’ (2000) vol. 59:3 *Cambridge Law Journal* 586–611 and S. Weatherill, ‘Breach of directives and breach of contract’ (2001) vol. 26:2 *European Law Review* 177–86. For another view, see P. Koutrakos, ‘On groceries, alcohol and olive oil: More on free movement of goods after *Keck*’ (2001) vol. 26:4 *European Law Review* 391–407. The implications of the judgment appear to have been addressed in Case C-159/00 *Saphod Audic v Eco-Emballages SA* [2002] ECR I-5031. On the effects of directives, see T. Tridimas, ‘Black, white and shades of grey: horizontality of directives revisited’ (2003) vol. 21 *Yearbook of European Law* 327–54.

<sup>103</sup> Case C-162/96 *Racke v Hauptzollamt Mainz* [1998] ECR I-3655.

war in and the break-up of the country), it reviewed the legality of the relevant Community legislation. It did so by viewing the applicant as relying directly upon the relevant provision of the suspended Agreement, hence avoiding the issue of whether they could rely upon customary international law rules.<sup>104</sup> Whilst not without problems,<sup>105</sup> this approach enabled the Court to ensure the application of international rules in the Community legal order by striking ‘an appropriate balance . . . between the rights of the individuals and the decision-making power of the Community institutions’.<sup>106</sup>

## CONCLUSION

This chapter has sought to illustrate how the Court’s approach to the legal position of the individual has been defined in the light of the idiosyncratic development of principles aimed at governing the multilayered system of conduct and management of EC external relations. It has also highlighted the emergence of a number of alternative and interconnected legal mechanisms, which would enable the individual to rely upon international rules within the Community legal order. The effectiveness of this system would inevitably rely upon the material scope of these mechanisms and the rigour with which the Court is prepared to apply them. In seeking to place the construction of the legal position of the individual within the broader context of EC external relations, this chapter suggests that the assessment of the effectiveness of its construction cannot be static. Instead, it will need to be redefined because it is dependent upon a number of factors which are, in themselves, subject to continuous redefinition. Some of them are external and are related to the so-called ‘constititionalisation’ of the international economic order: even those of us who are deeply sceptical of this overambitious view of current developments cannot doubt the incremental development of the international economic arena. Other factors are internal in the sense that they are related to the development of the EU: they concern not only the shaping of the internal market policies but also the various ways in which the framework of EU exter-

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<sup>104</sup> In a similar vein, the Court of First Instance had instrumentalised the principle of legitimate expectations in Case T-115/94 *Opel Austria v Council* [1997] ECR II-39. See generally, J. Wouters and D. Van Eeckhoutte, ‘The enforcement of customary international law through EC law’, in J.M. Prinssen and A. Schrauwen (eds), *Direct Effect: Rethinking a Classic of EC Legal Doctrine* (Groningen: Europa Law Publishing, 2002), pp. 183–234.

<sup>105</sup> See P.J. Kuijper, ‘The Court and the Tribunal of the EC and the Vienna Convention on the Law of Treaties 1969’ (1998) vol. 25:1 *Legal Issues of European Integration* 1–24.

<sup>106</sup> Advocate-General Jacobs in *Racke*, para. 90 of his Opinion.

nal relations evolves. These would include, for instance, the set of principles and objectives articulated in the now moribund EU Constitutional Treaty as applicable to the overall external actions of the EU<sup>107</sup> and the reform of the CCP.

The limits of the current construction of the legal position of individuals are tested regularly as the following two examples may illustrate. The first is about the ability of individuals to seek damages on the basis of the failure of the Community to comply with decisions of the Dispute Settlement Body (DSB). This was raised recently in *Biret*,<sup>108</sup> a case about the application of a number of Directives on the use of certain hormones which reached the Court on appeal.<sup>109</sup> The question was whether the Community was liable in damages for a violation of the Agreement on the Application of Sanitary and Phytosanitary Measures following the expiry of the deadline for compliance set by the Dispute Appellate Body.<sup>110</sup> The Court of First Instance had pointed out that there was an 'inescapable and direct link between the decision and the plea alleging infringement of the SPS Agreement' and concluded that the former could only be taken into account if the latter was directly effective. Following a detailed analysis by Advocate-General Alber of why DSB decisions should be directly effective,<sup>111</sup> the Court of Justice held that, on the facts of the case, the Community could not possibly have been liable for the period alleged by *Biret*. However, it also pointed out that the contested judgment contained two errors of law. The first one consisted of the failure of the Court of First Instance to comply with its duty to state reasons, as its line of reasoning was not sufficient to address *Biret's* argument regarding the violation of the SPS Agreement. The second error consisted of misinterpreting the scope of the ruling of the Court of Justice in *Atlanta*.<sup>112</sup> According to the Court, the latter judgment was irrelevant to the case before it because it was confined to the facts of the case: while the decision of the DSB was inescapably and directly linked to the issue of the inconsistency with WTO rules, that plea had

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<sup>107</sup> See M. Cremona, 'The Draft Constitutional Treaty: External relations and external Action' (2003) vol. 40:6 *Common Market Law Review* 1347–66.

<sup>108</sup> Case C-93/02 P *Biret International SA v Council* [2003] ECR I-10497.

<sup>109</sup> Case T-174/00 *Biret International SA v Council* [2002] ECR II-17.

<sup>110</sup> For the application of Article 288 EC in such circumstances, see G. Zonnekeyn, 'EC liability for non-implementation of adopted WTO Panels and Appellate Body Reports: The example of the 'innocent exporters' in the banana case', in V. Kronenberger (ed.), *The European Union and the International Legal Order: Discord or Harmony?* (The Hague: T.M.C. Asser Press, 2001), pp. 251–72.

<sup>111</sup> For an analysis of the Opinion, see G. Zonnekeyn, 'EC liability for the non-implementation of WTO dispute settlement decisions' (2003) vol. 6:3 *Journal of International Economic Law* 761–9.

<sup>112</sup> Case C-104/97 P *Atlanta v European Community* [1999] ECR I-6983.



not been repeated on appeal. It was for this reason that the argument had been rejected as inadmissible.

However, it should be stressed that, in the more recent judgment in *Van Parys*,<sup>113</sup> the Court reaffirmed its position as to the status of WTO law in the Community legal order. In its judgment, it addressed the following question: do the WTO Agreements give Community nationals a right to rely upon them in legal proceedings challenging the validity of Community legislation where the DSB has held that both that legislation and subsequent legislation adopted by the Community in order, amongst others, to comply with the relevant WTO rules are incompatible with those rules? Dealing specifically with the issue of the time limit set by the WTO organs, the Court ruled as follows: ‘The expiry of that time-limit does not imply that the Community had exhausted the possibilities under the understanding of finding a solution to the dispute between it and the other parties. In those circumstances, to require the Community courts (merely on the basis that that time-limit has expired) to review the lawfulness of the Community measures concerned in the light of the WTO rules, could have the effect of undermining the Community’s position in its attempt to reach a mutually acceptable solution to the dispute in conformity with those rules.’<sup>114</sup>

The second area which may challenge the limits of the current system of enforcement of international rules is the implementation case articulated in *Nakajima*.<sup>115</sup> The extent to which this may prove to be an efficient tool for the protection of individuals is dependent not only upon the Court’s willingness to adopt a more contextual approach but also the Community’s decision-making institutions and their practice to express their intention to comply with WTO obligations.

The picture emerging from the above analysis is that of a system both distinct from and similar to the development and management of the law of the internal market. It has become apparent that the parameters underpinning the legal position of individuals in EC external relations are quite distinct in nature: they are defined within the context of an international geopolitical and economic order, which the EU influences only in part and where the manifestation of the latter’s constitutional idiosyncrasies inevitably has an added layer

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<sup>113</sup> Case C-377/02 *Léon Van Parys NV v Belgisch Interventie- en Restitutiebureau (BIRB)*, judgment of 1 March 2005 (delivered by the Grand Chamber), not yet reported.

<sup>114</sup> *Ibid.*, para. 51.

<sup>115</sup> See G. Zonnekeyn, ‘The ECJ’s *Petrotub* judgment: towards a revival of the “*Nakajima doctrine*”?’ (2003) vol. 30:3 *Legal Issues of European Integration* 249–66. For a strict interpretation, see Case T-19/01 *Chiquita and others v Commission*, judgment of 3 February 2005, not yet reported.

of complexity. Yet, the effectiveness of the decentralised system of enforcement established by the Court of Justice incrementally over the years relies upon the actors which have been central to the development of the internal market law. In addition to the Court of Justice and the approach it will adopt to the construction of the alternative mechanisms of enforcement outlined above, the actors include national courts and their willingness to draw upon the principle of co-operation. The standard set by national courts in their contribution to the establishment and development of the internal market indicates that their increasingly central role in the management of the EC external relations will also enhance the legal position of the individual in that area.

# 11. Internal market governance in a globalised marketplace: the case of air transport

**Nick Bernard**

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## INTRODUCTION

The Commission's White Paper on Completing the Internal Market<sup>1</sup> had remarkably little to say about external trade. The only passage that acknowledges its relevance for the internal market is concerned with the maintenance of internal border controls that would result from the continued use of the then Article 115 EEC. It was thus a perspective which was doubly limited, first in terms of the markets concerned (goods market only, to the exclusion of services) and, secondly, in terms of the issues addressed (physical barriers/border controls). Admittedly, it has to be acknowledged that, notwithstanding the language of 'completion', the White Paper and the 1992 programme were never meant to provide a complete and systematic inventory of all the issues that still needed to be addressed to 'merge the national markets into a single market bringing about conditions as close as possible to those of a genuine internal market'.<sup>2</sup> 1992 was at least as much a political project, a rallying cry to re-start the European integration engine and get out of Euro-sclerosis, as it was an endeavour to ensure that the potential economic benefits of European integration were reaped.

As always, solving one particular set of problems brings to the fore hidden ones and lack of progress on external trade has become a more prominent issue than it was in the mid-1980s. It is not just a question of unbalanced progress (faster progress on the internal market and slower progress on external trade). Rather, the issue is that difficulties in relation to external trade affect the internal market itself.

While this is probably true in many sectors, the air transport sector provides

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<sup>1</sup> COM (1985) 310 final.

<sup>2</sup> Case 15/81 *Gaston Schul Douane Expéditeur BV v Inspecteur der Invoerrechten en Accijnzen, Roosendaal* [1982] ECR 1409, para. 33.

a particularly crisp illustration of the problem. Even though a comprehensive package of measures was adopted to liberalise air transport in the late 1980s, the European airline industry has, in a number of important respects, continued to operate largely on national lines and the potential benefits of liberalisation have not been fully reaped. No doubt, there would be room for improvement in the regulatory framework of intra-Community air transport. However, it is primarily elsewhere that one should look for a core explanation of this (relative) failure of air transport liberalisation. At heart, the problem lies in the impact of the *international* regulatory regime, which prevents a healthy operation of the internal market. In other words, it is at the interface between the domestic (intra-EU) and international regulatory framework that dysfunctions are to be found.

These dysfunctions will typically take the form of a conflict of norms: the international norm demands X and the internal market norm requires non-X. However, the question arises as to whether this constitutes an adequate characterisation of the problem or, on the contrary, whether the conflict of norms should merely be seen as the external manifestation of a deeper problem in the lack of communication between the regulatory frameworks and structures themselves. In the former case, some kind of jurisdictional mechanism (a court deciding which norm shall prevail) may be the answer. In the latter case, solutions need to be found in reforming decision-making mechanisms and regulatory structures and powers.

In the case of air transport, it is clear that the Commission has taken the view that greater co-ordination between the internal and international regime, and therefore greater involvement of European Union (EU) institutions in international air regulation, was necessary. Is this merely a grab for power by the Commission or does that correspond to a genuine need? How far does the functioning of the internal market in aviation require the involvement of the EU in international air regulation?

This chapter will first outline how the disjuncture between internal and international regulatory frameworks for air transport services has resulted in a sub-optimal functioning of the internal market. It will then discuss how this problem has been addressed by the Court of Justice in the so-called *Open Skies* judgments,<sup>3</sup> before considering the position taken by the institutions following those judgments.

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<sup>3</sup> Cases C-467/98 *Commission v Denmark* [2002] ECR I-9519; C-468/98 *Commission v Sweden* [2002] ECR I-9575; C-469/98 *Commission v Finland* [2002] ECR I-9627; C-471/98 *Commission v Belgium* [2002] ECR I-9681; C-472/98 *Commission v Luxembourg* [2002] ECR I-9741; C-475/98 *Commission v Austria* [2002] ECR I-9797 and C-476/98 *Commission v Germany* [2002] ECR I-9855. See also n. 28.

## AIR TRANSPORT REGULATION IN EUROPE PRIOR TO LIBERALISATION<sup>4</sup>

Before liberalisation, the regulatory framework for air transport within the EU was largely based on the system established by the 1944 Chicago Convention. The original ambition behind the Convention was to establish a permanent international body and a multilateral system based on common rules to regulate international air transport. Agreement on common rules, however, proved impossible to reach. Instead, Article 6 of the Convention establishes the principle that:

No scheduled international air service may be operated over or into the territory of a contracting State, except with the special permission or other authorization of that State, and in accordance with the terms of such permission or authorization.<sup>5</sup>

In effect, Article 6 draws the consequence of the principle of ‘complete and exclusive sovereignty’ of states over the airspace above their territory, affirmed in Article 1 of the Convention. The requirement of a ‘special permission or other authorization’ from each State to overfly or land on its territory in the absence of a universally agreed solution led to a system of bilateral negotiations between States on mutual traffic rights resulting in air service agreements (ASAs), in which the contracting parties determine which carriers on which routes, with which frequency and at which fare may provide air service between the territory of the parties to the ASA. A key feature of these ASAs is that they invariably contain a nationality clause as to the carriers authorised to operate routes between the States concerned. While the Chicago Convention defines the nationality of an aircraft by reference to its country of registration, ASAs will normally have provisions looking beyond the formal ‘flag’ of the aircraft and define nationality by reference to ownership and control. Thus, in an agreement between State A and State B, B will usually be allowed to refuse the operation of a route from A to B by a carrier who is not owned and controlled by State A or nationals of State A.

Given the close relationship between each Member State’s government and its (usually publicly-owned) ‘flag carrier’, ASAs were, as a rule, designed and

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<sup>4</sup> I will only be concerned here with market access and traffic rights and not with other aspects of air transport regulation, such as, for instance, safety, environmental issues, air traffic control or consumer rights.

<sup>5</sup> Note, however, Article 5 of the Convention, which has more liberal rules in relation to non-scheduled services; see also the International Air Services Transit Agreement annexed to the Convention, which provides for transit and technical stop rights.

implemented so as to protect the interests of the flag carriers of the parties. In practice, flag carriers would negotiate between themselves, either directly bilaterally or in the context of the International Air Transport Association (IATA),<sup>6</sup> the conditions under which routes between their respective countries would be exploited, and ask their governments for approval of those conditions. Indeed, as regards fares in particular, IATA had established frameworks and procedures to facilitate the conclusion of agreements between its member airlines on co-ordinated tariffs that each airline would then submit to governmental approval under the terms of the relevant ASA. The result was, therefore, a system of tightly regulated and legally protected duopolies on most routes, and a near total exclusion of meaningful competition in air transport within the EU, as elsewhere.

## THE 'THIRD' PACKAGE

Member States had originally assumed that air and sea transport were excluded from the scope of application of Treaty rules, notably those regarding free movement and competition, as a result of Article 80(2) EC, which provides that '[t]he Council may, acting by a qualified majority,<sup>7</sup> decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport'. However, in the *French Seamen* case,<sup>8</sup> the Court held that the exclusion in Article 80(2) EC only concerned the provisions relating to the common transport policy and therefore did not preclude the application of the general Treaty rules, and in particular those concerning the free movement of workers, to maritime transport. On this basis, it seemed reasonable to assume that the general Treaty rules would also apply to air transport. It nonetheless took another 12 years for the Court to confirm this in *Nouvelles Frontières*.<sup>9</sup> In that case, the Court held that not only free movement but also competition rules applied to air transport. If such was the case, the practice of governmental approval of inter-airline agreements on tariffs in the context of IATA would not survive. The Court had consistently held that a state measure that required or favoured the conclusion of anti-competitive agreements between undertakings

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<sup>6</sup> The International Air Transport Association is a private body set up by airlines on a worldwide basis at a conference in Havana in 1945 to facilitate co-operation between them.

<sup>7</sup> In its original version, Article 84(2) EEC required a unanimous decision of the Council.

<sup>8</sup> Case 167/73 *Commission v France* [1974] ECR 359.

<sup>9</sup> Joined Cases 209 to 213/84 *Criminal Proceedings against Lucas Asjes and others (Nouvelles Frontières)* [1986] ECR 1425.

or reinforced their effects would fall foul of Article 10 EC *juncto* Articles 3(g) and 81 EC. The Court confirmed this explicitly in the case.<sup>10</sup>

The *Nouvelles Frontières* judgment gave temporary reprieve to the Member States due to the absence of procedural rules to implement Articles 81 and 82 EC in the air transport sector. Article 81(1) EC would not, therefore, be directly applicable in the absence of any decision by the Commission or national competition authorities finding a breach of Article 81(1) EC.<sup>11</sup> Nonetheless, since all that was required was a Commission decision under Article 85 EC, it was plain that the system could no longer be maintained by the Member States, in opposition to a Commission eager for deregulation in the air transport sector.

Faced with the prospect of an air transport policy developed unilaterally by the Commission through its autonomous powers in the field of competition law, the Member States agreed in the Council to the development of a policy of controlled and gradual liberalisation. Thus, after decades of procrastination,<sup>12</sup> what had until then seemed impossible, *viz.* political agreement in the Council on the direction of air transport policy, was reached with remarkable speed.

Liberalisation was effected in three stages between 1987 and 1992. The last stage, the so-called ‘third package’, consisted of three key regulations:

- Regulation 2407/92 on air carrier licensing;<sup>13</sup>
- Regulation 2408/92 on access to intra-Community routes;<sup>14</sup>
- Regulation 2409/92 on fares.<sup>15</sup>

The third package establishes a liberalised regime for the provision of air transport within the EU. As long as a Community carrier satisfies the conditions (relating to financial viability and safety) defined in Regulation 2407/92 and has, under that Regulation, been granted an operating licence by the Member State where it has its principal place of business and registered office, such carrier is free, subject to limited conditions, to serve any route within the Community at whichever fares and with whichever frequency it deems fit.<sup>16</sup>

<sup>10</sup> *Ibid.*, paras 70–77.

<sup>11</sup> *Op. cit.*, n. 9, paras 46–69.

<sup>12</sup> It will be recalled that the European Parliament brought legal proceedings against the Council in 1983 for its persistent failure to develop a common transport policy: Case 13/83 *European Parliament v Council* [1985] ECR 1513.

<sup>13</sup> OJ 1992 L240/1.

<sup>14</sup> OJ 1992 L240/8.

<sup>15</sup> OJ 1992 L240/15.

<sup>16</sup> Article 4 of Regulation 2408/92 provides for an exception for thin or peripheral routes exploited under a public service obligation (PSO) regime. Only a very small proportion of intra-Community air transport is carried out under a PSO regime.

The third package, therefore, does away with the international system of governmental approval of fares and frequencies for intra-Community air traffic by Community carriers.

## EVALUATING THE SUCCESS OF LIBERALISATION

Liberalisation is not an end in itself. The extent to which it can be regarded as a success has to be determined in terms of what one expects by liberalising a particular sector. As far as air transport is concerned, liberalisation could result in a bigger output with the removal of state-imposed capacity controls, lower fares through greater competition and consolidation in an industry which, in Europe, was markedly fragmented.

In terms of output, there definitely was a substantial increase: between 1992 and 1999,<sup>17</sup> capacity increased by 50 per cent, from 142 726 to 214 481 million available-seat kilometres (ASKs).<sup>18</sup> However, it should be noted that during the same period, worldwide capacity, excluding the North American domestic market, increased by 41 per cent, from 1 676 678 to 2 363 232 million ASKs. Thus, while it is beyond doubt that liberalisation within the EU contributed to facilitating an increase in output, it would be difficult to discern a spectacular specific internal market effect in this capacity increase.

In terms of fares, the same period saw a contrasting evolution, with a substantial decrease in average promotional economy fares but, on the other hand, an increase in business class fares and fully flexible economy fares. This would suggest that liberalisation increased competition in the leisure segment of the market but not in the business segment. It is difficult to find a reason as to why competition would have increased between established flag carriers on the leisure but not the business segment of the market. A more probable explanation would link the increase in competition on the leisure segment to the appearance of low-cost carriers, such as Ryanair or Easyjet. Low-cost carriers operate under a different business model to established full-service carriers,

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<sup>17</sup> Unless otherwise indicated, all the figures used in this section are taken from the 2000 Annual Report 'Updating and Development of economic and fares data regarding the European Air Transport Industry' prepared by BAE Systems for the DG Energy and Transport of the European Commission under Contract No. B99-B27004010-S12.1738/P C2 98 002. A pre-2001 report has been chosen to avoid the distorting effect resulting from the events of 11 September 2001.

<sup>18</sup> ASK is a measure of passenger capacity, calculated by multiplying the number of seats available on a flight by the number of flights carried out and the number of kilometres for that flight. For instance, a daily flight between London Heathrow and Paris Charles-De-Gaulle (distance: 348km) on an aircraft with a capacity of 100 seats will generate  $100 \times 348 \times 365 = 12.7$  million ASKs.



focusing on a very strict control of costs and offering a basic ‘no frills’ service so as to enable them to offer lower fares than traditional carriers. Insofar as low cost carriers may operate from more remote, secondary airports, offer a barebones service and tend to offer less flexibility than full-service carriers (notably in case of operational irregularities such as delays or flight cancellations) they tend to be less suited to business travel but, on the other hand, can attract more cost-conscious leisure travellers. Low-cost carriers compete with traditional full-service carriers in the leisure travel market but far less so in the business travel market. They therefore bring competitive pressure on full service carriers’ promotional fares but not so much on fully flexible economy or business fares. The divergent price trends on fully flexible fares and promotional fares are therefore consistent with the view that competitive pressure following liberalisation comes primarily from the low-cost carriers.

It would seem, therefore, that liberalisation stimulated competition between low-cost carriers and established full-service carriers but did not result in increased competition between full-service carriers. Neither did it stimulate cross-border establishment by these carriers. Again, low-cost carriers made full use of the freedoms opened to them with liberalisation, with the most successful of them establishing themselves in other Member States.<sup>19</sup> By contrast, established full-service carriers have made comparatively little use of the opportunity to establish themselves in another Member State, be it by expansion or by merger or acquisition. Indeed, the structure of the European airline industry is, as the Commission itself noted,<sup>20</sup> remarkable for what has *not* happened following liberalisation. There have been very few cross-border merger and acquisitions; and the ranks and size of the major players, low-cost carriers excepted, have not changed much.

What little cross-border merger and acquisition activity there has been has followed two main patterns. In the first one, some major European airlines have acquired or taken a majority stake in a small, domestic or regional airline based in another Member State with the purpose of gaining a foothold in the market of that other Member State. One could cite, for instance, the acquisition by British Airways of TAT and Air Liberté in France and Delta Air<sup>21</sup> in Germany, or KLM’s acquisition of a 30 per cent stake in Braathens of Norway. Outside the EU/EEA, the SAir group similarly acquired a 49 per cent stake in a number of small EU airlines in France, Italy and Germany as well as in

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<sup>19</sup> For instance, the Irish low-cost carrier Ryanair has currently established hubs in eight Member States.

<sup>20</sup> European Commission, *Communication on the consequences of the Court judgments of 5 November 2002 for European air transport policy*, COM (2002) 649 Final, pp. 3–4.

<sup>21</sup> Later renamed Deutsche BA.

Sabena, the former Belgian national carrier.<sup>22</sup> These acquisitions have not proved successful. None of these small carriers managed to challenge the national carrier of the state concerned or even to develop a successful niche market for themselves. They remained loss-making and constituted a drain on the resources of the parent company. The most spectacular failure was that of the SAir group, since it brought with it the downfall of the parent company and airline, Swissair. In the other cases, the major carrier divested itself of the smaller carrier.<sup>23</sup>

The second trend in cross-border acquisitions has been for major carriers to acquire a small regional carrier for the purpose of using that carrier as a feeder airline to its network hub. This strategy might be illustrated by the purchase and transformation of Irish carrier Cityjet by Air France and of Air UK by KLM. At the time of its purchase by Air France, Cityjet operated, at a substantial loss, on the London City to Dublin route. It now operates a number of routes between Paris and secondary destinations on behalf of Air France under a franchise agreement.<sup>24</sup> Similarly, KLM gradually trimmed Air UK's (renamed KLM UK) domestic routes and non-strategic (viz. not Amsterdam-bound) European routes. KLM UK's operations were merged with KLM Cityhopper, KLM's main other regional subsidiary. The airline now operates exclusively routes between Amsterdam and a number of secondary airports in the UK and elsewhere in the EU.

On the other hand, until 2004 there had been no acquisitions and mergers among the major European carriers.<sup>25</sup> European carriers were small at the beginning of the decade compared to their US competitors and have remained so at the end of it. In 1999, the output of the four biggest European airlines was 345 604 million revenue-passenger-kilometres (RPKs)<sup>26</sup> whereas the output of

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<sup>22</sup> Since Switzerland is not within the EU, SAir could not acquire majority stakes in EU airlines. It was envisaged at the time, however, that following the conclusion of the EU–Switzerland bilateral Treaty, SAir would increase its stakes in EU carriers, notably Sabena.

<sup>23</sup> After merging TAT and Air Liberté, BA sold the enlarged Air Liberté to AOM, part of the SAir group, in 2000. Faced with severe financial difficulties at Braathens, KLM did not increase its stake and, on the contrary, sold it to SAS in 2001. Deutsche BA was finally sold by BA in 2003 for the token sum of €1.

<sup>24</sup> The destinations served by Cityjet from Paris are Dublin, London, Edinburgh, Gothenburg, Bologna and Florence. The only non-Paris bound route served by the Irish carrier is Dublin to Malaga.

<sup>25</sup> With the exception of the Swissair/Sabena debacle.

<sup>26</sup> RPK is a measure of passenger volume carried by an airline. It is obtained by multiplying the number of fare-paying passengers by the number of kilometres flown by those passengers. For instance, if an airline carries an average of 90 fare-paying passengers on a daily flight between London Heathrow and Paris Charles-De-Gaulle (distance: 348km), the flight will generate  $90 \times 348 \times 365 = 11.4$  million RPKs. While

the four biggest US airlines was not far from twice as much (639 870 million RPKs).<sup>27</sup> Admittedly, the market conditions in Europe are, and will remain, different from those in the United States (US). Distances between major economic centres are smaller and the existence of a good rail transport infrastructure means that rail is a more significant alternative to air transport. One should therefore expect European airlines to remain smaller, given the smaller size of the intra-European market. Even taking this into account, however, the European airline industry remained overly fragmented and there was an acute awareness in the industry of the need for consolidation. Certainly, some airlines, such as KLM, made no secret of their strong desire to merge with another carrier.

Increased competition from low-cost carriers further increased the pressure on traditional carriers to merge. However, the international regulatory framework of air transport stood as an obstacle to such mergers. Liberalisation may have removed the old Chicago Convention-based system of bilateral ASAs within the EU. However, this system remained in force with regard to air transport between Member States and third countries. From the perspective of mergers and acquisitions within the internal market, the nationality clause usually found in ASAs constitutes a major regulatory hurdle. If, for instance, a Spanish airline such as Iberia were to be acquired by a British airline such as British Airways, it would cease to be under the ownership and control of Spanish nationals. As such, it would run the risk of seeing its status as a designated Spanish airline revoked by the other party in all ASAs to which Spain is a party, and therefore lose all its traffic rights with third countries. Insofar as traffic with third countries, especially long-haul traffic, represents for most major carriers their main source of profit, merger was simply not an option. Even if the parties had been able to secure a waiver of the nationality clause by (some) third countries, such as the US, there could not be any guarantee that such a waiver would be maintained *ad infinitum*. As such, a merger would have constituted a substantial regulatory risk.

There was, thus, a clear conflict between the economic logic of the internal market, which should have led at least some flag carriers to merge and the international regulatory environment which stood as an obstacle to such mergers. However, how should we characterise that conflict? Should we analyse it as a conflict between two norms or should we rather view it as ultimately a problem of regulatory structure, translating itself from a legal perspective in

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ASKs indicate what the airlines offer (on the supply side), RPKs indicate what the passengers take up (on the demand side).

<sup>27</sup> The differences are even wider if one uses fleet size as a measure of size, with the first four US airlines having a combined fleet size of 2341 aircrafts, compared to 907 for the top four European carriers.

terms of competence? The Commission had long argued in favour of the latter. The Court of Justice in the *Open Skies* cases took, however, the opposite view.

## THE 'OPEN SKIES' JUDGMENTS

Since the early 1990s, the Commission has consistently argued in favour of an exclusive Community competence to conclude air transport agreements and persistently sought a mandate from the Council to negotiate such an agreement with the US, in particular. Faced with resistance from the Council, the Commission eventually sought to have its views vindicated through the legal process. To this end, it started infringement actions against a number of Member States<sup>28</sup> who had re-negotiated their ASA with the US during the 1990s and concluded so-called 'open skies' agreements.<sup>29</sup>

Pared down to their essential core, the Commission's arguments on exclusive Community competence in the field of air transport were based on the idea that exercise by the Member States of external powers in this field had a distortive effect on the internal market and that, therefore, competence had to be recognised as exclusive to the Community to avoid such distortions. This was not the first time that the Commission had used that line of attack. In effect, in the *Open Skies* cases, the Commission was to a large extent rehashing a line of reasoning that the Court had already rejected in Opinion 1/94 on Community competence in relation to the WTO agreements.<sup>30</sup>

The most elegant way of justifying an exclusive competence of the Community in this field would have been to argue that services in general, and air transport services in particular, should be understood as falling within the concept of the Common Commercial Policy (CCP). This avenue, however, had been closed by the Court in Opinion 1/94, in which it held that services involving the movement of persons could not be seen as falling within the

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<sup>28</sup> *Op. cit.*, n. 3. The Commission also started infringements proceedings against the UK in relation to the Bermuda II agreement with the US (concluded in 1977) but did not claim Community competence in this case: Case C-466/98 *Commission v United Kingdom* [2002] ECR I-9427.

<sup>29</sup> Open Skies agreements are the form of ASA currently favoured by the US and which seek to establish between the parties a fairly liberal regime, including unlimited route and traffic rights between the two countries for air carriers from both countries as well as an exchange of fifth freedom rights. Fifth freedom rights are the rights enjoyed by an airline to carry passengers (or freight) from another country to a third country in continuation of a flight from its own country (for example, the right for a US airline to carry passengers between Paris and Amsterdam following a flight between New York and Paris).

<sup>30</sup> [1994] ECR I-5267.

concept of the CCP. The Commission was therefore left to attempt to argue, as it had already attempted in Opinion 1/94 in relation to services in general, that the Court's case-law on implied powers conferred exclusive competence on the Community in the field of air transport.

Under one strand of reasoning, the Commission argued that, under Opinion 1/76<sup>31</sup> as interpreted in Opinion 1/94, the Community has exclusive competence to conclude an international agreement where such an agreement is indispensable to the effective exercise of internal competence. According to the Commission, such was the case in the field of air transport due to the impossibility of separating the internal and external markets. In the Commission's view, the distortions and deflections of trade that resulted from the *Open Skies* agreements constituted evidence of the necessity for Community action in this field to ensure the smooth functioning of the internal market in air transport. The Court, however, replied that nothing prevented the institutions from arranging concerted action by the Member States in their dealings with third countries so as to avoid any such distortion.<sup>32</sup> The Court took further comfort from the fact that, in adopting the third package, the Council had not felt it necessary to conclude agreements with third countries before establishing an internal market in air transport services. The necessity for Community action was not, therefore, established within the meaning of Opinion 1/76.

While this answer was hardly surprising, since it mirrored the position that the Court had already taken with respect to services in general in Opinion 1/94, it seems further to limit the significance of Opinion 1/76 in the sense that it appears increasingly difficult to imagine situations in which it would not be possible for the institutions to arrange concerted action by the Member States as an alternative to Community action. As Piet Eeckhout rightly points out, 'it is even doubtful whether the agreement in issue in Opinion 1/76 came within these parameters'.<sup>33</sup>

The other strand of the Commission's reasoning sought to rely on the *ERTA* case-law.<sup>34</sup> To the extent that the Community had, with the third package, adopted internal legislation concerning air transport services within the Community, the Community had by the same token acquired exclusive competence to enter into international agreements relating to the matters covered by those common internal rules. Since the network of 'open skies' agreements concluded between the US and a number of Member States

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<sup>31</sup> Opinion 1/76 (*re: Inland Waterways*) [1977] ECR 741.

<sup>32</sup> See para. 59 of the judgment.

<sup>33</sup> P. Eeckhout, *External Relations of the European Union: Legal and Constitutional Foundations* (Oxford: Oxford University Press, 1994), p. 91.

<sup>34</sup> Case 22/70 *Commission v Council (ERTA)* [1971] ECR 263.

enabled US airlines to have access to intra-Community routes<sup>35</sup> outside the framework provided in the third package, these agreements should be regarded as infringing the exclusive competence of the Community.

The Court, however, was equally unconvinced by this argument. It considered that the third package was concerned with access to intra-Community routes by Community carriers and left the question of access to intra-Community routes by third country airlines untouched. Intra-Community traffic rights for third country airlines could not, therefore, be regarded as falling within the exclusive competence of the Community. The Court, however, did recognise a more limited area of exclusive competence resulting from the intra-Community regulatory framework in relation to fares on intra-Community routes as well as access to computerised reservation systems.<sup>36</sup> Therefore, insofar as the agreements concluded by the Member States with the US touched upon these two issues, they were to be regarded as having been adopted in breach of the exclusive competence of the Community on these matters.

The Court's refusal to recognise a general exclusive Community competence in relation to ASAs means that the Court refused to analyse the conflict identified above between the internal market in air transport and the international regulatory framework resulting from bilateral agreements in terms of competence. It does not mean that the Court refused to acknowledge the existence of this conflict altogether. However, instead of addressing it in terms of competence, the Court addressed it in terms of conflict of norms between the EC Treaty on the one hand and individual agreements on the other.

In addition to its arguments on competence, the Commission further argued that the nationality clauses in ASAs were incompatible with Article 43 EC on freedom of establishment. Such clauses discriminate against nationals of a Member State wishing to establish themselves in another Member State since such nationals can be denied traffic rights to a third country by reason of their not being nationals of the state which is a party to the ASA, whereas nationals of that Member State cannot be denied such traffic rights. Thus, for instance, an airline under the ownership and control of British nationals could be

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<sup>35</sup> US airlines have access to those routes thanks to the fifth freedom rights that they enjoy under the 'open skies' agreements. While those fifth freedom rights are of limited significance and, in practice, barely used in relation to passenger traffic, cargo airlines do make actual use of them.

<sup>36</sup> The Court also recognised that the Community would, in principle, enjoy an exclusive competence over the issue of slot allocation at Community airports but considered that the agreements under discussion did not contain any commitment on this issue and did not, therefore, encroach on the competence of the Community in this respect.

denied, under the terms of the agreement between Belgium and the US, the right to carry passengers between Brussels and New York, whereas an airline controlled by Belgian nationals would have such a right. The Court had therefore no difficulty in finding that such clauses were incompatible with the EC Treaty.

If the problem lies in the incompatibility of a clause in the agreements with the EC Treaty rather than in an issue of competence, it follows that a solution will be found in eliminating or redrafting that clause so as to remove such incompatibility. The *Open Skies* judgments of the Court therefore put the Member States under an obligation to re-negotiate their agreements with the US so as to extend the benefit of the nationality clause to all Community carriers. Beyond agreements with the US, it is all ASAs containing a nationality clause, which means virtually all of them, that will have to be renegotiated. Two questions can be raised in relation to this duty to re-negotiate: first, is the right to fly from another Member State to a third country a right actually desired by airlines or should this be regarded as an empty exercise resulting from a paper victory by the Commission? Secondly, is individual re-negotiation by Member States the most effective way of addressing the issue?

In relation to the first question, there are strong reasons to doubt that flag carriers will want to start services from another Member State to a third country. All of them have adopted a 'hub-and-spoke' network structure, operating all their flights to and from their base in their home state. For network carriers operating a mixture of short and long-haul routes, this usually is the most efficient system.<sup>37</sup> However, low-cost carriers are organised on different principles and some of them may well be interested in starting routes from another Member State to a third country. In addition, the question is relevant for flag carriers for the reasons expressed earlier in this chapter: even if they do not want to start services from another EU state to another country, some flag carriers may, nonetheless, wish to acquire a carrier in another Member State who enjoys and exploits such rights. Indeed, the acquisition of KLM by Air France in 2004 provides such an example. There is little doubt that the *Open Skies* judgments have considerably reduced the regulatory risk involved in such an acquisition by lowering the likelihood of the acquired carrier being denied traffic rights by third countries.<sup>38</sup>

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<sup>37</sup> Indeed, US network carriers, who do not face the same regulatory problems regarding secondary establishment within the US, have also adopted a hub-and-spoke network system.

<sup>38</sup> It is significant, in this respect, that merger with another European carrier had been part of KLM's long-term strategy during the 1990s but that previous negotiations between KLM and potential suitors, such as British Airways, had proved extremely difficult, not least because of regulatory concerns over traffic rights.

With regard to the second question, even though the Court did not approach or solve the issue in terms of competence, the Commission nevertheless considers that, to some extent, the problem needs to be addressed through a review of the respective roles of the Community and the Member States with respect to international aviation, as will be discussed in the next section.

## INTERNATIONAL AVIATION AND EU COMPETENCE

The Commission developed its understanding of the consequences of the *Open Skies* judgments in two communications, adopted in November 2002<sup>39</sup> and February 2003.<sup>40</sup> The principles contained in these communications were further developed in a third communication adopted in March 2005,<sup>41</sup> on the basis of the experience gained in the 2 years following the judgments.

In these communications, the Commission puts forward a three-pronged approach to the problem posed by nationality clauses in ASAs entered into by the Member States: (1) re-negotiation by the Member States of their existing bilateral agreements so as to bring them in conformity with the judgments of the court; (2) opening of negotiations between the Community and third country specifically on the issue of nationality clauses, with the purpose of replacing them with a Community carrier designation clause, and finally (3) full-blown negotiations between the Community and third countries for community-wide agreements to replace individual ASAs entered into by the Member States.

### **Re-negotiation by the Member States of their Existing Bilateral Agreements**

This is the solution that flows most naturally from the *Open Skies* judgments. If the problem is that the Member States have negotiated terms which are incompatible with the EC Treaty, renegotiating the agreements so as to amend those terms to bring them in conformity with the Treaty seems the most obvious solution.

Ensuring equality between Community carriers, however, requires more than just replacing nationality clauses with a Community carrier designation

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<sup>39</sup> European Commission, *Communication on the consequences of the Court judgments of 5 November 2002 for European air transport policy*, COM (2002) 649.

<sup>40</sup> European Commission, *Communication on relations between the Community and third countries in the field of air transport*, COM (2003) 94.

<sup>41</sup> European Commission, *Communication on Developing the Agenda for the Community's external aviation policy*, COM (2005) 79.



clause. It also means ensuring that the interests of all Community airlines, and not just those controlled by the negotiating Member State or its nationals, are taken into account in other aspects of the negotiations too. It is, of course, in principle, true of all commercial agreements entered into by Member States with third countries that genuine equality would require the interests of all concerned undertakings, and not just national ones, are taken into account. The argument, however, has particular strength in the airline industry, where the interests of the state have often been understood as coinciding with the interests of the flag carrier and where the latter has traditionally been very closely involved in all stages of the negotiations.

As the Commission rightly points out, the principle of non-discrimination enshrined in Article 43 EC implies that:

in so far as they continue to take charge of negotiating market access arrangements, Member States are no longer negotiating air transport agreements in the interests of their national airlines alone. . . . [T]raffic rights must now be considered to be negotiated on behalf of Community carriers in a more general sense.<sup>42</sup>

A Regulation was adopted in 2004 in an effort to improve the chances of a non-discriminatory approach to negotiations by Member States.<sup>43</sup> The Regulation recognises that the problem cannot be solved merely by imposing substantive non-discrimination obligations on the Member States and uses a range of techniques to ensure the representation of interests other than that of the Member States and its national airline(s) in the negotiation process. The Commission and the other Member States are involved through a requirement of prior notification of the Member State's intention to enter into negotiation with a third country.<sup>44</sup> The conclusion of the agreement may also be subject to prior approval, through a comitology process using the advisory procedure, where the Commission is itself actively negotiating an agreement with the third country in question or where the proposed agreement does not contain standard clauses developed jointly between the Commission and the Member States through another comitology process.<sup>45</sup> The Regulation also gives all Community carriers established on the territory of the Member States the right to be involved in the negotiations on a par with the state's own carriers.<sup>46</sup>

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<sup>42</sup> European Commission, *op. cit.*, n. 40 above, para. 57.

<sup>43</sup> Regulation 847/2004 on the negotiation and implementation of air service agreements between Member States and third countries, OJ 2004 L195/3.

<sup>44</sup> See Article 1(2) of the Regulation. Under Article 1(3), other Member States may make comments, which the negotiating Member States have to take into account 'as far as possible' in the negotiations.

<sup>45</sup> See Article 4 of the Regulation.

<sup>46</sup> See Article 2 of the Regulation.

Finally, Member States are also required to establish non-discriminatory and transparent procedures for the allocation of traffic rights where the agreement limits such traffic rights.<sup>47</sup>

While the provisions of the Regulation are interesting in their recognition of the fact that the issue is at least as much, if not more, one of involvement of Community interests in the negotiating process as one of substantive obligations on the Member State, one may nonetheless express a note of scepticism on their actual effectiveness. National airlines and carriers from other Member States, who will often be in direct competition, will more often than not have divergent interests and there will be little incentive for the Member State to negotiate hard for the interests of other Community carriers. Negotiations by Member States in this sector carry an inherent risk of bias. The Regulation attempts to limit that risk, but it cannot eradicate it altogether. What may be its saving grace in this respect, however, is that, in practice, as noted above, few flag carriers are likely to want to fly from another Member State to a third country anyway. The only category of carriers who would be more likely to want to exercise such rights are low-cost carriers and then probably only for flights to neighbouring countries. In relation to its neighbours, however, Community policy is oriented towards the conclusion of agreements with the Community rather than bilateral agreements with individual Member States.

### **Partial renegotiation by the Community on Standard Clauses**

The second approach put forward by the Commission would consist of keeping the system of bilateral agreements between Member States and third countries but negotiating at Community level with third countries specifically in relation to the replacement of nationality clauses by Community carrier designation clauses and also in relation to those few areas recognised by the Court as falling within the exclusive competence of the Community. The Commission explained in its 2003 communication on relations between the Community and third countries in the field of air transport<sup>48</sup> why it regards this as a superior solution to re-negotiation by individual Member States.

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<sup>47</sup> See Article 5 of the Regulation. Member States are also required, under Article 6, to inform the Commission of these procedures and any changes to them. No prior approval of the Commission is necessary, although the Commission could, of course, always use its ordinary powers, including starting an action under Article 226 EC, should the procedures not be satisfactory in terms of transparency or non-discrimination. On the Commission's understanding of what constitutes a non-discriminatory and transparent procedure, see the Annex to its 2003 communication on relations between the Community and third countries in the field of air transport, *op. cit.*, n. 40 above.

<sup>48</sup> *Op. cit.*, n. 40 above.

Whether due to lack of enthusiasm or less effective negotiating skills, some Member States may be less successful than others in negotiating a Community carrier designation clause. As a result, airlines could be faced with an incoherent patchwork of variable traffic rights in different Member States of the Union. Moreover, this itself creates a disincentive for a Member State to negotiate such a clause, as it would run the risk of exposing its own carrier to greater competition from carriers from other Member States while at the same time its own carriers would not enjoy similar rights in those countries which were less effective at negotiating the clause. The Commission also considers that the Community would be in a stronger position to negotiate a Community carrier designation clause than a Member State acting in isolation, not least because of the unusual nature at present of such a clause in international aviation relations. In addition, and on the assumption that there is no desire to re-negotiate other aspects of existing bilateral agreements, there is also an efficiency factor, since the third country only needs to conduct one round of negotiation instead of 25.

The Commission therefore requested, and obtained,<sup>49</sup> from the Council a so-called ‘horizontal mandate’ to negotiate such clauses, on the basis of which it has, to date, concluded 24 sets of negotiations.<sup>50</sup> A drawback of this approach is that, to the extent that a large number of issues are still negotiated bilaterally between Member States and third countries, the wider problems of potential discrimination on issues other than the nationality clauses themselves are still not solved.

### **Negotiation by the Community of Replacement ASAs**

This clearly is the most *communautaire* solution to the problem but it is also one that comes at a higher cost in terms of Member States’ autonomy and, unsurprisingly, it is the one that generates the most resistance on the part of the Member States and of the Council as well as some third countries.<sup>51</sup>

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<sup>49</sup> See the minutes of the 2515th meeting of the Council (Transport/Telecommunications/Energy) held on 5–6 June 2003 (Council Document 10172/03, p. 6) and Council Decision authorising the Commission to open negotiations with third countries on air carrier ownership and control and other issues within Community exclusive competence (Council Document 11323/03).

<sup>50</sup> See Commission Press Release, ‘EU and South East Europe: first steps towards an extended Single Aviation Market’, Brussels, 9 June 2006, IP/06/764 and Commission Press Release, ‘European Union signs aviation agreement with New Zealand’, Brussels, 21 June 2006, IP/06/810.

<sup>51</sup> For the position of the US administration, in particular, see J. Shane, ‘Open Skies Agreements and the European Court of Justice’, speech at the American Bar Association’s Forum on Air and Space Law, Hollywood, Florida, 8 November 2002

The Commission's effort to secure a mandate from the Council to negotiate ASAs has, in the first place, focused on neighbouring countries and on the US. With regard to the former, the Commission's policy has been to seek comprehensive agreements going beyond just traffic rights<sup>52</sup> under the basic model of a European Common Aviation Area (ECAA) or 'Single Aviation Market'.<sup>53</sup> On the basis of a 1996 Council mandate, a draft agreement on these lines had been reached with a number of Central and East European states. The Court of Justice had, in Opinion 1/00 delivered in April 2002, given the green light in relation to the agreement, recognising its compatibility with the EC Treaty.<sup>54</sup> By that stage, however, the draft agreement had become somewhat obsolete, given the pending accession to the Community of most parties to the agreement. The ECAA model, however, remains the base of the Commission's policy for the Western Balkans and an agreement has been negotiated to that effect. The Commission has also been seeking a mandate to start negotiations with a number of Mediterranean countries on the basis of more traditional and less ambitious air service agreements, without excluding the creation of a Common Aviation Area with at least some of them as a long-term objective.

It is clear that the Commission has felt emboldened by the *Open Skies* judgments to seek mandates to negotiate ASAs with third countries. In its 2005 Communication on Developing the Agenda for the Community's external aviation policy,<sup>55</sup> the Commission contemplates further agreements in just about every geographic zone, albeit with a special emphasis on Russia and China,<sup>56</sup> in addition to the Community's immediate neighbours and the US.

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(Distributed by the Office of International Information Programs, US Department of State. Available at <http://usinfo.state.gov> – available at <http://www.state.gov/e/eb/rls/rm/2002/19501.htm>, consultation date: March 2005). While the views expressed in the speech by the (then) US Department of Transportation's Associate Deputy Secretary Jeffrey Shane were said, by him, to constitute a first and 'largely personal' reaction to the *Open Skies* judgment, they were clearly in line with US official policy and the speech has been widely distributed by the Department of State. See also '*Open Skies* or *Open Markets? The Effect of the European Court of Justice (ECJ) Judgments on Aviation Relations Between the European Union (EU) and the United States of America (USA)*', 17th Report HL Select Committee on the European Union, Session 2002–2003, HL Paper 92, Chapter 4.

<sup>52</sup> In addition to traffic rights, the Commission envisages agreements which would cover such issues as aviation safety, aircraft and personnel licensing or air traffic control.

<sup>53</sup> On the Commission's policy, see generally its Communication on a Community aviation policy towards its neighbours, COM (2004) 74.

<sup>54</sup> Opinion 1/00 (*re: The European Common Aviation Area*) [2002] ECR I-3493.

<sup>55</sup> *Op. cit.*, n. 41 above.

<sup>56</sup> In March 2005, the Commission issued two communications specifically on relations in the air transport field with these two countries: *Communication on a Framework for Developing Relations with the Russian Federation in the Field of Air*

The Council, however, has not shown the same degree of enthusiasm in relation to the development of the Community's international aviation policy and it remains to be seen which, if any, of the requested mandates it eventually grants the Commission. The widening of the 1996 mandate to negotiate an air transport agreement with the US,<sup>57</sup> however, constitutes the 'jewel in the crown' and a success for the Commission. The US and some Member States, such as the United Kingdom (UK), would have preferred a bilateral solution on the basis of negotiations with individual Member States. Indeed, the US Government organised a meeting in Paris in late February 2003 with representatives of several Member States for the purpose of finding solutions for re-negotiations of bilateral agreements in the light of the *Open Skies* judgments.<sup>58</sup> For the UK, the danger of a European-wide agreement is that specific British interests, notably in relation to the issue of access to Heathrow Airport by US carriers, might be sacrificed to the greater good of the Community as a whole.

However, the proposals initially put forward by the US to re-negotiate bilateral agreements<sup>59</sup> show the practical difficulty of a bilateral approach and lend strength to the Commission's view that Member States may not unilaterally be in a position to negotiate a nationality clause that would satisfy the requirements of the *Open Skies* judgments. While the US would have been ready to show flexibility on a number of issues, the question of allowing traffic rights from another Member State to airlines controlled by nationals of a country with which the US does not have an 'Open Skies' agreement would have been difficult to overcome. Yet, Article 43 EC would not allow such distinction. What would have been acceptable to the US in the context of bilateral negotiations would simply have been incompatible with the judgment of the Court in *Open Skies*.

## CONCLUSION

Since the beginning of the 1980s, the Commission had consistently argued that the proper functioning of the internal market in air transport required a

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*Transport*, COM (2005) 77 and *Communication on a Community Civil Aviation Policy towards the People's Republic of China – Strengthening Co-operation and Opening Markets*, COM (2005) 78.

<sup>57</sup> See n. 49 above.

<sup>58</sup> Reported in C. Woll, 'Transatlantic Relations as a Catalyst to European Integration – the Activism of the European Commission in the case of International Aviation', AICGS/DAAD Working Paper, 2003, p. 12. (available at <http://www.aicgs.org/Publications/PDF/woll.pdf>, consultation date: March 2005).

<sup>59</sup> See J. Shane's speech to the American Bar Association's Forum on Air and Space Law op. cit., n. 51 above.

common external community policy in aviation and it has sought, largely unsuccessfully, mandates from the Council to develop that policy. An analysis of the developments in the European air transport market in the 1990s vindicates the position taken by the Commission. This is so not so much because airlines are prevented from operating services from other Member States to third countries but rather because of the obstacle to cross-border mergers and acquisitions resulting from bilateral air service agreements between Member States and third countries.

By holding that nationality clauses in such agreements violate Article 43 EC on freedom of establishment by discriminating against carriers from other Member States, the Court provided an answer to that problem phrased in terms of conflict of norms rather than in terms of competence. Put differently, the problem is analysed as one of substantive law rather than one of governance structure. While this may be perfectly sound from a perspective of legal orthodoxy, it nevertheless masks the fact that the problem can only be addressed through consideration of governance structures and the range of actors involved in decision-making processes. All three modes of answer to the *Open Skies* judgments – renegotiation by Member States of their ASAs, limited agreements between the Community and third countries in relation to nationality clauses in agreements, or replacement of national ASAs by Community-wide agreements – involve reforming decision-making structures so as to open them to Community interests. In the air transport sector at least, and probably in other sectors too, it is no longer sustainable to separate internal market governance from international relations. International governance *is* an internal market issue.

## 12. The legality of the EC mutual recognition clause under WTO law

**Lorand Bartels**

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### INTRODUCTION

One of the cornerstones of the internal market is the principle of mutual recognition of goods, according to which the technical legislation of European Union (EU) Member States must allow the marketing of goods lawfully manufactured or marketed in another EU Member State, provided that the goods provide an equivalent level of protection of the various legitimate interests involved. With the conclusion of the EEA Agreement and the EC–Turkey customs union, this principle has, with some variation, now been extended to goods originating in the European Economic Area (EEA) and Turkey. The European Commission (the Commission), a keen supporter of mutual recognition, has sought to implement the principle by insisting that EU Member States insert a ‘mutual recognition clause’ in their technical legislation.

The purpose of this chapter is to examine whether the Commission’s model of the mutual recognition clause poses any problems under World Trade Organization (WTO) law. The difficulty is that this clause, if implemented, gives a preference to goods of EEA/Turkish origin compared to goods of other origin, which *prima facie* violates the non-discrimination provisions of the General Agreement on Tariffs and Trade (GATT 1994) and the Agreement on Technical Barriers to Trade (TBT Agreement).<sup>1</sup> Consequently, when a mutual recognition clause is contained in Member State legislation, the EC (representing that Member State in the WTO) may be in breach of its WTO obligations.<sup>2</sup> The EC

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<sup>1</sup> All WTO Agreements are available at [http://www.wto.org/english/docs\\_e/legal\\_e/legal\\_e.htm](http://www.wto.org/english/docs_e/legal_e/legal_e.htm).

<sup>2</sup> The EC takes the view that it is responsible for the conduct of its Member States when their conduct is attributable to the EC: see eg *EC – Geographical Indications (US Complaint)*, WT/DS174/R, adopted 20 April 2005, para. 7.725. However, in addition, the EC may be directly responsible under a treaty regardless of any attribution of conduct. See G. Gaja, ‘Second Report on Responsibility of International Organisations, UN Doc A/CN.4/541’, 2 April 2004, paras 10–11. On the consequences for the responsibility of the Member States see below at nn. 102–3.

may also directly be in violation of WTO law as a consequence of the Commission's policy on mutual recognition clauses,<sup>3</sup> or even as a consequence of a policy judicially enforced by the European Court of Justice (ECJ).<sup>4</sup>

These issues will be examined as follows. The chapter begins with a discussion of the EC mutual recognition clause, and its status under EC law. Next, it examines the legality of this clause under the GATT and the TBT Agreement. On the basis that the mutual recognition clause may violate most favoured nation obligations in these agreements, the chapter then investigates whether there might be a legitimate defence to any such violations. This involves consideration of the fact that the EC, the EEA and the EC–Turkey customs union are regional trade agreements under Article XXIV GATT, the fact that the EC is a full WTO Member, and the possibility that the discriminatory nature of the mutual recognition clause might be necessary for legitimate public policy reasons, such as to protect human life or health, or to safeguard consumer protection.

## THE EC MUTUAL RECOGNITION CLAUSE

The principle of mutual recognition within the (then) EEC was developed during the 1970s, but was given a powerful boost by the *Cassis de Dijon* judgment in 1979, which prohibited a marketing ban on alcoholic beverages lawfully produced and marketed in another Member State with an alcohol content lower than that permitted under national legislation.<sup>5</sup> With the coming

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<sup>3</sup> In WTO Appellate Body Report, *Guatemala – Anti-dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted 25 November 1998, at para. 69, n. 47, the Appellate Body said that '[i]n the practice established under the GATT 1947, a "measure" may be any act of a Member, whether or not legally binding, and it can include even non-binding administrative guidance by a government (see *Japan – Trade in Semi-Conductors*, adopted 4 May 1988, BISD 35S/116)'. This footnote was approved in the WTO Appellate Body Report, *United States – Sunset Review of Anti-dumping Duties on Corrosion Resistant Carbon Steel Flat Products From Japan*, WT/DS244/AB/R, adopted 9 January 2004, para. 85.

<sup>4</sup> In WTO Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products (US – Shrimp)*, WT/DS58/AB/R, adopted 6 November 1998, para. 173, the Appellate Body said that '[t]he United States, like all other Members of the WTO and of the general community of states, bears responsibility for acts of all its departments of government, including its judiciary'.

<sup>5</sup> Case 120/78 *Rewe-Zentrale AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649. K. Nicolaidis and M. Egan, 'Transnational market governance and regional policy externality: Why recognize foreign standards?' (2001) vol. 8:3 *Journal of European Public Policy* 454–73 at 461, argue that 'the ECJ did not



into force of the EC–Turkey customs union and the EEA Agreement, this principle has now been extended (with some limitations) to products from Turkey and the EEA. In 2003, the principle was formulated by the European Commission in the following terms:

[T]he Member State of destination of a product must allow the placing on its market of a product lawfully manufactured and/or marketed in another Member State or in Turkey, or lawfully manufactured in an EFTA State that is a contracting party to the Agreement on the European Economic Area, provided that this product provides an equivalent level of protection of the various legitimate interests involved.<sup>6</sup>

The Commission has long been an enthusiastic supporter of the principle of mutual recognition. It responded to the *Cassis de Dijon* decision with a Communication commenting on the judgment,<sup>7</sup> and has pursued a number of educational and other initiatives with the aim of convincing the Member States to take mutual recognition seriously. Member States are required to give prior notification of their draft technical regulations,<sup>8</sup> which are published on an EU database (TRIS).<sup>9</sup> In addition, the Commission has proposed that the Member States include a ‘mutual recognition clause’ in any legislation setting out technical standards. Such a clause would exempt products of EEA/Turkish origin from the application of the technical regulation in which it is contained, except where it is necessary to ensure an appropriate level of protection. This proposal has been taken up by the Council which, in a Resolution of 28 October 1999, called on the Member States ‘to review and simplify the relevant national legislation and its application procedures, for example, by inserting appropriate

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“invent” mutual recognition with its *Cassis de Dijon* ruling nor did the ruling pick a new focal point among many possible others. Instead, the very idea of mutual recognition was refined and tested over more than a decade through a complex interplay between European institutions in various sectors throughout the 1970s.’ For an overview of the cases, see P. Oliver and M. Jarvis, *Free Movement of Goods in the European Community*, 4th edn (London: Sweet and Maxwell, 2003), pp. 133–8.

<sup>6</sup> European Commission, *Commission Interpretative Communication on Facilitating the Access of Products to the Markets of Other Member States: The Practical Application of Mutual Recognition*, OJ 2003 C265/2.

<sup>7</sup> European Commission, *Communication from the Commission Concerning the Consequences of the Judgment Given by the Court of Justice on 20 February 1979 in Case 120/78 (‘Cassis de Dijon’)*, OJ 1980 C256/2.

<sup>8</sup> Directive 98/34/EC, laying down a procedure for the provision of information in the field of technical standards and regulations OJ 1998 L204/37, amended by Directive 98/48/EC, OJ 1998 L217/18. For a discussion of the predecessor to this Directive, see S. Weatherill, ‘Compulsory notification of draft technical regulations: The contribution of Directive 83/189 to the management of the internal market’ (1996) 16 *Yearbook of European Law* 129–204.

<sup>9</sup> The database is located at <http://ec.europa.eu/enterprise/tris>.

mutual recognition clauses in relevant legislative proposals and improving national procedures for applying efficiently these clauses'.<sup>10</sup> A model mutual recognition clause has been drafted by the Commission, which is in the following terms:

The requirements of this law do not apply to products lawfully manufactured and/or marketed in another Member State of the European Union or in Turkey, or lawfully manufactured in an EFTA State that is a contracting party to the EEA agreement.

If the competent authorities have proof that a specific product lawfully manufactured and/or marketed in another Member State of the European Union or in Turkey, or lawfully manufactured in an EFTA state that is a contracting party to the EEA agreement, does not provide a level of protection equivalent to that sought by this law, they may refuse market access to the product or have it withdrawn from the market, after they:

- have informed the manufacturer or the distributor in writing which elements of the national technical rules prevent the marketing of the product in question, and
- have proved, on the basis of all the relevant scientific elements available to the competent authorities, that there are overriding grounds of general interest for imposing these elements of the technical rule must be imposed on the product concerned and that less restrictive measures could not have been used, and
- have invited the economic operator to express any comments he may have within a period of (at least four weeks or 20 working days), before issuing an individual measure against him restricting the marketing of this product, and
- have taken due account of his comments in the grounds of the final decision.

The competent authority shall notify the economic operator concerned of individual measures restricting the marketing of the product, stating the means of appeal available to him.<sup>11</sup>

The Commission's initiative on mutual recognition clauses has been treated ambiguously by the ECJ. In 1998, the ECJ gave the initiative its blessing in *Foie Gras*, which concerned a French decree setting out various mandatory quality and composition requirements before a product could be marketed as *foie gras*.<sup>12</sup> The Court accepted the legitimacy of the objectives of consumer information and protection, but held that the means chosen to achieve these

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<sup>10</sup> Council of the European Union, *Resolution of 28 October 1999 on Mutual Recognition*, OJ 2000 C141/4, para. 14(a).

<sup>11</sup> European Commission, *op. cit.*, n. 6 above, p. 11. This is the 'detailed' form of the clause. The Commission also allows for the possibility of a 'simple' clause when other parts of the legislation include the administrative guarantees set out in the Communication (*ibid.*).

<sup>12</sup> Case C-184/96 *Commission v France (Foie Gras)* [1998] ECR I-6197. The criteria were a minimum *foie gras* content, the permitted ingredients, the maximum saccharose and seasoning content, the maximum percentage of fat given off and of homogenate and/or water, the maximum degree of humidity and specific detailed rules concerning presentation and packaging (para. 7).

objectives was disproportionate.<sup>13</sup> More controversially, the Court then went on to make the following comment:

In the light of the foregoing considerations, it is declared that, by adopting the Decree without including in it a mutual recognition clause for products coming from a Member State and complying with the rules laid down by that State, the French Republic has failed to fulfil its obligations under Article [28] of the Treaty.<sup>14</sup>

This was by no means a necessary conclusion, and it has not passed uncriticised in the academic literature.<sup>15</sup> As earlier, however, the Court's favourable statement on mutual recognition was very much to the taste of the Commission. The Commission has repeatedly referred to *Foie Gras* in its policy documents on mutual recognition and in 2002, it even went so far as to claim that the Member States were under an *obligation* systematically to insert a mutual recognition clause in all of their existing technical legislation.<sup>16</sup>

However, later cases indicate that the Commission (and for that matter the Court in *Foie Gras*) may have been taking it too far. In *Commission v France*, the Court had to decide whether legislation requiring prior authorisation of a food additive before food could be marketed was compatible with Articles 28 and 30 EC.<sup>17</sup> Relying on the judgment in *Foie Gras*, the Commission argued that 'the absence in the French legislation of provision for mutual recognition is sufficient to demonstrate the failure to fulfil obligations'.<sup>18</sup> The Court ignored this argument, and instead imposed two administrative conditions concerning the rights of economic operators to apply for authorisation of the food additive.<sup>19</sup> In his Opinion in this case, Advocate-General Mischo was more definite: Articles 28 and 30 EC do not, he said, require a mutual recognition clause to be included in national legislation concerning chemical additives in food.<sup>20</sup> Other cases confirm this view. In *Greenham and Abel*, criminal proceedings based on the same legislation, the Court again ignored the argument by the defendants that Articles 28 and 30 EC required a mutual recogni-

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<sup>13</sup> *Ibid.*, paras 21–27.

<sup>14</sup> *Op. cit.*, para. 28.

<sup>15</sup> P. Eeckhout, 'The European Court of Justice and the legislature' (1998) 18 *Yearbook of European Law* 1–28 at 20. Eeckhout submits that mutual recognition clauses are best confined to Community legislation.

<sup>16</sup> European Commission, *Second Biennial Report on the Application of the Principle of Mutual Recognition in the Single Market*, COM (2002) 419 final, p. 26.

<sup>17</sup> Case C-24/00 *Commission v France* [2004] ECR I-1277.

<sup>18</sup> *Ibid.*, para. 17.

<sup>19</sup> *Op. cit.*, n. 17, paras. 25–29. The relevant conditions had been laid down in Case C-344/90 *Commission v France* [1992] ECR I-4719, para. 8, and Case C-192/01 *Commission v Denmark* [2003] ECR I-9693, para. 44.

<sup>20</sup> *Ibid.*, para. 17 of the Opinion.

tion clause,<sup>21</sup> while Advocate-General Mischo again approved his earlier statement that these provisions do not require any such clause.<sup>22</sup> Finally, in *Commission v Italy*, the Court held that, by requiring prior authorisation of energy foods produced and marketed in another Member State, Italy had breached Article 28 EC.<sup>23</sup> However, this was not because Italy had not included a mutual recognition clause in its legislation; rather it was because Italy had failed to demonstrate that its procedure was necessary and proportionate to meet the objectives of public health or consumer protection. Interestingly, it seems from the judgment that the Commission did not even argue in this case that the legislation should have contained a mutual recognition clause.

These decisions are not entirely fatal to the Commission's ambition of requiring Member States to include a mutual recognition clause in their national legislation, though clearly this policy will have to be softened for legislation concerned with food safety.<sup>24</sup> Even if the Commission is now unable to force the Member States to include mutual recognition clauses in all of their national technical legislation, such clauses are likely to remain an important feature of most such legislation. For this reason it remains necessary to review the extent to which such clauses may violate WTO law.

## ARTICLE I:1 OF GATT 1994

In the first place, the EC mutual recognition clause may violate the unconditional most-favoured-nation obligation in Article I:1 of GATT 1994. This provision states as follows:

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation . . . and with respect to all rules and formalities in connection with importation and exportation, *and with respect to all matters referred to in paragraphs 2 and 4 of Article III* . . . any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally

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<sup>21</sup> Case C-95/01 *Criminal Proceedings against Greenham and Abel* [2004] ECR I-1333.

<sup>22</sup> *Ibid.*, para. 79 of the Opinion.

<sup>23</sup> Case C-270/02 *Commission v Italy* [2004] ECR I-1559.

<sup>24</sup> It is interesting to note that in its 2003 Communication (op. cit., n. 6 above), the Commission no longer referred to a Member State's 'obligation' to include a mutual recognition clause in their legislation. Rather, the Commission now 'wants' the Member States to pursue such a policy (para. 6.1). Perhaps the Commission was influenced by the adverse Opinions of Advocate-General Mischo in the two cases just discussed (though it failed to mention these Opinions in its Communication).

to the like product originating in or destined for the territories of all other contracting parties.<sup>25</sup>

The ‘matters referred to in paragraphs 2 and 4 of Article III’ relate respectively to internal taxes and charges, and to ‘all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use’. According to longstanding WTO jurisprudence, this covers all internal regulations affecting the conditions of competition in the domestic market.<sup>26</sup> As a result of the inclusion of such matters in Article I:1, WTO Members are entitled to receive the advantages of such internal regulations, importantly, even when these advantages are not granted to domestic products.<sup>27</sup>

The mutual recognition clause is clearly part of an internal regulation likely to affect the conditions of competition on the domestic market, and it is therefore covered by this aspect of Article I:1. This means that it is necessary to answer the following questions: are products of non-EEA/Turkish origin ‘like’ products of EEA/Turkish origin and, if so, is any ‘advantage, favour, privilege or immunity’ being granted to products of EEA/Turkish origin that is not immediately and unconditionally being accorded to these other products?

### ‘Like Products’

An argument might be raised that EEA/Turkish products are not ‘like’ similar products of different origin on the basis that only EEA/Turkish products have been demonstrated to meet the EC’s minimum safety standards.<sup>28</sup> There have not been any Appellate Body reports on the criteria relevant in determining ‘likeness’ in the context of the most favoured nation obligation in Article I GATT, and so to some extent this is still an open question, particularly given that the Appellate Body has stressed that ‘likeness’ can mean something different in each provision in which the concept appears.<sup>29</sup> However, taking as a

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<sup>25</sup> Emphasis added. For discussion of ‘any other origin’ see nn. 98–103 below.

<sup>26</sup> GATT Panel Report, *Italian Discrimination Against Imported Agricultural Machinery*, adopted 23 October 1958, BISD 7S/60.

<sup>27</sup> See GATT Panel Report, *Japan – Trade in Semi-Conductors*, adopted 4 May 1988, BISD 35S/116, para. 60 (allegation that Japan had promoted the domestic purchase of US semiconductors). For a review of this question, and a similar conclusion, see J. Mathis, ‘Mutual recognition agreements: Transatlantic parties and the limits to non-tariff barrier regionalism in the WTO’ (1998) vol. 32:6 *Journal of World Trade* 5–31 at 13–14.

<sup>28</sup> For example, the General Product Safety Directive (2001/95/EC), OJ 2002 L11/4.

<sup>29</sup> WTO Appellate Body Report, *Japan – Taxes on Alcoholic Beverages (Japan – Alcoholic Beverages II)*, WT/DS8/AB/R, adopted 1 November 1996, para. 23.

guide the interpretation of this term in Article III GATT,<sup>30</sup> it would seem that the minimum requirements would involve physical similarity, end use and consumer preference.<sup>31</sup>

In *EC – Asbestos*, the Appellate Body determined that risk to human health caused by the use of a product was an important element in determining whether a disfavoured product (containing asbestos) was ‘like’ a favoured product (containing asbestos substitutes).<sup>32</sup> One might, therefore, think that product safety is a relevant criterion in a ‘like product’ determination. However, in *EC – Asbestos* the regulatory distinction was drawn expressly on the basis of the physical differences between the two types of product. Panels have taken another approach entirely when the distinction between disfavoured and favoured products has been drawn on the basis of considerations which could have no possible bearing on their ‘likeness’, for example, whether a particular product is definitively imported into a country or sold domestically,<sup>33</sup> the characteristics of the seller or purchaser of the product,<sup>34</sup> and – importantly for present purposes – the origin of the product.<sup>35</sup> In such cases, panels have held that it is permissible to have regard to a *hypothetical* disfavoured product, which will inevitably be ‘like’ the favoured product. Hypothetical ‘like’ products have even been considered in cases of *de facto* discrimination. In *EEC – Beef from Canada*, a GATT 1947 panel found that the EEC had violated the most-favoured-nation obligation in Article I:1 GATT by granting favoured treatment to products which had undergone conformity assessment procedures in the United States (US) but not in any other country;

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<sup>30</sup> Article III GATT sets out the ‘national treatment’ obligation with respect to internal taxes and regulations.

<sup>31</sup> For a discussion, see R.E. Hudec, ‘“Like product”: The differences in meaning in GATT Articles I and III’, in T. Cottier, P. Mavroidis and P. Blatter (eds), *Regulatory Barriers and the Principle of Non-Discrimination in World Trade Law* (Ann Arbor: University of Michigan Press, 2000), pp. 101–24, esp. pp. 117–19. Hudec proposes that ‘product distinctions involving internal measures should be judged under a broader standard that focuses on the competitive relationship between the affected products and pays less attention to physical characteristics’ (p. 117) but recognises that the cases do not support this proposal (p. 119).

<sup>32</sup> WTO Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, paras 113–14 and 152–53 (Concurring Member).

<sup>33</sup> WTO Panel Report, *Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, WT/DS155/R, adopted 16 February 2001, para. 11.169.

<sup>34</sup> *Ibid.*

<sup>35</sup> WTO Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry (Indonesia – Automobiles)*, WT/DS54/R, adopted 23 July 1998, para. 14.113.

quite aside from the question whether Canada (the complainant) produced products meeting the EEC's standards, the panel defined the relevant 'like product' in terms of the product description in the EC law setting out the favoured treatment.<sup>36</sup>

Applying these considerations to the present case, it is clear that, according to the EC mutual recognition clause, two identical products would be treated differently simply on the basis of whether they originate in the EEA or Turkey or elsewhere. In these circumstances, a hypothetical 'like product' may be presumed.

### **'Advantage, Favour, Privilege or Immunity'**

There are two types of 'advantage, favour, privilege or immunity' received by EEA/Turkish products. First, these products are automatically exempted from the application of national technical regulations, except where the importing Member State can prove that the product does not meet national safety standards. The 'advantage' that this presents has been explained, ironically, by the Commission itself, in the course of explaining the need for mutual recognition clauses. On the application of national technical regulations to imported products, the Commission has said as follows:

Such rules may oblige the economic operator to withdraw EEA/Turkish products from the market of the Member State of destination. They are also likely to oblige the economic operator to adapt EEA/Turkish products depending on the Member State of destination. This will give rise to additional costs for the economic operator. Even where these additional costs are borne by consumers in the final analysis, the mere prospect of having to advance these costs constitutes a barrier for operators, since it is likely to deter them from entering the market of the Member State in question.<sup>37</sup>

The non-application of national technical regulations is thus an obvious 'advantage' accorded to EEA/Turkish products. Unlike other products, these do not need to be adapted to the EU Member State of destination.

The second advantage is that EEA/Turkish products benefit from an automatic recognition of the results of conformity assessment procedures carried out at their place of origin. This latter advantage, when not extended to products of other origin, may constitute *de facto* discrimination in violation of Article I:1, as was held in *EEC – Beef from Canada*.<sup>38</sup>

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<sup>36</sup> GATT Panel Report, *European Economic Community – Imports of Beef from Canada* (*EEC – Beef from Canada*), adopted 10 March 1981, BISD 28S/92, para. 4.2(a).

<sup>37</sup> European Commission, *op. cit.*, n. 6 above, p. 5.

<sup>38</sup> GATT Panel Report, *EEC – Beef from Canada*, n. 36 above, para. 4.3.

**... Accorded 'Immediately and Unconditionally'**

None of these 'advantages, favours, privileges or immunities' is afforded *immediately and unconditionally* to 'like products' of other origin – in fact, they are not accorded at all. However, even if these advantages were offered conditionally, there would be a violation of Article I:1 GATT. As the Appellate Body said in *Canada – Automobiles*:

We note next that Article I:1 requires that '*any advantage, favour, privilege or immunity granted by any Member to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other Members.*' (emphasis added) The words of Article I:1 refer not to *some* advantages granted 'with respect to' the subjects that fall within the defined scope of the Article, but to '*any advantage*'; not to *some* products, but to '*any product*'; and not to like products from *some* other Members, but to like products originating in or destined for '*all other Members*.'<sup>39</sup>

While the Appellate Body perhaps overemphasises the words 'any' and 'all' in Article I:1, to the exclusion of the more obviously applicable term 'unconditional', the meaning of the obligation is clear. At the very least, as the panel in *Canada – Automobiles* said, 'the obligation to accord "unconditionally" to third countries which are WTO Members an advantage which has been granted to any other country means that the extension of that advantage may not be made subject to conditions with respect to the situation or conduct of those countries'.<sup>40</sup> It probably also means, more broadly, as the panel in *Indonesia – Automobiles* said, that 'any such advantage . . . cannot be made conditional on any criteria that is [*sic*] not related to the imported product itself'.<sup>41</sup>

It must be concluded that any EU Member State legislation implementing the EC mutual recognition clause accords an advantage to products of EEA/Turkish origin that is not accorded immediately and unconditionally to like products of other origin. Consequently, such legislation will be in violation of Article I:1 GATT.

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<sup>39</sup> WTO Appellate Body Report, *Canada – Certain Measures Affecting the Automotive Industry (Canada – Automobiles)*, WT/DS139/AB/R, adopted 19 June 2000, para. 79.

<sup>40</sup> WTO Panel Report, *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/R, WT/DS142/R, adopted as modified by the Appellate Body Report, 19 June 2000, para. 10.23. The panel went on to say, however, that '[a]n advantage can be granted subject to conditions without necessarily implying that it is not accorded "unconditionally" to the like product of other Members' (para. 10.14). This ruling seems incorrect.

<sup>41</sup> WTO Panel Report, *Indonesia – Automobiles*, n. 35 above, para. 14.143.



## THE AGREEMENT ON TECHNICAL BARRIERS TO TRADE

As well as being subject to GATT 1994, the types of measures that are intended to include the mutual recognition clause are regulated by the WTO Agreement on Technical Barriers to Trade (the TBT Agreement).<sup>42</sup> This Agreement imposes conditions, including non-discrimination against WTO Members, on mandatory technical regulations<sup>43</sup> and conformity assessment procedures.<sup>44</sup> The Agreement also regulates voluntary technical standards, but these are not relevant for the purposes of this chapter.

### Technical Regulations (Article 2.1)

Article 2.1 of the TBT Agreement sets out both a national treatment obligation and a most-favoured-nation obligation with respect to technical regulations. It states as follows:

With respect to their central government bodies: Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin *and to like products originating in any other country*.<sup>45</sup>

The mutual recognition clause raises questions concerning only the most-favoured-nation aspect of this provision.

### ‘Like products’

Article 2.1 of the TBT Agreement requires WTO Members not to discriminate

<sup>42</sup> On the relationship between GATT 1994 and the TBT Agreement, see n. 85 and accompanying text below.

<sup>43</sup> A technical regulation is defined in Annex 1 of the TBT Agreement as: ‘[d]ocument which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method’.

<sup>44</sup> Conformity assessment procedures are defined in Annex 1 of the TBT Agreement as: ‘[a]ny procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled. *Explanatory note:* Conformity assessment procedures include, inter alia, procedures for sampling, testing and inspection; evaluation, verification and assurance of conformity; registration, accreditation and approval as well as their combinations.’

<sup>45</sup> Emphasis added. For further discussion of ‘any other origin’ see nn. 98–103 below.

between 'like products'. In this respect, Article 2.1 is similar to the most-favoured-nation obligation in Article I:1 GATT and the national treatment obligation in Article III GATT, both of which also require non-discrimination with respect to 'like products'.<sup>46</sup> The term 'like product' in Article 2.1 of the TBT Agreement has never been interpreted in dispute settlement proceedings, but it is reasonable to assume that in the context of the most-favoured-nation obligation, it will have the same meaning as in Article I:1 GATT. Based on the analysis above, it follows that the EC mutual recognition clause necessarily differentiates between two sets of 'like product'.

### **'Less favourable treatment'**

The content of the most favoured nation obligation in Article 2.1 differs in certain respects from Article I:1 GATT. The test is no longer whether an 'advantage, favour, privilege or immunity' is accorded to 'like products' of WTO Members. Rather, it is whether these like products are receiving 'less favourable treatment'. While the terminology differs, in practice any failure to accord an advantage to a 'like product' will necessarily be 'less favourable treatment'. However, it may nevertheless be useful to draw an analogy with the equivalent term in Article III:4 (the obligation to grant to imported products no less favourable treatment than is granted to like domestic products). The Appellate Body held in *Korea – Beef* that different treatment is not necessarily 'less favourable', even when the difference is origin-based.<sup>47</sup> In the context of Article III GATT, the question is whether, as a result of the 'treatment', the *conditions of competition* between imported and domestic products were less favourable to the imported products.<sup>48</sup>

Applying this test to the most-favoured-nation obligation in Article 2.1 of the TBT Agreement, the question would be whether the conditions of competition for non-EEA/Turkish products are less favourable than for EEA/Turkish products. It seems that this is indeed the case: to grant automatic market access to products lawfully marketed in the EEA and Turkey while withholding this benefit from other products necessarily places the latter at a competitive disadvantage. It may, therefore, be assumed that this element of Article 2.1 is satisfied.

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<sup>46</sup> Note, however, that the second sentence of Article III:2 applies to 'directly competitive or substitutable products'.

<sup>47</sup> WTO Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef (Korea – Beef)*, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, para. 134.

<sup>48</sup> *Ibid.*, paras 135–37 (referring to the term 'treatment no less favourable' in Article III:4).

**Conditionality (Articles 2.7 and 10.7)**

A more significant difference between Article 2.1 of the TBT Agreement and Article I:1 GATT is that Article 2.1 does not expressly require the ‘treatment’ to be accorded unconditionally or immediately. An argument could, therefore, be made that Article 2.1 imposes an obligation merely to accord no less favourable treatment to like products *from any WTO Member meeting certain conditions*, for instance, having technical regulations recognised by the importing WTO Member as equivalent to its own. There are arguments both for and against the proposition that such conditionality is permitted in Article 2.1.

Against the proposition is the fact that the text of Article 2.1 of the TBT Agreement ensures no less favourable treatment to products of ‘any WTO Member’ without qualification. This could be taken as meaning that ‘any WTO Member’ simply means *any* WTO Member, regardless of whether that Member meets any conditions. This is especially the case if one applies literally the words of the Appellate Body in the passage quoted above from *Canada – Automobiles*.<sup>49</sup> On the other hand, the absence of an express prohibition on conditional most-favoured-nation treatment could also be taken as meaning that conditionality is permitted. The contextual arguments are equally ambiguous. Article 2.1 was drafted against the background of Article I:1 GATT, which imposes a requirement that ‘advantages’ be accorded to like products *immediately and unconditionally*. This could be taken as meaning that these requirements in Article I:1 GATT are transposed into Article 2.1 of the TBT Agreement; alternatively it could be inferred that the omission of these requirements was intentional.

There is an additional contextual factor that favours a reading of Article 2.1 of the TBT Agreement as allowing for a limited form of conditionality. This is the fact that both Articles 2.7 and 10.7 of the TBT Agreement assume that the recognition of the equivalence of technical regulations by an importing WTO Member depends upon whether those regulations adequately fulfil that Member’s objectives. It is submitted here that these provisions can only be given full effect if Article 2.1 is given a broad reading to include a limited form of conditionality. Article 2.7 states that:

Members shall give positive consideration to accepting as equivalent technical regulations of other Members, even if these regulations differ from their own, provided they are satisfied that these regulations adequately fulfil the objectives of their own regulations.

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<sup>49</sup> See n. 39 above and accompanying text.

This provision is in two parts. First, it establishes an obligation that, at a minimum, requires an importing WTO Member to give ‘positive consideration’ to any request made by an exporting WTO Member to have its regulations considered as equivalent to its own.<sup>50</sup> Whether this means that WTO Members are under a positive obligation to take the initiative in investigating the adequacy of the technical regulations of other Members is an open question, though it is unlikely. The use of the words ‘give positive consideration’ and ‘accepting’ indicates that it is up to the exporting WTO Member to make the first move. It also difficult to know whether this provision imposes any substantive obligations on WTO Members to accept technical regulations as equivalent. The standard, a subjective test, is certainly deferential to the opinion of the importing WTO Member. On the other hand, a WTO Member might have difficulties in arguing that it does not consider a technical regulation to be equivalent to its own, if, for example, that regulation is identical to a technical regulation of its own.<sup>51</sup>

The obligation in Article 2.7 of the TBT Agreement does not add much to the question of whether Article 2.1 allows for conditional most-favoured-nation treatment. The aspect of Article 2.7 that does bear on this question is the proviso to the obligation: that WTO Members are not under an obligation to give positive consideration to requests if they are not satisfied that the regulations meet their objectives. This proviso contains slightly circular language (the positive consideration should precede the determination of whether the regulations meet their objectives) but it clearly implies that WTO Members need not recognise as equivalent any technical regulations that they consider unsuitable. The relevance of this proviso to the question of conditional most-favoured-nation treatment is that, like the obligation, the proviso applies to the recognition of technical regulations from *all* WTO Members. It follows that,

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<sup>50</sup> Compare the second sentence of Article 15 of the Anti-dumping Agreement, which states that ‘[p]ossibilities of constructive remedies provided for by this Agreement shall be explored before applying anti-dumping duties where they would affect the essential interests of developing country Members’. In WTO Panel Report, *European Communities – Anti-dumping Duties on Imports of Cotton-Type Bed Linen from India (EC – Bed Linen)*, WT/DS141/R, adopted as modified by the Appellate Body Report on 12 March 2001, para. 6.238, the panel said that ‘Article 15, in our view, imposes no obligation to actually provide or accept any constructive remedy that may be identified and/or offered. It does, however, impose an obligation to actively consider, with an open mind, the possibility of such a remedy prior to imposition of an anti-dumping measure that would affect the essential interests of a developing country.’ The panel found that the EC had violated Article 15 by rejecting the possibility out of hand.

<sup>51</sup> In this case, there may also be a violation of the requirement in Article 2.2 to ensure that technical regulations are no more trade restrictive than necessary in order to achieve a legitimate objective.

by virtue of this proviso, an importing WTO Member is under no obligation to permit the sale on its territory of products from a WTO Member produced in accordance with technical regulations if that WTO Member does not consider that those regulations meet its objectives, even if it permits the sale of products from other WTO Members produced in accordance with technical regulations which, in its opinion, *do* meet its objectives. Article 2.7 thus permits differential treatment of products according to whether the importing WTO Member has recognised the equivalence of the technical regulations under which they are produced.

A similar assumption is implicit in Article 10.7 of the TBT Agreement, which mentions agreements to recognise technical regulations, standards and conformity assessment procedures (in practice, these are in the form of mutual recognition agreements). This provision states as follows:

Whenever a Member has reached an agreement with any other country or countries on issues related to technical regulations, standards or conformity assessment procedures which may have a significant effect on trade, at least one Member party to the agreement shall notify other Members through the Secretariat of the products to be covered by the agreement and include a brief description of the agreement. Members concerned are encouraged to enter, upon request, into consultations with other Members for the purposes of concluding similar agreements or of arranging for their participation in such agreements.

The provision has two elements. First, in keeping with the title of Article 10 ('Information About Technical Regulations, Standards and Conformity Assessment Procedures'), it imposes a notification requirement when an agreement has been reached.<sup>52</sup> In addition, it 'encourages' WTO Members to extend most-favoured-nation treatment to other WTO Members with respect to their existing mutual recognition agreements. This second aspect of Article 10.7 is rather strange, given that it is located in a provision on transparency. Nevertheless, it implies that the parties to mutual recognition agreements are not under an obligation to accord to such third parties unconditional most-favoured-nation treatment (on the other hand, nothing in Article 10.7 implies that the parties are not under an obligation at least to provide conditional most-favoured-nation treatment).

It is impossible to reconcile the proviso in Article 2.7 and the implication in Article 10.7 with a strict interpretation of Article 2.1. In order to avoid reducing these provisions to 'inutility' (to use the neologism favoured by the

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<sup>52</sup> Between 1995 and 2003, there had been 43 notifications of mutual recognition agreements under Article 10.7 of the TBT Agreement: see WTO Document, *Ninth Annual Review of the Implementation and Operation of the TBT Agreement – Note by the Secretariat*, G/TBT/14, 5 March 2004, Figure 5.

Appellate Body),<sup>53</sup> it is at a minimum necessary to interpret Article 2.1 as meaning that an importing WTO Member must accord no less favourable treatment to products from the territories of WTO Members that, in its opinion, and subject to certain procedural requirements, have equivalent technical regulations.

It might also be possible to see Article 2.7 and perhaps the final sentence of Article 10.7 as derogations from Article 2.1,<sup>54</sup> but this, it is submitted, would be going too far. First, it is debatable whether there is sufficient textual justification for treating this provision as a self-standing ‘right’, given the absence of the strong language of ‘notwithstanding’,<sup>55</sup> ‘exception’<sup>56</sup> or ‘shall not apply’<sup>57</sup> that is customarily found in such provisions. In addition, to see Article 2.7 as a self-standing ‘right’ would remove any requirement to grant even conditional most-favoured-nation treatment in the recognition of the equivalence of the technical regulations of other WTO Members. Regardless of whether this is a legitimate policy choice, it is not *necessary* to avoid the most-favoured-nation obligation in order to reconcile Article 2.7 with Article 2.1. For this reason, it is preferable to reconcile the conflicting provisions by means of an interpretation of Article 2.1 rather than a derogation from it.

### Other agreements

An interpretation of Article 2.1 as requiring conditional most-favoured-nation treatment is supported by the fact that two other WTO Agreements similarly

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<sup>53</sup> WTO Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, p. 21. For a discussion of the principle of ‘effective interpretation’ in WTO jurisprudence, see M. Lennard, ‘Navigating by the stars: Interpreting the WTO Agreements’ (2002) vol. 5:1 *Journal of International Economic Law* 17–89 at 58–61.

<sup>54</sup> The Appellate Body has distinguished two types of derogations: exceptions (where the defendant bears the burden of proof) and provisions which have the effect that an obligation ‘does not apply’ (where the complainant bears the burden of proof). The nature of these derogations was discussed in WTO Appellate Body Report, *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries (EC – Tariff Preferences)*, WT/DS246/AB/R, adopted 20 April 2004, para. 88. For further discussion and criticism of the Appellate Body jurisprudence, see L. Bartels, ‘The Appellate Body Report in *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries*’, in T. Cottier, J. Pauwelyn and E. Bürgi (eds), *Human Rights and International Trade* (Oxford: Oxford University Press, 2005).

<sup>55</sup> As in Article XXIV GATT, and the Enabling Clause and Article 3.3 of the Agreement on the Application of Sanitary and Phytosanitary Measures.

<sup>56</sup> As in Article XX GATT.

<sup>57</sup> As in Article 27.2(b) of the Agreement on Subsidies and Countervailing Measures.

require systems of conditional but non-discriminatory recognition of the quality standards of other WTO Members. Article VII of the General Agreement on Trade in Services (GATS) states that when a WTO Member recognises the standards or criteria for the authorisation, licensing or certification of services suppliers on the basis of an agreement or arrangement, it 'shall afford adequate opportunity for other interested Members to negotiate their accession to such an agreement or arrangement or to negotiate comparable ones with it'. Likewise, 'where a Member accords recognition autonomously, it shall afford adequate opportunity for any other Member to demonstrate that education, experience, licenses, or certifications obtained or requirements met in that other Member's territory should be recognized'. These provisions are procedural, rather than substantive, but it seems clear that, in certain circumstances, a failure to grant equivalence could still amount to a violation of these provisions.

Even more strongly, Article 4.1 of the Agreement on Sanitary and Phytosanitary Measures (SPS Agreement) states that 'Members shall accept the sanitary or phytosanitary measures of other Members as equivalent, even if these measures differ from their own or from those used by other Members trading in the same product, if the exporting Member objectively demonstrates to the importing Member that its measures achieve the importing Member's appropriate level of sanitary or phytosanitary protection.' Article 4.2 continues, by stating that 'Members shall, upon request, enter into consultations with the aim of achieving bilateral and multilateral agreements on recognition of the equivalence of specified sanitary or phytosanitary measures.' Here there is no doubt that the provision has substantive weight.

### **Procedural requirements**

Another question is whether a WTO Member needs to accord the relevant favourable treatment to products from WTO Members if no application for recognition has been made under Article 2.7. Here, there are two questions. First, does an application need to be made before the conditional most-favoured-nation obligation is violated? The answer to this question would appear to be in the affirmative, given the words 'positive consideration' and 'accepting'. The second question is whether such an application needs to be made by the exporting WTO Member or whether it could also be made by a private operator. This question is difficult to answer on the basis of the text of Article 2.7, but the intergovernmental nature of the WTO system indicates that it should not lightly be presumed that the WTO agreements include private rights of enforcement.<sup>58</sup> Article 2.7 should, therefore, be interpreted as a grant

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<sup>58</sup> See P. Koutrakos, 'The external dimension of the internal market and the individual', Chapter 10 in this volume.

of rights only to other WTO Members. The conclusion would be that where that right is not exercised, an importing WTO Member should not be under any obligation to grant the conditional most-favoured-nation treatment otherwise required under Article 2.1.

Both of these points are confirmed by other areas of WTO law involving conditional market access, where the obligations of an importing WTO Member to grant market access are triggered only when the exporting WTO Member demonstrates that it meets the relevant conditions. The recognition provisions in Article VII GATS and Article 4 SPS (quoted above) expressly place the onus on the exporting WTO Member to demonstrate equivalence. Article 6.3 of the TBT Agreement similarly states that ‘Members are encouraged, at the request of other Members, to be willing to enter into negotiations for the conclusion of agreements for the mutual recognition of results of each other’s conformity assessment procedures.’

These points are further confirmed by the Appellate Body’s interpretation of the conditions in the Chapeau of Article XX GATT, according to which WTO Members are entitled to apply differential treatment to the products of exporting WTO Members depending on the conditions prevailing in the territories of those Members.<sup>59</sup> In theory, this could require a WTO Member either to investigate all those conditions before applying differential treatment, or to allow private operators to demonstrate those conditions, or to allow affected WTO Members to demonstrate those conditions. In *US – Shrimp* (Article 21.5), the Appellate Body approved a measure of the third type: it was sufficient for the US merely to allow an exporting WTO Member to demonstrate that the conditions prevailing in its territory were sufficient to meet the requirements for market access to the US market.<sup>60</sup>

These considerations are not, of course, determinative of the question whether the obligation to accord conditional most-favoured-nation treatment under Article 2.1 of the TBT Agreement could only be violated once an exporting WTO Member has made an application for such treatment, but they do indicate that such a result is not inconsistent with any underlying WTO principles.

## Conclusions

It follows from this analysis that Article 2.1 of the TBT Agreement requires WTO Members to grant most-favoured-nation treatment to products of other WTO Members, subject to those affected WTO Members applying for

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<sup>59</sup> WTO Appellate Body Report, *US – Shrimp*, n. 4 above, para. 164.

<sup>60</sup> WTO Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted 21 November 2001, paras 148–49.



recognition of the equivalence of the technical regulations under which those products were manufactured, and those regulations actually being equivalent, according to the importing WTO Member. At the very least, then, the technical regulations of EU Member States must provide for the possibility that products from another WTO Member are granted the favourable treatment granted to products of EEA/Turkish origin (a) if that WTO Member has requested recognition of the equivalence of its technical regulations under Article 2.7 of the TBT Agreement and (b) the EU (or a Member State) is of the opinion that the technical regulation is indeed equivalent.

These are not onerous requirements, and yet even so the wording of the EC mutual recognition clause would appear to preclude the Member State from meeting them.<sup>61</sup> The difficulty is that the mutual recognition clause does not even provide for the possibility that products from other WTO Members might be entitled to the same treatment as like products of EEA/Turkish origin; indeed, it enshrines discrimination against these other WTO Members. In this respect, the clause recalls the ‘closed list’ of beneficiaries of special preferences for countries engaged in the combating of drug production and trafficking under the EC Generalized System of Preferences (GSP) scheme, which the Appellate Body held to be discriminatory in *EC – Tariff Preferences*.<sup>62</sup> Any legislation including the mutual recognition clause is likely, therefore, to violate Article 2.1 of the TBT Agreement, although a finding of a violation may depend upon a WTO Member making a request for recognition of equivalence of its technical regulations.

### Conformity Assessment Procedures

In addition to its express recognition of EEA/Turkish technical regulations, the EC mutual recognition clause also implies recognition of the results of conformity assessment procedures carried out in the EEA and Turkey to verify that products produced in those territories are made in accordance with applicable technical regulations.<sup>63</sup> As was demonstrated above, in not allowing for simi-

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<sup>61</sup> See also J.P. Trachtman, ‘Toward open recognition? Standardization and regional integration under Article XXIV of GATT’ (2003) vol. 6:2 *Journal of International Economic Law* 459–92 at 480, who states that ‘the language of these agreements [TBT and SPS Agreements] would not appear to condone artificial, RTA-based, limitations on the right to “qualify” for recognition’.

<sup>62</sup> Appellate Body Report, *EC – Tariff Preferences*, n. 54 above, para. 182.

<sup>63</sup> Cf. Case 196/85 *Commission v France* [1987] ECR 1597 (involving tax discrimination under Article 95 EC), in which, having accepted that an importing Member State may require the results of conformity assessment procedures before granting a particular treatment to imported goods, the ECJ went on to say that: ‘[i]f they

lar recognition of the conformity assessment procedures of other WTO Members, the EC mutual recognition clause is likely to be in violation of Article I:1 GATT. However, does it also violate TBT Agreement rules on the recognition of the results of conformity assessment procedures?

### **Most-favoured-nation obligation**

Article 5.1.1 of the TBT Agreement establishes non-discrimination obligations with respect to access to domestic conformity assessment procedures. This provision states as follows:

Members shall ensure that, in cases where a positive assurance of conformity with technical regulations or standards is required, their central government bodies apply the following provisions to products originating in the territories of other Members:

5.1.1 conformity assessment procedures are prepared, adopted and *applied* so as to grant access for suppliers of like products originating in the territories of other Members under conditions *no less favourable than those accorded to suppliers of like products of national origin or originating in any other country, in a comparable situation*; access entails suppliers' right to an assessment of conformity under the rules of the procedure, including, when foreseen by this procedure, the possibility to have conformity assessment activities undertaken at the site of facilities and to receive the mark of the system.<sup>64</sup>

Article 5.1.1 clearly imposes a non-discrimination obligation with respect to the granting of access to *domestic* conformity assessment procedures to the suppliers of other WTO Members.<sup>65</sup> However, Article 5.1.1 does not impose any most-favoured-nation obligation on the recognition of conformity assessment procedures carried out in the territories of *other* WTO Members.

There are two possible ways in which such an obligation might, nevertheless, be found in the TBT Agreement. The first depends upon the fact that an automatic recognition of the results of conformity assessment procedures undertaken abroad implies the *non-application* of domestic conformity assessment procedures to suppliers of those products. This raises the question of

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are to be compatible with the principle of proportionality, such provisions must leave the exporting Member State free to choose control methods and to designate the authority responsible for the controls, and they must not make recognition of equivalence dependent on the prior negotiation of an agreement between the national authorities concerned' (para. 16).

<sup>64</sup> Emphasis added.

<sup>65</sup> Article 5.1.1 would most likely be violated by WTO Members implementing mutual recognition agreements (MRAs) providing for conformity assessment procedures limited to products of a certain origin; see P. Beynon, 'Community mutual recognition agreements, technical barriers to trade and the WTO's most favoured nation principle' (2003) vol. 28:2 *European Law Review* 231–49 at 12–13, discussing the EC–Australia and EC–New Zealand MRAs, which contain such restrictive rules of origin.

whether Article 5.1.1 imposes a most-favoured-nation obligation on the non-application of such procedures to products of a particular origin. The limited wording of this provision would seem to lead to a negative answer.<sup>66</sup> Article 5.1.1 is not a broad obligation covering all facets of the recognition of conformity assessment procedures. It merely regulates *access* to conformity assessment procedures, such ‘access’ being defined as ‘suppliers’ right to an assessment of conformity under the rules of the procedure’. It is therefore unlikely that Article 5.1.1 could have the effect of indirectly imposing a most-favoured-nation obligation on the recognition of the results of conformity assessment procedures undertaken in the territory of another WTO Member.

The second possibility is that Article 2.1 mandates most-favoured-nation treatment for conformity assessment procedures. However, this seems unlikely.<sup>67</sup> Article 2.1 only applies to ‘technical regulations’ and these are defined in a manner that would seem to exclude conformity assessment procedures.<sup>68</sup> Moreover, the conceptual division drawn in the TBT Agreement between technical regulations and conformity assessment procedures should prevent any overlap in obligations. The result, perhaps surprising, is that a measure that would be prohibited by the GATT (assuming the correctness of the decision in *EEC – Beef from Canada*<sup>69</sup>) would not be prohibited under the TBT Agreement.

### **Recognition of conformity assessment procedures (Article 6)**

Recognition of the conformity assessment procedures carried out in the territories of other WTO Members is expressly regulated by Article 6. This provision states as follows:

With respect to their central government bodies:

6.1 Without prejudice to the provisions of paragraphs 3 and 4, Members shall ensure, whenever possible, that results of conformity assessment procedures in other Members are accepted, even when those procedures differ from their own, provided they are satisfied that those procedures offer an assurance of conformity with applicable technical regulations or standards equivalent to their own procedures.<sup>70</sup>

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<sup>66</sup> Cf. Mathis, *op. cit.*, n. 27 above, p. 16, on the basis that Article 5.1.1 relates to all matters covered by Article III GATT (i.e. all internal measures).

<sup>67</sup> Cf. Beynon, *op. cit.*, n. 65 above, p. 13.

<sup>68</sup> See n. 43 above.

<sup>69</sup> See n. 36 and accompanying text above.

<sup>70</sup> The reference to ‘applicable technical regulations or standards’ means that in cases where the technical regulations of another WTO Member have been recognised as equivalent (under Article 2.7), these are the applicable technical regulations, whereas otherwise it will be the technical regulations of the importing WTO Member.

Article 6.1 also sets out some of the means by which the question of equivalence (of the certifying bodies) can be demonstrated to the importing Member's satisfaction. It states that:

It is recognized that prior consultations may be necessary in order to arrive at a mutually satisfactory understanding regarding, in particular:

6.1.1 adequate and enduring technical competence of the relevant conformity assessment bodies in the exporting Member, so that confidence in the continued reliability of their conformity assessment results can exist; in this regard, verified compliance, for instance through accreditation, with relevant guides or recommendations issued by international standardizing bodies shall be taken into account as an indication of adequate technical competence;

6.1.2 limitation of the acceptance of conformity assessment results to those produced by designated bodies in the exporting Member.

Article 6.3 encourages Members to enter into mutual recognition agreements with respect to conformity assessment procedures. This provision states that:

Members are encouraged, at the request of other Members, to be willing to enter into negotiations for the conclusion of agreements for the mutual recognition of results of each other's conformity assessment procedures. Members may require that such agreements fulfil the criteria of paragraph 1 and give mutual satisfaction regarding their potential for facilitating trade in the products concerned.

Bearing in mind that Article 6.1 is qualified as being 'without prejudice to paragraphs 3 and 4', it is obviously important to ascertain the meaning of Article 6.3. One author has said that WTO Members entering into mutual recognition agreements under Article 6.3 are entitled to deviate from the whole of Article 6.1.<sup>71</sup> However, this seems to be true only insofar as this is necessary to give effect to Article 6.3. Article 6.1 already recognises the need for WTO Members to satisfy themselves as to the competence of a conformity assessment body. Article 6.3 states various additional points: first, that agreements may be an appropriate means of carrying out this task; secondly, that such agreements may be mutual; thirdly, that such agreements should be 'at the request' of exporting Members; and fourthly, that the conditions in Articles 6.1.1 and 6.1.2 are voluntary.<sup>72</sup> At no point does Article 6.3 imply that the

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<sup>71</sup> Mathis, *op. cit.*, n. 27 above, p. 17. Mathis also considers that Article 6.3 is a derogation from what he sees as a relevant most-favoured-nation obligation in Article 5.1.1.

<sup>72</sup> While the reference in Article 6.3 to 'the criteria of paragraph 1' is ambiguous, it cannot logically refer to the provisions of the first paragraph, as the obligation to accept equivalent conformity assessment procedures in that paragraph is redundant in the case of mutual recognition agreements. The 'criteria' must therefore refer to the conditions in the subparagraphs of Article 6.1.

existence of a mutual recognition agreement on conformity assessment procedures permits a WTO Member to avoid its obligations under Article 6.1 to accept the results of equivalent conformity assessment procedures of other WTO Members *not* party to a mutual recognition agreement.

### **Conclusions**

If there is no obligation in the TBT Agreement to accord most-favoured-nation treatment with respect to the recognition of the results of conformity assessment procedures carried out in the territories of other WTO Members, then technical regulations containing the EU mutual recognition clause would not violate the TBT Agreement merely by requiring the recognition of the results of EEA/Turkish conformity assessment procedures without similarly requiring the recognition of the results of other conformity assessment procedures. In this respect, the TBT Agreement seems to be less onerous than Article I:1 GATT.

However, technical regulations containing a mutual recognition clause may violate Article 6.1 to the extent that they preclude Member States from recognising the equivalence of these other conformity assessment procedures,<sup>73</sup> although (as with Article 2.1) such a violation could only be made out following a request by the exporting WTO Member to have its conformity assessment procedures recognised by an EU Member State.

## **DEFENCES**

Given the likelihood of violations of Article I:1 of GATT 1994 and Articles 2.1 and 6.1 of the TBT Agreement, it is thus necessary to ascertain whether there is any way of justifying the discriminatory EC mutual recognition clause under any applicable exceptions to these agreements. Here, there are at least three possibilities. The first involves the EC's character as a regional trade agreement and the applicability of the so-called 'Article XXIV defence'; the second is an argument that the EC has a 'political' status that renders it immune from certain WTO rules; and the third is an argument that the mutual recognition clause is necessary to protect human life and health.

### **Article XXIV of GATT**

As regional trade agreements, the EC, the EEA and the EC–Turkey customs union are regulated by Article XXIV GATT. This provision is generally considered to establish a conditional right to form customs unions and free

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<sup>73</sup> Cf. Article 2.7 with respect to recognition of equivalent technical regulations, discussed at n. 50 above.

trade areas, as an exception, primarily but not exclusively, to the most-favoured-nation obligation in Article I:1 GATT. The overall permission is set out in Article XXIV:5 GATT, and states as follows:

[T]he provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area . . . .

Traditionally, the EC took a very expansive view of Article XXIV. In 1957, the (then) EEC argued that a customs union should be exempted from all other GATT obligations ‘insofar as the application of these provisions would constitute obstacles to the formation of the customs union *and to the achievement of its objectives*’.<sup>74</sup> Such a broad interpretation of Article XXIV would have permitted all manner of measures in violation of WTO rules, so long as they could be justified as serving the *objectives* of the Community. However, this broad view was defeated in an earlier (though unadopted) GATT panel report,<sup>75</sup> and was finally put to rest in the 1999 WTO Appellate Body Report on *Turkey – Textiles*.<sup>76</sup>

In this case, the Appellate Body made two important findings. First, it made it clear that Article XXIV is only a limited exception from other GATT obligations and that regional trade agreements must comply with the conditions set out in this provision.<sup>77</sup> Secondly, the Appellate Body devised an ‘Article XXIV defence’ for measures taken under regional trade agreements. It said:

[O]n the basis of this analysis of the text and the context of the chapeau of paragraph 5 of Article XXIV, we are of the view that Article XXIV may justify a measure which is inconsistent with certain other GATT provisions. However, in a case involving the formation of a customs union, this ‘defence’ is available only when two conditions are fulfilled. First, the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of a customs union that

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<sup>74</sup> GATT Working Party Report, *The European Economic Community*, adopted 29 November 1957, L/778, BISD 6S/70, p. 77 (emphasis added).

<sup>75</sup> GATT Panel Report, *EEC – Member States’ Import Regimes for Bananas*, DS32/R, unadopted, 3 June 1993, para. 358.

<sup>76</sup> WTO Appellate Body Report, *Turkey – Restrictions on Imports of Textile and Clothing Products (Turkey – Textiles)*, WT/DS34/AB/R, adopted 19 November 1999. This case concerned new quantitative restrictions imposed by Turkey as a result of its new customs union with the European Community.

<sup>77</sup> These conditions are that the formation of a regional trade agreement should not lead to increased trade barriers to third countries (Article XXIV:5(a)), and that, internally, duties and other restrictive regulations of commerce must be eliminated on ‘substantially all the trade’ between the members of the regional trade agreement (XXIV:8(a)(i) and (b)).

fully meets the requirements of sub-paragraphs 8(a) and 5(a) of Article XXIV. And, second, that party must demonstrate that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue. Again, both these conditions must be met to have the benefit of the defence under Article XXIV.<sup>78</sup>

In summary, the Article XXIV defence has three elements: timing of the measure, legality of the regional trade agreement (these two are conflated in the passage quoted), and necessity of the measure to the formation of a regional trade agreement. How do these three elements apply to technical regulations containing the EU mutual recognition clause?

### Timing

The quoted passage from *Turkey – Textiles* renders it doubtful whether Article XXIV can ever be used to excuse a WTO violation resulting from a measure that is adopted *after* the formation of a regional trade agreement. Nonetheless, the panel in *US – Line Pipe* introduced a slightly broader reading of this element of the Article XXIV defence, stating that a subsequently adopted measure might still benefit from the Article XXIV defence as long as the mechanism for the measure was established on the formation of the free trade area.<sup>79</sup> It is difficult to know how to apply this dictum to measures adopted by the European Community, which has institutional mechanisms capable of implementing a variety of subsequent measures in pursuit of the objectives set out in the EC Treaty.

### Legality of the regional trade agreement

Strictly speaking, the next question should be whether the EC, the EEA and the EC–Turkey customs union meet the requirements of permitted regional trade agreements in paragraphs 8(a) and 5(a) of Article XXIV. However, this may not be necessary. In *Turkey – Textiles*, it was assumed by the panel (in a finding not reviewed by the Appellate Body) that the customs union at issue in that case was compatible with these provisions, and the argument proceeded with the third element of the Article XXIV defence.<sup>80</sup> Here it may also be assumed that these regional trade agreements meet the necessary conditions.

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<sup>78</sup> WTO Appellate Body Report, *Turkey – Textiles*, n. 76 above, para. 58.

<sup>79</sup> WTO Panel Report, *United States – Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea (US – Line Pipe)*, WT/DS202/R, adopted as modified by the Appellate Body Report on 8 March 2002, para. 199.

<sup>80</sup> See WTO Appellate Body Report, *Turkey – Textiles*, n. 76 above, para. 59.

### **Necessity of the measure to the adoption of the regional trade agreement**

What, then, of the third element of the Article XXIV defence, whether the measure is ‘necessary’ to the adoption of a regional trade agreement? It is not entirely certain how this test is to be applied. In particular, it is uncertain whether ‘necessity’ is to be determined according to economic or political criteria.<sup>81</sup> Indeed, the Appellate Body has been criticised for ‘inventing’ this test without any textual basis.<sup>82</sup> However, assuming that the test applies, on any reading it is extremely unlikely that it could be said to be necessary to the formation of a regional trade agreement to adopt a policy of discriminatory automatic exemption from the application of national technical regulations.<sup>83</sup> Indeed, even a *non-discriminatory* mutual recognition clause is unlikely to be necessary to the formation of a regional trade agreement.

In summary, then, on the current state of the law, it is not likely that the Article XXIV defence can operate to protect the discriminatory EC mutual recognition clause. Aside from the fact that these clauses have been or would be adopted after the formation of the relevant regional trade agreements, it is simply not *necessary* to the formation of these regional trade agreements.

### **Article XX of GATT**

It might be possible to argue that the mutual recognition clause is justified as necessary to protect human life or health or to ensure consumer protection under Articles XX(b) and (d) of GATT respectively. However, any such argument is unlikely to be successful. Following *Korea – Beef*, the ‘necessity’ test involves a balancing of three factors: the effectiveness of the measure in protecting the value, the trade restrictiveness of the measure and the importance

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<sup>81</sup> See L. Bartels, ‘WTO dispute settlement practice on Article XXIV of the GATT’, in F. Ortino and E.U. Petersmann (eds), *The WTO Dispute Settlement System 1995–2003* (The Hague: Kluwer Law, 2004), pp. 263–73, pp. 269–71.

<sup>82</sup> J. Pauwelyn, ‘The puzzle of WTO safeguards and regional trade agreements’ (2004) vol. 7:1 *Journal of International Economic Law* 109–42 at 132–5.

<sup>83</sup> See also J. Mathis, *Regional Trade Agreements in the GATT/WTO: Article XXIV and the Internal Trade Requirement* (The Hague: TMC Asser, 2002), pp. 252–3, and B. Onguglo and T. Ito, *How to Make EPAs WTO Compatible? Reforming the Rules on Regional Trade Agreements*, Discussion Paper No. 40 (Maastricht: European Centre for Development Policy Management, 2003), paras 138–40. Note, however, the view of K. Nicolaidis, ‘Non-discriminatory mutual recognition: An oxymoron in the new WTO lexicon?’, in Cottier et al. (eds), *op. cit.*, n. 31 above, pp. 267–301, p. 293, that ‘MRAs would not be subject to non discrimination requirements if they are part of a regional trading arrangement’.



of the value to be protected.<sup>84</sup> Even on a generous interpretation of these factors, it would be difficult to justify the *de jure* exclusion of some WTO Members from the automatic EC recognition policy as ‘necessary’ to achieve these objectives in most foreseeable cases. Moreover, even if such a clause were ‘necessary’ to achieve these objectives, it would have to meet the conditions in the Chapeau, which require that measures be applied in a manner that does not constitute arbitrary or unjustifiable discrimination between countries where the same conditions prevail. It is difficult to see how the automatic and necessary discrimination against non-EEA/Turkish products can possibly be considered justifiable or not arbitrary. It is, therefore, highly unlikely that Article XX would protect the discrimination inherent in the EC mutual recognition clause.

### Relationship between the TBT Agreement and GATT 1994

Even if Article XX or Article XXIV could justify the EC mutual recognition clause, at most they could excuse a violation of Article I:1 GATT. It is highly unlikely that these provisions would be able to justify violations of the TBT Agreement. This follows from the General Interpretive Note to Annex IA of the WTO Agreement, which states that the TBT Agreement prevails over GATT 1994 to the extent of any conflict.<sup>85</sup> *Prima facie*, in a situation in which a measure is prohibited under the TBT Agreement but permitted under GATT 1994, the prohibition under the TBT Agreement will prevail.<sup>86</sup> There is an exception, however, where another agreement incorporates by reference a right in GATT 1994. Thus, the Article XXIV defence has been applied to

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<sup>84</sup> WTO Appellate Body Report, *Korea – Beef*, n. 47 above, para. 166. See J. Neumann and E. Türk, ‘Necessity revisited: Proportionality in World Trade Organization law after *Korea – Beef*, *EC – Asbestos* and *EC – Sardines*’ (2003) vol. 37:1 *Journal of World Trade*, 199–233 at 211.

<sup>85</sup> This Note states that ‘[i]n the event of a conflict between the provisions of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex IA to the Agreement Establishing the World Trade Organization [including the TBT agreement] . . . the provision of the other agreement shall prevail to the extent of the conflict’.

<sup>86</sup> See Pauwelyn, *op. cit.*, n. 82 above, pp. 129–30. Trachtman, *op. cit.*, n. 61 above, p. 472, takes the view that the General Interpretive Note does not apply to this situation, on the grounds that there can be no ‘conflict’ between a right (as in Article XXIV) and a prohibition (as in the TBT Agreement). For the reasons given in J. Pauwelyn, *Conflict of Norms in Public International Law: How WTO Law Relates to Other Rules of International Law* (Cambridge: Cambridge University Press, 2003), pp. 170–71, this is not persuasive. See also Appellate Body Report, *EC – Tariff Preferences*, n. 54 above, at paras 101–02, where the Appellate Body held that exceptions (containing rights) prevail over prohibitions to the extent of any conflict.

violations of obligations in other WTO agreements where there has been an express<sup>87</sup> or implied<sup>88</sup> reference to rights under the GATT. However, there are no such references in the TBT Agreement, and so it is difficult to escape the conclusion that a measure prohibited under the TBT Agreement cannot be saved under Article XXIV GATT.<sup>89</sup> At most, Article XXIV has the potential, in this set of circumstances, to justify a violation of Article I:1 GATT.

The corollary of the priority granted to the TBT Agreement is that where a measure involving technical regulations, technical standards or conformity assessment procedures is permitted under the TBT Agreement but prohibited under the GATT 1994, the implied 'right' to take the measure under the TBT Agreement prevails. This is a difficult argument, because the right is, at most, implied, based on the fact that the TBT Agreement purports to 'cover the field' with respect to the regulation of technical regulations, standards and conformity assessment procedures. Nonetheless, if this is correct, then it might be concluded that, even if it violates Article I:1 GATT, the discriminatory EC mutual recognition clause may be justified if the affected WTO Member has not made an application for recognition of the equivalence of its technical regulations (under Article 2.7) or its conformity assessment procedures (under Article 6.1), which – according to the above analysis – are requirements for any violation to be found under the TBT Agreement.

### **Special Status of the European Community**

It might also be possible to argue that ordinary WTO rules should not apply to the EC in the same way as to other regional trade agreements because of its more developed political character. This argument has usually been made in the context of the question whether the EC is subject to the conditions imposed on regional trade agreements under Article XXIV.<sup>90</sup> Arguing in favour of such an exception in 1963, Helmut Steinberger reasoned that:

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<sup>87</sup> WTO Appellate Body Report, *Turkey – Textiles*, n. 76 above, para. 45, n. 13 (applying the Article XXIV defence to the Agreement on Textiles and Clothing, based on a statement in that agreement that '[n]o new restrictions . . . shall be introduced except under the provisions of this Agreement or relevant GATT 1994 provisions'); referred to in the context of the Safeguards Agreement in WTO Panel Report, *United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/R, adopted as modified by the Appellate Body Report on 21 January 2001, para. 8.180.

<sup>88</sup> WTO Panel Report, *US – Line Pipe*, n. 79 above, para. 7.150; see Pauwelyn, *op. cit.*, n. 82 above, p. 128.

<sup>89</sup> Trachtman, *op. cit.*, n. 61 above, p. 473, comes to the opposite conclusion, on the basis of an 'effective' interpretation.

<sup>90</sup> See n. 78 above.

It seems doubtful whether, on concluding the GATT, the parties intended to subject comprehensive political integrations to the restrictions of Article XXIV . . . One can therefore interpret Article XXIV restrictively to the extent that the integration of two customs unions resulting in a comprehensive State or State-like unity, in which the substitution of more than one customs union by one alone results only incidentally, but is not the essence of an essential State-political unity encompassing an area of sovereignty, does not fall within the meaning of the term customs union or free trade area as this is used by GATT, and is therefore also not subject to the other criteria of Article XXIV.<sup>91</sup>

Franz Jaeger argued similarly, some years later, that:

the Contracting Parties of the General Agreement were evidently not thinking of unities of the legal and political forms of a State. Such forms of integration can therefore also no longer be considered as the norms addressed by the relevant GATT conditions: *for them Article XXIV is not applicable.*<sup>92</sup>

On the other hand, GATT and WTO practice would seem to undermine these propositions. Not only was the EEC Treaty itself subject to examination under Article XXIV,<sup>93</sup> but every enlargement of the EU has been promptly attended by notification and review within the competent organ of the GATT and now WTO, in accordance with the requirements of that provision.<sup>94</sup> Perhaps for this reason, the present author has been unable to find any modern support for

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<sup>91</sup> H. Steinberger, *GATT und regionale Wirtschaftszusammenschlüsse: Eine Untersuchung der Rechtsgrundsätze des Allgemeinen Zoll- und Handelsabkommens vom 30 Oktober 1947 (GATT) über die Bildung regionaler Wirtschaftszusammenschlüsse* (Köln, Berlin: Carl Heymanns, 1963), p. 124 (translation by author).

<sup>92</sup> F. Jaeger, *GATT, EWG und EFTA: Die Vereinbarkeit von EWG- und EFTA-Recht mit dem GATT-Statut* (Bern: Stämpfli & Cie, 1970), p. 244 (translation by author; emphasis in original).

<sup>93</sup> See n. 74 above. Interestingly, Steinberger, op. cit., n. 91 above, p. 126, approved this procedure. For an argument in 1962 that the EEC did not constitute a political union amounting to a *rebus sic stantibus* voiding existing most-favoured-nation treaty obligations, see P. Hay, 'The European common market and the most-favoured-nation clause' (1962) vol. 23:3 *University of Pittsburgh Law Review*, 661–84 at 680–82.

<sup>94</sup> Examinations were undertaken within the GATT system by *ad hoc* Working Parties and are now undertaken by the WTO Committee on Regional Trade Agreements. See EC accession of Denmark, Ireland and the UK, GATT Doc L/3677, C/M/10, report adopted 11 July 1975; EC accession of Greece, GATT Doc L/4845, BISD 30S/168, report adopted 9 March 1983; EC accession of Portugal and Spain, GATT Doc L/5936, BISD 35S/293, report adopted 10 October 1988. Examinations are now taking place on EU accession of Austria, Finland and Sweden, WT/REG3 and EU enlargement (10 new Member States), WT/REG170. The full list of notified regional trade agreements may be found at [www.wto.org/english/tratop\\_e/region\\_e/eif\\_e.xls](http://www.wto.org/english/tratop_e/region_e/eif_e.xls).

the proposition that, as far as Article XXIV is concerned, the EC should benefit from a 'political exception' in the WTO.

Even if the possibility of such an exception was plausible, it would have to be established precisely how to determine when an entity has a sufficient 'political' status for it to benefit from such an implied exception. It would seem that a basic requirement would be that the entity have international legal personality. However, the existence of international legal personality may not be sufficient for an escape from the requirements of Article XXIV.<sup>95</sup> After all, the EEC had international legal personality under its original founding Treaty. Nor should it necessarily matter that the political unit has acceded to the WTO agreement.<sup>96</sup> All that is required for accession to the WTO is that the entity be 'a separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement'.<sup>97</sup> These requirements do not exceed those for international legal personality which, as just demonstrated, do not themselves exempt a customs territory from compliance with Article XXIV.

One must conclude that the requirements of Article XXIV continue to apply to a more integrated 'political' regional trade agreement, regardless of whether the political entity is itself a WTO Member. Still, this does not dispute the issue. A softer argument might be made that, as a question of interpretation,

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<sup>95</sup> The fact that an organ has international legal personality does not exempt a state from its responsibility under international law for acts carried out by that organ. The panel in WTO Panel Report, *Turkey – Textiles*, WT/DS34/R, adopted as modified by the Appellate Body report on 19 November 1999, at para. 9.42, cited the Separate Opinion of Judge Shahabuddeen in *Certain Phosphate Lands in Nauru (Nauru/Australia)*, [1992] ICJ Rep 240 (26 Jun), p. 284, for the proposition that a State continues to be responsible under international law when it acts with other States through a common organ, even when that organ is a separate State (in that case Australia). See also *Matthews v UK* [1999] ECHR 12, para. 32, in which the European Court of Human Rights held that 'Member States' responsibility [under the European Convention on Human Rights] . . . continues even after . . . a transfer of competences [to an international organisation i.e. the EC].'

<sup>96</sup> G. Marceau and C. Reiman, 'When and how is a regional trade agreement compatible with the WTO?' (2001) vol. 28:3 *Legal Issues of Economic Integration* 297–336 at 330, take the view that accession is relevant; see also F. Roessler, 'The relationship between regional trade agreements and the multilateral trade order: A reassessment', in F. Roessler (ed.), *The Legal Structure, Functions and Limits of the World Trade Order* (London: Cameron May, 2000), p. 181 n. 1, who states that on accession to the GATT, '[the EC's] existence would no longer require justification under Article XXIV'.

<sup>97</sup> Article XII of the WTO Agreement; Article XXXIII of GATT 1947 was in the same terms. Note the EC's claim that it is not a 'separate customs territory Member of the WTO': *EC – Geographical Indications (US Complaint)*, n. 2 above, para. 7.156. The panel agreed, on the perhaps questionable basis that 'separate' implies a geographical rather than legal distinction: *ibid.*, paras 7.162–67.

the reference to the ‘country’ of origin of the goods being granted favourable treatment in Article I GATT and Article 2.1 of the TBT Agreement should be taken as not including the territory of a member of a customs union that is also a WTO Member. There is some textual support for such a proposition. The Explanatory Notes to the WTO Agreement specify that:

The terms ‘country’ or ‘countries’ as used in this Agreement and the Multilateral Trade Agreements [including the GATT 1994 and the TBT Agreement] are to be understood to include any separate customs territory Member of the WTO.

*A contrario*, it might be argued that the term ‘country’ is to be understood as *not* including any WTO Member that is no longer a separate customs territory, such as, for example, an EC Member State. If so, a member of a customs territory that is itself a Member of the WTO would not need to extend to other WTO Members the preferential treatment that it accords to goods from another member of the customs territory. However, whether this applies to the EC is doubtful. In the first place, in *EC – Geographical Indications (US Complaint)* the EC itself took the position that it is not a separate customs territory Member of the WTO.<sup>98</sup> Secondly, the purpose of the Explanatory Note is clearly to extend WTO rights and obligations to customs territory WTO Members, not to diminish those rights and obligations for WTO Members that happen to be members of that customs territory.

In *EC – Geographical Indications* the panel accepted, for other reasons, that EC nationals were not included in the phrase ‘nationals of another country’ in the most-favoured-nation obligation in Article 4 of TRIPS. First, the panel noted the existence of an EC nationality.<sup>99</sup> To that extent, it seems, the ‘nationality’ of the EC Member States is subsumed in a broader notion of EC ‘nationality’, and the phrase ‘nationals of another country’ can be interpreted to exclude EC nationals *as* nationals of the EC Member States. This seems plausible, but it has no analogue with the ‘nationality’ of products produced in a regional trade agreement. This is demonstrated, among other things, by the longstanding debate on whether members of regional trade agreements may exempt products from their fellow members from the application of safeguard measures.<sup>100</sup> Moreover, the policy of mutual recognition itself draws a distinction between ‘domestic’ products of an EC Member State and the ‘non-domestic’ products of other EC Member States (as well as EEA States and Turkey). This is quite unlike the non-discriminatory notion of EC nationality.

Secondly, the panel noted that that the ‘advantages’ were granted under EC

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<sup>98</sup> Ibid.

<sup>99</sup> Ibid., para. 7.725, referring to its findings at para. 7.150.

<sup>100</sup> This debate resulted in a statement in a footnote to the Agreement on Safeguards expressly leaving this question open. See generally, Pauwelyn, n. 82 above.

law, albeit implemented by the Member States. It also agreed with the EC that the Member States were, for this reason, not responsible for EC acts.<sup>101</sup> However, as noted above, the mere fact that an international organisation possesses legal personality (and can adopt its own measures) does not relieve its Member States of responsibility under international law.<sup>102</sup> Nor are the Member States likely to be so relieved under the WTO. It is more than likely that responsibility continues to be joint, or even joint-and-several.<sup>103</sup> This argument is, therefore, of doubtful validity or relevance even to the question at issue in *EC – Geographical Indications*.

### EEA and EC–Turkey Customs Union

In any case, even if the EC and its Member States are for any of these reasons granted special treatment in the WTO, or are subject to a different interpretation of the phrase ‘any other country’ in WTO most-favoured-nation obligations, this does not extend to the EEA countries or Turkey, which also benefit from the EC’s mutual recognition clause. Neither of these agreements has the political status to allow for the application of a ‘political exception’ and neither of these agreements involves a transfer of responsibility from the Member States to another organisation that is, itself, a WTO Member.<sup>104</sup>

## CONCLUSION

The conclusions of this analysis may be stated as follows. First, insofar as the technical regulations of an EU Member State contain the mutual recognition clause, and thereby grant an automatic exemption from the application of national technical regulations to EEA/Turkish products but not to products

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<sup>101</sup> Ibid.

<sup>102</sup> See n. 95 above; also Gaja, n. 2 above, para. 13, and, generally, Report of the International Law Commission on the work of its fifty-fifth session (2003), Topical summary of the discussion held in the Sixth Committee of the General Assembly during its fifty-eighth session, prepared by the Secretariat, A/CN.4/537, 31 January 2004, para. 20.

<sup>103</sup> See, e.g., the view of Tesauro AG in Case C-53/96 *Hermès* [1998] ECR I-3603, para. 14, that ‘the Member States and the Community constitute, vis-à-vis contracting non-member States, a single contracting party or at least contracting parties bearing equal responsibility in the event of failure to implement the agreement’.

<sup>104</sup> In WTO Panel Report, *Turkey – Textiles*, n. 95 above, the customs agreement between the Community and Turkey was found to lack international legal personality sufficient to enable Turkey to escape its international obligations under GATT (para. 9.40).

from other countries, as well as recognising the results of conformity assessment procedures undertaken in EEA/Turkish territories but not in the territories of other WTO Members, these regulations *ipso facto* violate Article I:1 GATT 1994. For the same reasons, technical regulations containing the mutual recognition clause may violate Articles 2.1 and 6.1 of the TBT Agreement respectively, but only if the affected WTO Member has requested the EU Member State to recognise its technical regulations or conformity assessment procedures as equivalent, and the EU Member State has either refused to give positive consideration to such a request or (most likely) has unjustifiably rejected such a request. Furthermore, if no such request has been made, then by virtue of the conflicts rule granting the TBT Agreement priority over GATT 1994 in cases of conflict, it is possible that the violations of Article I:1 may be excused.

Otherwise, there are no applicable defences. It does not matter that the mutual recognition clause exists in the context of regional trade agreements (the EC, the EEA, and the EC–Turkey customs union). The Article XXIV defence does not apply, as automatic recognition is not *necessary* to the formation of a regional trade agreement. Even if it did, the Article XXIV defence could, at most, excuse a violation of Article I:1 GATT, given that prohibitions under the TBT Agreement prevail over any rights in the GATT. Nor can Article XX of GATT excuse any violations, as the discriminatory measure is highly unlikely to be necessary for the protection of human life or health or for consumer protection. Nor, for the same reasons, is it likely to meet the requirements of the Chapeau to Article XX. Whether it might be argued that the special status of the EC brings it outside the scope of at least some WTO obligations is possible, though doubtful, but in any case this would at most excuse a discriminatory mutual recognition clause applying to goods from within the EU; as it stands, the clause applies to goods from outside the EU. Consequently, the EC’s mutual recognition clause, as it currently exists, violates WTO obligations.

The analysis undertaken here has, however, given some indication of what is needed for a mutual recognition clause (and policy) consistent with WTO obligations. At present, violations under the TBT Agreement may depend upon prior requests for equivalence by affected WTO Members. However, it is only a matter of time before such requests are made, and at that point any legislation containing a mutual recognition clause will be in violation of the TBT Agreement. In anticipation of such an event, the EU Member States should amend their technical legislation to ensure that other WTO Members can demonstrate that their technical regulations are equivalent to their own. In other words, rather than adopting the EC mutual recognition clause as it currently exists, the EU Member States should move to a policy of conditional but non-discriminatory recognition of the technical regulations of all WTO Members.

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