Fostering growth in Europe: Reinforcing the internal market

JOSÉ MARÍA BENEYTO AND JERÓNIMO MAÍLLO (Directors)
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Growth, Employment and the Single European Market

JOSÉ MARÍA BENEYTO AND JERONIMO MAÍLLO [1]

More than 20 years have passed since the symbolic date of completion of the Single European Market in 1993. The creation of this Single Market, with its 175 million employments, 21 million undertakings and 500 million consumers, is one of the most emblematic projects of the European integration process, an uncontestable success in spite of its lacunae and imperfections.

The project of this economic area without internal borders with free movement of goods, persons and capital, was linked, since its inception, to the generation of new opportunities for growth, employment and thus economic and social progress. Moreover, it was aiming as well at promoting de facto solidarity among the Member States.

Its development has historically contributed to a significant increase in GDP and the creation of new jobs through the introduction of new dynamics such as, among others, an increase in cross-border trade and a restructuring of the European industry which pushed towards specialization and innovation and therefore towards more competitive performance and more advantages for consumers (lower prices, higher quality, larger variety and better access). This growth increase was combined with parallel improvements in economic and social cohesion.

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[1] Director of the Institute for European Studies and Coordinator of its Centre for Competition Policy and Market Regulation, respectively.

Within the creation of a united Europe, the project of the Common Market has shown a great capacity to generate consensus and mobilize support. It is one of the best examples –perhaps the best thus far– of the advantages of unity versus fragmentation. It is therefore not surprising to conceive it as one of our most valuable assets. It is at the core of the European integration process: a part of its DNA and therefore shared by all its Member States and their populations.

However, its potential has not yet been fully exploited. More than 20 years after the magic date of 1993, when the basics were said to be attained, there are still many obstacles to withdraw and some sectors to complete. The Single Market is still an unfinished project. There is still much to do and new opportunities to grow and create progress. This is good news particularly in a period of crisis, provided we manage to see it as a window of opportunities and we are able to exploit that potential and transform it into growth and employment.

The international conference held at CEU San Pablo University in Madrid at the end of last year and the present publication aim at, on the one hand, reminding the value of the Single European Market and the importance of preserving its achievements; and on the other hand, identifying its lacunae, discussing some of them and advancing proposals to fill the gaps and to improve its functioning. As the title of the book shows, it claims for a reinforcement of the Single European market and believes in its potential to generate additional growth and jobs.

But, which type of growth? Naturally, more than merely growth in GDP. It must serve to generate sustainable and smart growth, with due consideration to environmental, consumer, social and other public interest concerns. Where does the right balance between growth and these other public concerns lie on? The answers to these questions are something open to discussion and which very likely, at least in some cases, will require a certain margin of flexibility to address diversity.

Subsisting obstacles to the Single Market should be detected, reexamined and either eliminated, or at least reduced, unless they were indispensable to protect other public interests.

Areas such as cross-border trade in services, including network industries and financial services, regulated professions, public procurement, company and insolvency law, the energy, transport

and digital markets, among others, allow for further liberalization, less fragmentation and better regulation and governance at EU level. Furthermore there is still room for improving enforcement and conflicts resolution mechanisms.

A strong competition policy is essential for maintaining a level playing field in the Single European Market and controlling excessive distortions of competition of both private and public origin. It can highly contribute to promote innovation, research and development and support growth. However, when implementing and enforcing competition provisions, we should pay attention to avoid misuse of its tools and wrong deviation from the aims of competition policy. A more intense industrial policy, at both EU and national level, should be promoted without necessarily creating a conflict with competition policy or fragmenting the Common Market.

Lastly, we need more coherence between the internal and external dimensions of the Single European Market. We should never forget that, in the future, more than 90% of world growth will be originated outside of our borders. Taking these data into account, one of the big challenges –not to say the biggest challenge– of the Single European Market will be to attain a better coordination and further coherence between its internal and external dimensions. By using the strength and experience of our internal dimension, we can reinforce our external influence and improve the competitiveness of our industry beyond Europe. It is possible -and we should fight for it- to reconcile a further opening of the European Market while simultaneously requiring reciprocity in global markets: with leadership and initiative, but without ingenuity.

According to this conception, the book is divided in seven parts which could be regrouped under four main blocks. The first one puts the Single European Market into context and collects the key speeches of Michel Barnier, the EU Commissioner for the Single European market, and Ramón de Miguel, Former Secretary of State for European Affairs in Spain, at CEU San Pablo University. The second block (Parts II, III and IV of the book) deals with some of the main lacunae and challenges of the Single European Market, especially trade in services (including an analysis of network industries), public procurement, company law and social challenges. The third block comprises Parts V and VI. It examines

EU Competition policy as a tool to foster growth and deals with the interactions between competition policy, industrial policy and sectoral regulation. The last block (Part VII) revises market supervision, market governance and conflicts resolution mechanisms, such as SOLVIT, EU Pilot, IMI and decentralized networks. It also tackles the coherence of the internal and external dimension of the Single European market.

One of the strengths of the book is the excellent and variable profile of its contributors, with different backgrounds (Law, Economics, Political Science….), different professional perspectives (they come from EU Institutions, Member States' Administrations, private legal practice, companies, diplomacy and the academic world) as well as different geographical origins and sensitivities (North, South, West and East of Europe, both Center and periphery). This variety enriched the debate at the international conference held in Madrid, added new perspectives and comments to the draft papers and has definitely contributed to improve the quality of this final publication.

In conclusion, the Single European Market is, as explained above, one of our most valuable assets but it is also part of the key challenges for our future. It is still on the agenda and plays a crucial role to exit the crisis, to create growth, jobs and to foster our competitiveness. Clear evidence is given by the Opening Statement of the next President of the European Commission in its very recent speech before the European Parliament. He identifies 10 key challenges for our economies and societies. Six out of those ten key challenges have something to do, directly or indirectly, with the Single European Market and the topics dealt with in this book. The first one because Juncker places growth and job creation at the core of the its strategy and he considers essential a right regulatory environment and the promotion of a climate of entrepreneurship and job creation. The second key challenge is a connected Digital Single Market. The third one is an Energy Union, including therefore less fragmented energy markets and more unified external dimension. The fourth one is a deeper and fairer Internal Market with a Strengthened Industrial Base (including reflections on industrial policy, financial services, capital markets, and free movement of workers). Furthermore, two other key challenges tackled the external dimension of the Single Market (in particular, a reasonable and balanced Free Trade Agreement with the USA and the promotion of

Europe as a stronger global actor). No doubt that the Single European Market will continue to be at the core of the past, present and future of the European integration process.

Finally, we would like to thank the European Commission, in particular the Jean Monnet action, for funding the international conference and this publication. We are very grateful for their support as well as for the excellent answers and contributions to our call for papers and this book. Last but not least, we cannot but mention the great work of the two coordinators, Justo Corti and Pilar Milla.

Part I

Putting the SEM into context

1

Reinforcing the unity and competitiveness of the Single Market[1]

MICHEL BARNIER*

Minister,
Ladies and Gentlemen,
Dear Friends,

Allow me first of all to thank the Instituto Universitario de Estudios Europeos of the University of San Pablo, and its President, Marcelino Oreja Aguirre, for this kind invitation.

It has been five years now since the collapse of Lehman Brothers. And more than three years since the first worries about sovereign debts within the Eurozone.

And yet we are still in Europe bearing the effects of this series of financial, budgetary, economic and social crises. Even if we now see the first signs of recovery, not least here in Spain thanks to the courageous action you saw fit to take, European GDP is expected to stagnate in 2013, 23.5% of young Europeans are in unemployment, and the average public debt is 92% of GDP.

In a country such as Spain, how can we expect engaged youth to have faith in the future when 56% of them are unemployed?

How can we ask businessmen and women and SMEs to take risks and to innovate when they encounter such difficulties in gaining access to the finance they need to develop their ideas?

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[1] Speech launching the International Conference "Fostering Growth: Reinforcing the internal market" held on the 20th September 2013 at the University Institute for European Studies, University CEU San Pablo, Madrid within the context of the 'Single Market Month' events organised by the EU Commission.

* Member of the European Commission responsible for Internal Market and Services.

In these difficult times which you know too well, there are, nonetheless, two reasons for hope. On the one hand, several indicators now show that the often difficult reforms carried out in Spain are bearing fruit: Investor confidence is returning, as shown in the decline in the Spanish 'spread', which has reached its lowest level in two years, at parity with Italian interest rates. Exports are doing well, to the point that they represent hence forward a third of Spanish GDP, the highest level since the introduction of the euro. On the other, this third quarter of 2013 is the first to see positive growth since 2011.

Then, having imperilled achievements we thought irreversible such as the euro, the crisis has led in Europe to unprecedented advances, although this is too often unappreciated.

Three examples:

(i) First example : Financial regulation. If all the measures we have now taken to introduce greater supervision, responsibility and transparency in the system had been in place five years ago, we would doubtless have avoided many of the consequences of the financial crisis.

As for the Banking Union we are in the process of creating, it doubtless represents our largest common project since the creation of the euro. It will allow us finally to manage together the principal source of financing, and at the same time the principal source of risk, in our countries, for it is the banks which finance 75% of the European economy.

(ii) Second example: the strengthening of economic and budgetary coordination within the Eurozone. For 20 years we have had a monetary union in economic disunity. The crisis has shown us that this is not sustainable. With the new tools such as the reformed Stability and Growth Pact and the European Semester of economic policy coordination, we shall remedy these shortcomings.

(iii) Third example : having imperilled the integrity of the single market, the crisis has led us to consolidate, deepen and modernise that which remains Europe's principal asset.

This is the purpose of the Single Market Act, which consists of a number of quite concrete proposals for making life easier for Europeans

and businesses. For instance, the Single European Patent will permit undertakings to protect their innovation throughout Europe at a cost a seventh of that which obtains today. This ought to serve as an additional spur to innovation, particularly for the 22 million European SMEs.

Another example: the new European Venture Capital Funds will allow for improved access for financing innnovative start-ups, which are all too frequently casualties of the timidity of the banks.

Finally, the agreement reached last June on the reform of public procurement marks a real effort of simplification with tangible improvements, especially for SMEs, such as a sharp reduction in documentation to be filed – only the undertaking which wins the tender required to provide supporting documents.

Ladies and Gentlemen.

Beyond its positive impact on the competitiveness of undertakings and the European economy in general, how can this great reform of the single market improve the daily lives of Europeans, especially the youngest amongst them?

Allow me to draw three examples:

(i) First, professional mobility.

In the EU, we have an average unemployment rate nudging 11% yet at the same time a million vacancies for posts in engineering and the technical professions. We must build upon the single market to change this.

In order better to match the supply and demand of labour, we have proposed an improved recognition of professional qualifications, a precondition for making the free movement of workers a real, effective right for Europeans.

The agreement reached last June between the European Parliament and the Council will enable doctors, nursing staff, and architects too, who have settled in another European country to have their qualifications recognised more easily.

This agreement also introduced a European Professional Card which will speed up the recognition procedure, so bringing a practical simplification, and lowering costs.

Finally, led by László Andor, we are working on remodelling the EURES Portal, which lists job opportunities published across Europe, to make it a genuine tool for cross-border employment placement and recruitment.

That having been said, even if it can lead to experience which is often useful, it is clear that mobility should not be the sole vista for young graduates who cannot find work at home.

We must use every available tool at European level to support vocational training and retraining projects. Just this week, the Commission proposed that the European Globalisation Adjustment Fund be used to help 300 construction workers in the Valencia region to re-acquire jobs.

The single market must also enable us to forge new opportunities for young people in their own countries.

(ii) This is, for example, the purpose of our initiatives in the Digital Single Market.

The realisation of a genuine digital single market would improve the purchasing power of consumers, provide new opportunities for SMEs, and create jobs. In some countries, the digital economy creates 2.6 jobs for every job lost in the 'offline' economy[2].

I would add that this potential of the digital single market is particularly high in Spain, which already ranks fourth in Europe by amount of sales (€13 thousand million in 2012)[3] online.

And yet there remain today numerous barriers. What seems unremarkable within the borders of a Member State –access to websites, payment online, delivery– is not always so at EU level. The deployment

[2] Sourc Manyika J and others, 'Big Data: The next Frontier for Innovation, Competition, and Productivity' (MacKinsey Global Institute 2011).

[3] Source: Jongen W, Weening A and Ferraiuolo C, 'Europe B2C Ecommerce Report 2013' (Ecommerce Europe 2013).

of broadband remains too heterogeneous and the digital divide is a hard fact in some regions.

With our Digital Strategy and our E-Commerce Action Plan of January 2012, we hope to do away with each of these barriers.

For example, the European payments market is today fragmented, the cost getting up to €130 thousand million per year. On 24th July last, we proposed a legislative package to make internet payments cheaper and safer, for both retailers and consumers.

Let me illustrate what we want to do with a practical example: with a major producer of smartphones on the point of bringing out a telephone with biometric identification, what is it we must put in place to enable payment to be made?

Payment by internet without payment card! Purchase whereby the consumer confirms an order and a 'direct debit' transfer directly on his or her telephone, electronically. This is not 10 years in the future, but tomorrow!

Another example: parcel delivery, which is 3 to 5 times dearer when between two European countries, over what is often equal distances. 68% of online orders abandoned are abandoned because of delivery problems.

This is why yesterday I checked out all postal operators in Europe, looking for solutions. And they are there!

Not everything can be put right overnight, but they have made important commitments, such as, for instance: the putting in place systems for simplified return of a parcel which the consumer, for one reason or another, does not want; better logistics and monitoring of an order from one country to another to avoid loss of time or to enable the consumer to trace his or her purchase; or yet more competitive and accessible offers for shipments of lesser value. We will follow up these commitments in the coming months.

(iii) Finally, our reform of the single market in order to reinforce social cohesion.

With the Single Market Act we strive to create the conditions for new growth, stronger but also more innovative, greener, offering greater

employment, and more inclusive. This social concern is something I have wished to put at the heart of my tenure in the European Commission.

Within the framework of public procurement for example, we have provided for the possibility for contracting authorities to take better account of production methods of the contracted work or services, considering for example employee working conditions or the degree of inclusion of vulnerable people.

We also launched an ambitious initiative to make proper room in the single market for social undetakings, which pursue objectives other than simply profit.

The new Social Entrepreneurship Funds, running since last July, ought to improve access to financing for these undertakings, for which we are also trying to simplify the regulatory environment, and improve their visibility.

Ladies and Gentlemen.

Recognition of professional qualifications, digital single market, social enterprise initiative: these few examples are of course not the whole story.

But they have the merit of showing that, through the adaptation of the single market, we can take at European level effective measures to improve social cohesion and provide new opportunities for Europeans, especially the youngest amongst them.

To achieve these reforms, and to adapt the single market to the knowledge economy, to demographic change and to ecological transition, we must work together: European Union, Member States, regions, businesses, the academic and voluntary sectors.

On the occasion of the 20th anniversary of the single market in 2012, the European Commission Representation in Spain had taken the initiative of launching working groups on three key areas of the single market in Spain: the regulated legal professions, intellectual property and corporate social responsibility. These sorts of steps, which lead a multidisciplinary team to take stock of the state of the single market and then to specific recommendations, should be encouraged.

With 'Single Market Month', which will take place across Europe from 23rd September to 23rd October coming, we wager the collective intelligence of teamwork by calling to our assistance the internet and the new media.

From today, you can login to our site to submit your ideas for policies to improve the single market.

From 23rd September, these ideas will be discussed over four thematic weeks devoted to jobs, social rights, banks and E-commerce. You will have in particular the opportunity to debate online with members of the European Parliament, Commissioners or the representatives of civil society.

I count on you actively to participate in this new kind of exercise and to share with us your many, original and inspiring ideas for the next stages in the reform of the single market.

Europe is you, it's all of us. You have your say and your ideas to bring to the table, to change it for the better.

Thank you for your kind attention.

2

Reinforcing the Single European Market: Opportunities and challenges in the current economic downturn

RAMÓN DE MIGUEL*

This is the opening of a very valuable International Conference aimed at exploring new ways to reinforce the Single European Market.

First of all, I would like to thank CEU San Pablo University and particularly my good friend Jose Maria Beneyto for inviting me to share with you a few thoughts about the realization of Single European Market, being the focal point of this ambitious conference. I would not dare to address extremely difficult questions arising in the current complex economic context of today's European Union. These issues will be dealt with thoroughly along the following pages by scholars and well-reputed specialists in European Law. Rather, my introductory words will only attempt to underline the importance of the subject and the need to multiply our efforts to make the internal market work more efficiently, especially in the present landscape of economic downturn.

I praise the University for European Studies of CEU San Pablo University for taking this opportune initiative in a time where the strength of the Single European market is being put to the test. The economy of the EU is still suffering the consequences of the recent financial crisis: industrial production remains low, the markets are depressed, unemployment is rampant and the consumers have not recovered the confidence that would make the commercial system work. In a moment when many of the elements of the European construction are being

* Former Secretary of State for European Affairs, Spanish Government.

continuously questioned, coming back to the origins of our common European project seems a very healthy exercise.

This *retour aux sources* exercise is essential to understand the roots of this common project. We talk about the "internal market" or the "Single European Market" as new concepts, new jargon developed by the European Commission to define this new economic reality. However, the internal market is not new. It is probably the oldest concept of the European architecture. It refers to le marché commun, the old common market which was the basis for the original agreement to eliminate the problems of European nationalisms and overcome the national rivalries that originated the two wars almost destroying our continent.

Putting the market to work to unite different peoples and cultures is not a new aspiration either. It has been used over the centuries by our traditional monarchies to consolidate nationalities. Even in relatively recent times we have seen the birth of powerful European states by the establishment of a common market. The "zollverein" introduced by Bismarck made possible glue together the modern German state.

The elimination of borders, the custom union and the harmonization of the internal market have been the most powerful tools to unify territories over the centuries while creating new spaces for free trade and prosperity. No wonder that the founding fathers of the European integration project soon foresaw that the best way to bring together in a common endeavor the two nations confronted at the two preceding World Wars –Germany and France– required forcing them to share the market of the strategic commodities at the heart of the conflict: coal and steel. This market was the basis of the CECA treaty in 1950, as you all know, the beginning of our European adventure. The experience was successful and only six years later, in 1956, the founding fathers were ready to launch in the treaty of Rome a more ambitious goal: the common market, *le marché commun*.

The common market was the foundation of an economic architecture inspired by the four basic freedoms (free circulation of goods, labour, capitals and freedom of establishment) with solid legal principles embedded in the primary law binding on the member states and enforceable before the European Court of Justice.

The common market was conceived as an instrument for trade and prosperity in its inception, but in practice it became much more than that. It was the hardcore around which the whole system of regional integration was developed. A sophisticated set of legal provisions that were introduced in the treaty to guarantee the exercise of the four freedoms and free competition; common policies were developed to reinforce the market; the role given to the European Commission was reinforced as the guardian of the treaties being granted the monopoly over legislative initiative; finally, the support of the Court of Justice, crowned a complex legal structure unique in the international political landscape.

The common market was what initiated a totally new form of polity. It was not a national state, a federation or a confederation of states but a sui generis form of regional integration of states sharing a common geographical space, common legal principles and a common market. This sui generis polity enjoyed certain degree of limited sovereignty over the matters conferred upon them by the treaties whereas in other areas not defined by the primary law, member states still enjoyed full sovereignty.

For thirty years the common market and the Treaty of Rome were the engine moving forward the European structure. Secondary law was developed to guarantee the four freedoms and articulate the common policies reinforcing the common market. After this period of time, the European project was ready to make a step further and the vision of an extraordinary President of the European Commission, Jacques Delors, made possible to launch an intergovernmental conference to revisit the Treaty of Rome.

The Single European Act of 1986 was very ambitious in its motivations and aims. Not in vain, it included some elements depicting prematurely what would be later known as the European Monetary Union. Setting these visions aside, this treaty showed that the realization of the common market was key to achieve further political or monetary goals.

The Single European Act is the treaty of the Single European Market the treaty of the “internal market”. These expressions have blurred the very well known expression of “common market” and may be used indistinctively in this book, as refer to the same core concept.

The common market was conceived by the Commission and the member states as the essence of the European architecture and the foundations on which more ambitious goals, such as the political and the monetary union, had to be built.

The Single European Act contains a very complete set of provisions to reinforce and achieve the common market. In particular, the introduction of qualified majority in all decisions concerning the internal market was a major step. With that instrument the Delors Commission launched a plan to complete the Single European Market and set the deadline in the year 1992 to achieve this objective.

Those were years of frantic activity to realize and develop the common market but, as I remember very well because I served as Chef de Cabinet and Director General in the European Commission between 1986 and 1996, these were also years of great frustrations due to the resistance of many member states that put a brake on the improvement of the single market in many fields.

1993 was the year of the realization of the internal market. That was 20 years ago and you all know that much remains to be achieved. In the present time, there are still some economic sectors where the common market malfunctions or is simply not existent: provision of services, public procurement, energy, transport, not to speak of emergent economic sectors like the digital economy or financial markets where very little has been done so far. These are just a few examples of the many challenges still overshadowing the completion of the Single European Market in the current context of economic downturn.

In the last twenty years, the economic context has radically changed and yet, little effort has been made to adapt the internal market to the challenging reality. The present EU is not the same organization of 1993. The number of Member States has doubled, so has the number of consumers and now we are exceeding the 500 million consumers in a European Union of 28 Member States. The decision making process has become complex and sophisticated. Our ambitions have also changed. We have a common area of Justice and Freedom, we aspire to a more improved political union and common foreign and defense policy. We have a common currency and we have discovered that there is not such a thing as common economic or fiscal policies essential to maintain a common monetary policy

Despite all these frustrations our economy has improved since the nineties and the European Union is in many fields an example of excellence and social improvement. Despite that, it is fair to acknowledge that the world surrounding us has also improved. There are countries that were irrelevant 20 years ago that are today powerful actors in the world economic and trade system. The EU and the more important of its member states have lost their position of preeminence in the global context.

What is wrong with the European Union? We have suffered a prolonged economic stagnation and we have also discovered that our system malfunctions and difficult decisions will have to be made sooner than later to confer more competence upon the Union in order to address the current challenges evidenced by the monetary and economic union. But all of this, on my opinion, does not necessarily explain why we are having a slower recovery than many countries, we have an intolerable level of unemployment, our industrial output is in decay and the level of confidence of the consumers is far too low.

In every European Council many new ideas and initiatives are suggested to improve our economy: policymakers talk about the objectives that Brussels should pursue to make our system more efficient; the European Parliament debates about the many measures to take… And meanwhile, we hear all these debates and we, -I mean the people in this room and many other stakeholders like us- wonder why public voices rarely refer to the Single European Market as a starting point to face the current economic downturn.

You all certainly remember James Carville the chief strategist of Bill Clinton during his successful campaign against George H. W. Bush in 1992. He coined that famous phrase "It's the economy, stupid".[1] This sentence was crucial to focus the efforts of the candidate Clinton on what was essential for the voters: the state of the economy and also became a slogan of the campaign.

I have the impression that we have to take the spirit of that slogan and voice out loud here in Madrid and in all corners of the European Union "It's the single market, stupid". It is the single market what our

[1] Kelly M, 'THE 1992 CAMPAIGN: The Democrats -- Clinton and Bush Compete to Be Champion of Change; Democrat Fights Perceptions of Bush Gain' New York Times (New York, 31 October 1992).

economy is missing. We have made a long way since the Treaty of Rome but we have not had neither the determination nor the conviction to complete that common market dreamt by our founding fathers. We have collectively failed to understand that the single market is the only solid foundation for our ambitions of having a robust economic and monetary union. This economic and monetary union will simply not work without a well integrated and harmonized single market, and that is a token frequently disregarded.

The failure of the single market represents the image of the European Union failure. National selfish interest has always been hidden behind implementation issues regarding measures complete the SEM. We have a custom union that has eliminated tariffs in our internal market but the number of non tariff barriers that have affected trade between member states and even regions inside member states has been on the rise in the last twenty years. Member states maintain physical barriers to avoid interconnections in the electricity and gas sectors that are crucial to economic development. The services sector has obstacles everywhere. Public procurement is an activity almost reserved to nationals of the different member states. Telecommunications and the digital society do not work at EU level. The free circulation of capitals does not work in a uniform manner and the freedom of establishment is only recognized occasionally.

What kind of common market do we have? No wonder that the European Union does not work perfectly. The nationalistic tensions are questioning all the underpinning ideals about putting the forces of the market together to get a stronger, more efficient and more prosperous union.

The results are obvious. The US with a population of 320 million consumers, less than the EU, is riddled with a public debt that doubles our own. Their export of goods is one third of the EU. Their internal market, contrary to us, functions and is in good health. The balance is positive for them. They have a better income per capita, their unemployment is lower, the level of consumption is higher, their industrial output is bigger and they invest more money in R&D.

I believe this is the time to act. The completion of the Single European Market should be number one in the political agenda of the European

Union. We can do our best to influence politicians and parliamentarians in our member states but it has been obvious that national governments stick to their shortsighted and nationalistic interests.

The Commission has to take full responsibility in this matter. We do not want them to take, for the time being, more legislative initiatives in this field. What the Commission should do at this juncture is fully exercise its powers as the guardian of the treaties and make member states to comply with the commitments already taken under the Treaties and the *acquis communautaire* and, whether incompliance occurs, the Commission shall not doubt to take legal action and enforce the relevant provisions before the European Court of Justice as the last arbitrator to settle disputes between member states and European institutions. Very little will be achieved, if the Commission has not the courage to embark in a decisive plan of action for opening proceedings against infringing member states and take them to the Court of Justice with the conviction that this institution has always been given the staunchest support for the European project.

International conferences like this, promoted by the CEU San Pablo University, play out a very significant role by .enhancing the public awareness about the importance of the Single European Market and its potentialities in the current context. Nevertheless, in order to achieve this goal, academic efforts are not enough. A louder political outcry is necessary: "It's the internal market, stupid" that will make our political leaders understand that the European Union cannot be made without the old strong common market.

Madrid 28th of October 2013.

Part II

Further liberalization on the provision of services?

3

Fostering Growth: The importance of the Services Directive[1]

JÜRGEN TIEDJE*

1. Introduction

The Services Directive which was adopted in 2006 and which had to be implemented in all Member States by 2009 is often seen as the key for making the Single Market freedoms work: the business community should fully benefit from the right of establishment and the freedom to provide services. As to the underlying legal principles, the Directive is often compared to the *Cassis de Dijon*[2] judgment – a judgment of the Court of Justice that has paved the way for the free movement of goods and for the principle of mutual recognition decades ago.

However, a comparison with court judgements does not help in understanding what the Services Directive could deliver in the years to come. In particular, it does not suffice to consider to which extent the Services Directive is a piece of European law which consolidated the jurisprudence of the Court of Justice on the right of establishment (Art. 49 TFEU) and the freedom to provide services (Art. 56 TFEU). The jurisprudence has been mainly driven by complaints from individual companies and citizens who intend to expand economic activities beyond national borders. Instead, it is more important in these days to focus on the economic impact of the Services Directive in its entirety. Sectors falling under the Services Directive today amount to almost half of the Spanish annual GDP and affect half of all

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1 This article is based on a speech held at the International Conference organised by the CEU San Pablo University on 28 October 2013 in Madrid. It has been updated in order to take account of developments until April 2014. It only reflects the personal views of the author and does in no way reflect the official position of the European Commission.

2 Case 120/78 *Cassis de Dijon* [1979] ECR 837.

jobs in Spain. Therefore, the Services Directive represents an opportunity for the economy in each Member State.

If I refer to an opportunity, it does not mean that implementing the Services Directive is like a pleasure trip at the Golden Gate Bridge offering quick win-wins. It is an opportunity which sometimes requires difficult national decisions and which only unfolds over time in the Member State in which such decisions have been taken.

When giving my strictly personally views, please allow me to focus on three main questions:

- Why is the Services Directive an opportunity for the economy in each Member State?
- What work could be undertaken in a Member State to seize this opportunity?
- Which additional work streams are pursued at the level of the European Union in these days?

2. Why is the services directive an opportunity for each member state?

Today, the economies of most of the Member States of the European Union are facing a major crisis, but there are signs of recovery. Under these circumstances, we should not lose sight of the fact that the single market and in particular the Services Directive offer opportunities for Member States. There are lessons to be drawn from the past in order to demonstrate the scale of the opportunities.

In 2008 – before the crisis started, the average income per capita was 500 Euros higher than the average income per capita that would have been, if the Single Market had not been created in 1992. Similarly, the GDP in 27 Member States was 2.13% higher compared to a situation, where the Single Market would not have been put in place.[3]

[3] See Directorate General Internal Market and Services, '20 Years of the European Single Market, Together for New Growth' (European Commission 2012). <http://ec.europa.eu/internal_market/publications/docs/20years/achievements-web_en.pdf>

Against this background, the Services Directive is key because it invites all stakeholders in all Member States to rethink the importance of services. The entire services area accounts for 71% of GDP in the European Union. Services falling within the scope of the Services Directive cover 46% of the GDP in the European Union. The Services Directive offers a major opportunity to get our economies back on track and to find new growth opportunities, thus contributing to the creation of more jobs in each Member State.

Certainly, the period for implementing the Services Directive expired for the Member States already at the end of 2009. However, the European Union has sent clear signals in the last two years, that there is no reason for complacency and that it would not limit its efforts just on late-comers or bad pupils amongst Member States, who did not deliver as promised under the Directive. All Member States are asked to be more ambitious in the upcoming years.

In its Communication of June 2012, the European Commission assessed where Member States stand in the implementation of the Services Directive.[4] It combined its assessment with a strong call for seizing the growth opportunities the Directive offers in the future: If a Member State abolishes restrictions as envisaged in the Services Directive, the total economic gain can be about 2.6% of the GDP. If a Member State wants to be less ambitious and sticks to the minimum the Directive requires, the gains will only account for 0.8% of the GDP.

In its Annual Reports on the State of the Single Market Integration from November 2012 and November 2013[5], the European Commission again asserted that services sectors in general are growing fast and generate the most potential for employment. The Annual Single Market Integration Report represents a contribution to the Annual Growth Survey issued at the same time and setting out the general EU economic priorities for the year to come. Reviewing national policies in the different areas of services is therefore a major economic priority for each Member State in the European Union (and thus part of the European semester process).

4 COM (2012) 261 final of 8/6/2012.

5 COM (2012) 752 final of 28.11.2012 and COM (2013) 785 final of 13.11.2013.

In concrete terms, the Annual Single Market Integration Reports offer a first evaluation of country specific recommendations (CSR's)[6] which have been issued beforehand. The annual report from November 2013 also warned that the trade integration of goods in the Single Market stands at approximately 22%, whilst the trade integration for services stands at only around 5%. This warning matters to those Member States, which rely on exporting services in order to restore growth in their domestic economies.

The need for growth at domestic level and the need for more integrated service markets in the European Union should not be perceived just as political buzzwords. Growth in service markets is the way towards jobs at domestic level; more trade in services inside the European Union allows for more jobs which not only depend on purely domestic demands but on demands leading to increased exports to other Member States. In Spain, the unemployment rate in 2012 has been threatening: 26.2%. More than 1.2 million people have been unemployed for over two years. An ambitious implementation of the Services Directive in the future can bring people back into jobs as well.

Therefore, it is also no surprise that the European Council of 25 October 2013 invited the Council of Ministers and the European Commission to provide yearly progress reports on national reforms of services in the future. This invitation reinforces the need to increase efforts in reforming services markets in general.[7]

3. What work could be undertaken in a member state teize the opportunity?

Spain already did the groundwork for a successful implementation of the Services Directive by 2009. To this end, it chose a comprehensive

6 Country specific recommendations matter in particular for Member States for which an Excessive Deficit Procedure (EDF) is ongoing. As to Spain, the Council adopted recommendations on Spain's national reform programmes on 10/7/2012 for the year 2012 and on 9/7/2013 for the year 2013.

7 See President Barroso's contribution to the European Council of 20 and 21/3/2014 under http://ec.europa.eu/commission_2010-2014/president/news/archives/2014/03/pdf/services_en.pdf; see also Commission staff Working Paper of 31 March 2014 published under http://ec.europa.eu/internal_market/services/docs/services-dir/implementation/140331-staff-working-document-national-reforms_en.pdf

approach. An ambitious horizontal law in 2009 (Ley 17/2009) implemented the main principles and articles of the Services Directive. An Omnibus Law (Ley 25/2009) addressed changes in sector-specific legislation at national level, whereas the Autonomous Communities were also in charge of making the necessary amendments to their sector-specific laws at regional level.

However, I do not want to look backwards. I would like to focus on what is currently being discussed in Spain. Recall, that a more ambitious implementation of the Services Directive can lead to an economic gain of 2.6% of the GDP. Such an ambitious implementation should also be a response to the need for national reforms which the European Union called for under the European semester process.

There are good reasons to undertake such reforms. One example is business services[8] where Spain lies behind many other Member States of the European Union. In 2005, the demand for business services in Spain, in terms of hours per capita, was below 65% of the average at European Union level throughout all activities. It has been estimated that achieving average levels of demand and productivity could contribute to the creation of at least 0.7 million jobs dedicated to business services and increase the contribution of business services to the GDP by EUR 30 billion to 160 billion.[9]

In these days, Spain undertakes many efforts[10] to achieve an ambitious implementation of the Services Directive:

• The Spanish government proposed the **draft law on Professional Services and Associations** on 2 August 2013. If finally adopted in 2014, it would represent a major step towards opening up professional services to competition and generating employment for young talented people. Compulsory membership to professional associations would be limited to

8 In April 2013, the Commission set up a High Level Group on business services which is expected to provide policy recommendations in spring 2014 (see www.ec.europa.eu/enterprise/policies/industrial competitiveness/industrial-policy/hig-business-services/index_en.htm

9 See "A Growth Agenda for Spain", McKinsey-Fedea, December 2010 as well as the summary of the discussion of this study with the Bruegel Institute Brussels (www.bruegel.org/nc/evetns/event-detail/event/206-a-growth-agenda for spain/).

10 See the last National Reform Programme issued by the Spanish Government in 2013 (www.ec.europa.eu/europe2020/pdf/nd/nrp2013_spain_es.pdf).

what the society really needs. Professional activities could still be reserved but only when justified by a clear overriding reason of public interest. Given that professional services represent at least 8% of the GDP of Spain, such a reform could significantly reduce burdens, such as compulsory membership of professional associations for which no proper overriding public interest prevails. This reform would also be the necessary reply to recommendations issued by the European Council in the context of the "European semester".

• Spain has also undertaken important steps which should significantly improve the environment for business, in particular for **small and medium sized companies** – which are the main beneficiaries under the Services Directive. There has been the law in support of entrepreneurs (Ley 14/2013) from last September and the law liberalising trade in December 2012.

• The Services Directive also pushes Member States to avoid multiple layers of administration and to **cut "red tape"**. One example is the need to ensure that authorisations are valid throughout the whole of the Member State to avoid scenarios where businesses need to gather authorisations region by region. The **law on market unit**y which was approved in December 2013 thus improves the business environment and stimulates free movement of services throughout Spain. The implementation of the market unity law should ensure that legislative competences at different levels are neither duplicating requirements nor leading to diverging requirements.

• Another example concerns **e-government**. A few Member States took the view to strictly implement the Services Directive in regards to the **point of single contacts** (PSC) and not to dovetail its implementation with domestic reforms in the area of e-government. The majority of the Member States however seized the opportunity to integrate the development of points of single contact into domestic e-government plans run in their administrations. Spain belongs to this group (though it is facing a challenge with aligning its e-governance agenda with its cities and municipalities). I believe that, in the long term, linking points of single contact to domestic e-government agenda is the more effective way because it should comprise all levels of a Member State – the national level, the regional level and the local level (with which companies have also lots of correspondence).

I have given examples of how Spain is progressing towards an ambitious implementation of the Services Directive in order to fully tap into the potential of an increase of 2.6% of GDP.

Is this a time for compliments? Yes, indeed a lot has been achieved in Spain. Is there time for a complacency? No, because there is a need for a rigorous implementation of what has been agreed upon and there is a need for the strong support of business to make use of these reforms to create more jobs

4. Which additional work streams are pursued at the level of the European Union in these days?

I mentioned that the Commission invited Member States to go for an ambitious implementation of the Services Directive in June 2012. In its Communication, the Commission already highlighted particular issues, where further work will be necessary at European level. I would like to focus on five priorities.

A first priority concerns professional services. It is felt that more could be achieved by bringing the professions closer to the Single Market, by allowing more mobility of professionals within the Single Market, by allowing more cross-border competition of professional firms and by simplifying access to regulated professions. Against this background, the European Commission issued two important policy documents focusing on professional services at large on 2 October 2013:

• A communication which sets out a work plan for a mutual evaluation of rules governing the access to all regulated professions in all Member States[11]. We expect Member States to come back to us with national action plans in 2015 and in 2016 in order to explain to us where they see possibilities for reform in their jurisdiction. This will also concern Spain. As already indicated above: For the next two years the objective of this exercise is to facilitate professional mobility and access to the markets

[11] The principle of this work plan is agreed with the European Parliament and the Council of Ministers in the modernised Professional Qualifications Directive (see Art. 59 of Directive 2013/55/EU, OJ L 354, p.132) and not under the Services Directive.

of professional services across Member States. This initiative has been conceived in response to European Council conclusions of March 2012 (and has been reaffirmed by the conclusions of the European Council of October 2013).

• Secondly, a Commission services Staff Working document which reports a peer review carried out with all Member States in late 2012/ early 2013. This peer review, which builds on Article 15 of the Services Directive, did not focus on rules governing the access, but on the exercise of professional activities including the mandatory use of tariffs. Rules governing the exercise of an activity concern conditions under which professional firms can operate such as capital or voting rights requirements or limiting a professional activity to a sole person. Throughout the peer reviews with Member States, there was a consensus on the overriding reasons of general interest at stake but there is a major divergence on how to respect the principle of proportionality. Therefore, the Commission departments will engage with some Member States in particular to remove the most stringent requirements on legal form and shareholdings.

More generally –and this will be a **second priority**– there is a need to look further into the way Member States carry out the proportionality assessment when introducing or maintaining national regulations restricting the free movement of services. In the same vein, the Commission is currently considering [12] how to best apply any professional indemnity insurance requirements for service providers, who wish to establish a secondary establishment or to provide services in another Member State on a temporary basis. On 31 March 2014, the Commission published a staff working document which offered a more detailed analysis of the challenges related to insurance in a cross-border context.[13]

As a **third priority**, I would like to mention the Commission's zero-tolerance policy –as already announced in the "Services Communication" of June 2012. There are fundamental obstacles, such as nationality or residence requirements, which require immediate abolition by a Member State. It is no longer possible to support the need for such requirements

[12] To this end, Commission departments carried out a public consultation in summer 2013.

[13] See under http://ec.europa.eu/internal_market/services/docs/services-dir/implementation/140331-staff-working-document-access-to-insurance_en.pdf.

in current times. For this reason, Commission departments apply a zero tolerance policy in regards to obstacles not tackled during the implementation of the Services Directive by a Member State in the past. This policy has already led to changes in Member States' legislations– around 40 cases have been launched by Commission departments, out of which around two thirds led to amendments of national legislation.

As a **fourth priority**, I would like to mention the ongoing work on the points of single contact (PSC) and on the 2013 agreement of a PSC Charter[14] with Member States on how to further improve the efficiency of the points of single contact and how to widen their scope to make them more business friendly. The Commission plans to carry out an in-depth assessment of the progress achieved with the implementation of the Charter in the second half of 2014. The availability and accessibility of e-procedures will play an important role in this context. The adoption and implementation of a future regulation on electronic identification and trusted services for electronic transactions in the internal market (the so-called eIDAS Regulation[15]) will be an additional milestone in this field. However, this regulation –which will in future replace the 1999 Directive on electronic signatures– should not be a reason for delaying the already ongoing work under the Services Directive. The framework agreed upon under the Services Directive will continue to apply for the competent authorities communicating via the points of single contact for the time being.

Finally, Article 20 of the Services Directive offers service recipients, in particular consumers, an opportunity to buy services throughout the single market without being discriminated. This part of the Services Directive is less well known than the Passenger Rights Directive. The reason is that the latter Directive offers stronger rights for consumers and accordingly is used more often by consumers and consumer centres. However, 2014 will be a year to raise more awareness of the consumers' opportunities under the Services Directive (including via social media) and to clarify further their concrete rights if services cannot be provided from other Member States or at an objectively discriminatory price.

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14 See under http://ec.europa.eu/internal_market/services/docs/services-dir/psc-charter_en.pdf

15 A political agreement on such a new regulation has been reached between the European Parliament and the Council of Ministers on 28/2/2014 – see press memo 14/151 of 28/2/2014 by the European Commission. A formal adoption of the regulation is expected for September 2014 at the latest.

5. Conclusions

The Service Directive is key for completing the Single Market and is designed to support Member States as an economic priority under the European Semester. Its successful and ambitious implementation is pivotal for our economic recovery. It is up to Member States as well as the business community and other stakeholders to seize the opportunities the Directive actually offers. The European Commission is ready to support them but is also prepared to take additional initiatives if need be.

4

Problems in the liberalisation and regulation of network industries in the EU: State of play and prospects[1]

JAVIER GUILLÉN CARAMÉS*

ABSTRACT

European Union and Member States have been engaged in the liberalisation of network industries for the past 30 years. The liberalisation of regulated sectors has encountered a range of difficulties and continues to face a number of challenges. This paper addresses some of these challenges: specifically, it focus on the problems surrounding the combined application to regulated markets of economic regulation and competition law. Firstly, it will analyse the origin of regulated markets and the reasons why they were structured around state monopolies; secondly, it will consider the basis of why it became necessary to liberalise those markets, by exposing the original market incumbents to open competition from new entrants. After this brief overview of the liberalisation of regulated markets, in the third part it will analize the present state of the liberalisation process and the emerging difficulties it has encountered. Finally, it will set out a number of conclusions on the prospects for the liberalisation of regulated sectors and the challenges to be faced

KEYWORDS: Liberalisation, Network Industries, Competion Law, Economic Regulation, Regulatory Risk, Regulatory Authoritiest

1. Introduction

The process of liberalisation of the so-called "regulated" sectors (telecommunications, energy, postal services, transport, etc.) has been ongoing in the European Union for more than thirty years. Progress has

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been uneven across the various regulatory domains, however: for instance, air transport has been fully liberalised, whereas in the energy market and in passenger rail transport the liberalisation process has been slower and remains incomplete.

The liberalisation of regulated sectors has encountered a range of difficulties and continues to face a number of challenges. This paper addresses some of these issues: specifically, I shall focus on the problems surrounding the combined application to regulated markets of economic regulation and competition law. I shall first analyse the origin of regulated markets and the reasons why they were structured around state monopolies; secondly, I shall consider the question of why it became necessary to liberalise those markets, by exposing the original market incumbents to open competition from new entrants. After this brief overview of the liberalisation of regulated markets, in the third part of this paper I shall examine the present state of the liberalisation process and the emerging difficulties it has encountered. Finally, in order to conclude, I shall briefly set out a number of conclusions on the prospects for the liberalisation of regulated sectors and the challenges to be faced.

2. Some reasons why network industries adopted the form of state monopolies

Throughout the twentieth century, regulated sectors in Europe adopted the form of state monopolies for a number of different reasons [2].

First, it was widely believed that these markets were natural monopolies; the services provided by these network industries could accordingly be operated only by monopoly undertakings of a public nature, i.e., under the ownership of the state. In some such markets –such as energy and telecommunications– this approach was largely justified on grounds of economies of scale. The necessary infrastructure was very expensive and practically impossible to duplicate because of the prohibitive cost this would involve.

[2] See for instance, Geradin D (ed), 'He Opening of State Monopolies to Competition: Main Issues of the Liberalization Process', *The liberalization of state monopolies in the European Union and beyond,* vol 23 (Kluwer Law International 2000); Muñoz Machado S, 'Fundamentos e Instrumentos Jurídicos de La Regulación Económica' (2010) 1 15.

Secondly, in most European states there was an entrenched administrative culture surrounding the notion of "public service". Monopoly undertakings providing a public service were rewarded accordingly: or, to put it more accurately, the state would grant a wide range of exclusive rights so that monopoly undertakings would be able to provide a so-called "universal service". This meant that monopoly undertakings were under an obligation to provide their universal public service in all territories of the state, including areas where this was unprofitable; what was more, the service had to be provided to all citizens to a specified standard of quality and continuity so as to assure economic and social cohesion throughout the state.

And thirdly, some of these sectors – e.g. energy, and, in particular, power supply to consumers – were strategically important for the national interest; governments saw a need to control such markets directly. A range of non-economic factors were grounds for state protectionism: (a) strategic considerations relating to national defence; (b) labour-related factors, owing to the large number of employees working for such undertakings; (c) the social requirement that the universal public service be provided to all citizens; and (d) political reasons – since public undertakings were state-controlled, they were closely interlinked with public authorities.

3. Key issues to the liberalisation process

3.1. The case for creating a new economic model for regulated sectors

The state monopoly model for regulated markets attracted severe criticism in the late 1970s from economic theorists, sector regulators, consumer organisations and business operators, who began to build a new model for organizing and providing general interest services or, as they are now termed, services of general economic interest.

While it was obvious that regulated sectors or network industries requiring essential infrastructure might naturally have a range of substantially monopolistic features –e.g., energy, telecommunications–

in other markets, such as air transport and postal services, the need for this was at least doubtful.

In addition, the view began to be taken that, whereas in markets heavily determined by infrastructure and so displaying monopolistic features that partly justified the incumbent's continued monopoly for a transitional time, this ought to be no bar for certain segments of such markets gradually to be liberalised, thus letting in new economic operators on the basis of open competition. This would obviously have to involve the abolition of certain exclusive rights so far enjoyed by the incumbents.

Therefore it was shown, that provision of the universal public service in these markets did not necessarily call for preserving public monopolies involving "cross subsidies" from profitable to unprofitable service divisions.

Moreover, it was found that in general monopoly undertakings provided services to a poor standard of quality. From the standpoint of the general public, prices were high and service quality was low. The absence of competition meant that state-controlled undertakings providing universal services had no incentive to improve quality or bring down prices. This reality pointed to a need to change the model for the provision of network services. It was believed that liberalisation and the entry of new operators on the basis of open competition would drive down prices and raise the quality of service provision.

Finally, the European institutions –the Commission especially– took the view that the continued maintenance of state monopolies constituted a major obstacle to the achievement of the common market. It was clear that the exclusive rights granted by Member States to state-controlled undertakings severely obstructed the free circulation of goods and services throughout the European Union. These protectionist measures were manifestly contrary to the guiding principles established in the Treaties, particularly in the EC Treaty.

The European Commission was accordingly prompted to adopt a wide range of measures to liberalise these network industries. For example, in the telecommunications sector several liberalisation

directives were approved on the legal basis of former Article 86 EC Treaty (now Article 106 TFEU), which made the Commission directly competent to introduce such measures. Elsewhere, such as in the energy industry or the postal services sector, the legal basis used was Article 95 EC Treaty, which, insofar as it required the use of the co-decision procedure, called for a greater effort of dialogue and negotiation among Member States. This pattern closely reflected the tension in these sectors –the energy sector particularly– between those Member States whose administrative-law tradition was inclined to preserve far-reaching government intervention (e.g. France, Belgium) and those Member States (e.g., Netherlands, United Kingdom) seeking swift liberalisation.

3.2. The liberalisation of regulated sectors: the elements shaping the new model

The Community institutions harboured a clear political will to liberalise regulated sectors, largely motivated, as I have said, by the aim to achieve a common internal market throughout the European Union.

The underpinnings of the process of liberalisation of regulated sectors were:

First, the European Community institutions adopted a large number of directives that were primarily concerned to abolish the exclusive rights granted by national legislations to monopolistic service providers. It is to be noted that one of the hallmarks of the liberalisation process was that the opening up of regulated markets to competition was gradual rather than automatic. In the telecommunications sector, for example, some services were opened up to competition before others. Similarly, in the energy industry, in some Member States consumers were allowed a free choice of supplier, whereas in other Member States this possibility was introduced only later. The key reason for this was that monopoly undertakings needed a transitional regime to adjust their organisational structure and resources to the rigours of open competition.

Secondly, liberalisation was constrained by the need to create a suitable regulatory framework. Specific regulatory measures had to be adopted and, in addition, the regulatory authorities to be created had to be independent from both the government of the day and market players.

As a general rule, the legislation being introduced was designed to build a new regulatory framework for the provision of the universal public service in each market. The universal service model has usually been regarded in the European Union as of paramount importance, as shown by the fact that it has been preserved even in the new context of liberalisation and open competition. Hence, the universal service has been configured afresh, alongside the introduction of the elements required to open up regulated sectors to competition. Specifically, liberalisation directives have contained express mandates addressed to the Member States to assure third-party access to networks and infrastructure by means of "unbundling" (vertical de-merging of undertakings) and the gradual abolition of state aid to incumbents. It can be said that the intention of the European Union has been to create an open-competition framework that reconciles the rights of incumbents with the rights of new entrants.

As mentioned earlier, liberalisation together with the adoption of a new regulatory framework, demanded the creation of "independent regulatory authorities". Opening up a market to competition called for the existence of a regulatory authority capable of ex ante design of the ground rules, eliminating market failures and ensuring that the market functioned in consonance with the principles of open competition. As pointed out earlier, it was accordingly necessary for the regulatory authority to be independent both from government and from the undertakings that were to compete on regulated markets.

The third fundamental pillar supporting the process of liberalisation of network industries is the application of competition law to undertakings operating in such markets. Hence the application of Article 102 TFEU, prohibiting abuse of a dominant position, is essential in these markets, where the incumbent starts out with a clearly dominant position and may be tempted to abuse it to eliminate new entrants or prevent their entry altogether. In addition, the gradual emergence of open competition in liberalised markets may bring about new difficulties that impair such competition, such as cartels that fix prices or carve up markets. Here, Article 101 TFEU is vital to the prevention of anti-competitive conduct. From the standpoint of the application of competition law, what is more, suitable liberalisation is crucially dependent on the introduction of specific measures on the control of concentrations between undertakings and on the entire range of provisions applicable to state aid.

These three pillars are equally important in the process of liberalisation of regulated sectors and call for suitable implementation and development so as to strike the right balance between the competing interests that may arise as the process moves forward.

4. State of play: problems of liberalisation

Nowadays it can be asserted that the process of liberalisation of network industries has reached an advanced stage. In the domains of telecommunications or air transport, for instance, liberalisation has clearly garnered significant benefits for consumers, who enjoy lower prices and a wide choice of suppliers and offerings. In other sectors, however, such as energy and rail passenger transport, liberalisation has been slower.

European directives for the liberalisation of these regulated sectors impose the minimum conditions under which such markets must be thrown open to competition, but it is the Member States themselves, through their regulatory authorities, who must drive the liberalisation process. The liberalisation of these network industries has encountered a range of difficulties, which I shall outline in the following sections.

4.1. Regulatory authorities

The process of liberalisation of so-called "network industries", primarily led by the European institutions, has entailed –frequently as a result of an obligation imposed on Member States in the various relevant liberalisation directives– the creation of national regulatory authorities for each main regulated market, each such body having a varying degree of independence. The EU legislation shaping the opening up to competition of the various network industries has therefore always required that the administrative authority competent to regulate the activities of operators on a given market be independent from such operators.

It is to be noted, however, that EU directives have not systematically required that a regulatory authority be in the form of an independent public authority, this having been a requirement determined by the national legislation– i.e., a public authority that has its own legal personality, has no hierarchical connection to the competent territorial

authority, is functionally independent, and is supported by a whole range of safeguards of its independence. The requirements differ from one directive to another, and are particularly detailed for some regulated markets, such as electricity and rail transport.

However, it has become the usual practice to create independent authorities in this form, on the view that it is the most effective way to assure the regulator's independence from market operators and from any pressures exerted by the government of the day.

In Spain, various independent public authorities –*termed organismos reguladores*– were created under the Sustainable Economy Act (Ley *2/2001 de Economía Sostenible*[3] referred as "LES" hereinafter), each such body exercising its powers in a specific regulated sector. LES created a general legal framework for public authorities within the scope of this legal category – the *Comisión del Mercado de las Telecomunicaciones* (Telecommunications Market Commission), the *Comisión Nacional de la Energía* (National Energy Commission), the *Comisión Nacional de los Servicios Postales* (National Commission for Postal Services), and the *Comisión Nacional del Juego* (National Gambling Commission); later, there was added the *Comisión de Regulación Económica Aeroportuaria* (Commission for the Economic Regulation of Airports). This common legal framework dealt with key aspects such as organisational structure, the appointment of members of governing bodies, staffing, transparency, and the safeguards of independence.

Alongside the sector-specific regulatory authorities exercising *ex ante* economic regulation of network industries, there was a national competition authority, the *Comisión Nacional de Competencia* (CNC hereinafter), in charge of applying competition law to these sectors.

This organisational model, involving the co-existence of sector-specific regulatory authorities in charge of *ex ante* intervention and a competition authority whose intervention has generally been *ex post* –when market players may have incurred in anticompetitive conduct falling within the scope of Articles 101 or 102 TFEU– has not been free from difficulties and dysfunctions.

3 Spanish Parliament Act 2/2011 on Sustainable Economy (Sustainable Economy act) [2011] BOE num. 55, p. 25033-25235.

Moreover, at the EU level, the relationship between national regulatory authorities and the European Commission –especially DGCOMP, which has the exclusive and supreme competence to apply the rules of EU competition law– has sometimes come under strain. In the telecommunications sector, for instance, the Commission, on grounds of European competition law, has penalised the conduct of operators that had previously been greenlighted by their respective national regulatory authority, as in the *Deutsche Telekom* case[4] In the energy sector, the *EOn/ Endesa* case, in which the Spanish regulatory authorities were declared to be in breach of their role of control of undertakings under Regulation 139/2004, also exhibits the Commission's lack of confidence in national regulatory authorities[5].

Within Spain itself, tensions arose between sector-specific regulatory authorities and the national competition authority, CNC: in the electricity market, various operators were fined by the CNC for overpricing in the technical constraints market. The Spanish Competition Act (Ley de Defensa de la Competencia hereinafter referred as "LDC") has introduced various mechanisms for coordination among sector regulators and the competition authority with the aim of preventing these dysfunctions in liberalised markets.

In order to mitigate failures of coordination in regulated markets as a result of the overlapping intervention of two public authorities (and sometimes three authorities, if the European Commission were to come into play), which had created a sense of legal uncertainty among market operators, Spain formed in june 2013 a new regulatory authority,

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4 Case T-271/03 Deutsche Telekom (2008) ECR II 485.

5 Commission Decision M.4197, 20 december 2006, considered Spain violated Regulation 139/2004 on the control of concentrations between undertakings (the EC merger regulation), due to the adoption and entry into force, without prior communication to and approval by the Commission, of the decision made by the Spanish authorities (Minister of Industry and the National Commission of Energy) which subjected Eon's acquisition of control over Endesa to a number of conditions which are incompatible with the provisions of the Treaty on the free movement of capital and freedom of establishment, therefore unduly interfering with the Commission's exclusive competence to decide on a concentration with community dimension. This decision was challenged by Spain to the Court of Justice. The EU Court of Justice declared the validity of the Commission decision and the violation by Spain of the Treaty provisions, (Case C-196/07 Commission of the European Communities v Kingdom of Spain [2008]).

the *Comisión Nacional de los Mercados y de la Competencia*[6] (National Market and Competition Authority), merging all the sector-specific regulatory authorities and the national competition authority into a single independent entity. The intention is to achieve higher consistency in the application of regulatory policies guided by congruent principles: market entry, unbundling of network management and service provision over networks, network access, public service obligations, open competition, etc.

4.2. Regulatory legal (un)certainty for undertakings

One of the most problematic issues surrounding the process of liberalisation of regulated sectors is that market players are subject to tight regulation by regulatory authorities and governments. These fast-changing markets require that their regulatory frameworks be swiftly adapted to emerging challenges. Market players suffer from a sense of uncertainty when planning their investments and strategies, and this has given rise to legal problems. Academic commentary and the case law alike refer to this issue as "regulatory risk".

Regulatory risk is determined by a situation of instability or uncertainty in a regulated economic sector. Such instability is usually caused by a shift from a monopoly –stable and predictable by its own nature– to a free-market framework involving new economic operators and new conditions.[7]

The traditional stable regulatory framework of monopoly markets moved to the diametrically opposite situation. An entirely new regulatory framework arose, comprising both binding rules and "soft law" guidelines with a closely specialised focus on the target regulated sector, usually adopted by the competent regulatory authority. The regulatory authority concerned must have regard to the economic and technological realities shaping the development of the market: it is to be borne in mind that the law governing regulated sectors is largely economics-based.

6 Spanish Parliament Act 3/2013 on the creation of the National Market and Competition Authority (National Market and Competition Authority Act) [2013] BOE num. 134, p. 42191.

7 See Rodríguez Bajón S, 'El Concepto de Riesgo Regulatorio: Su Origen Jurisprudencial : Contenido, Efectos Y Límites' [2012] Revista de administración pública 189.

The challenge faced by the regulatory authority is that the market reality delimiting the regulations to be applied is generally unstable and unpredictable, particularly in markets in the throes of liberalisation, such as the electricity market. The fast-changing economic and social context calls for ongoing adjustments and fine-tuning and, occasionally, major shifts in the regulatory framework, particularly in sectors sharply affected by economic and technological change, which may entail that certain forms of conduct that were formerly allowed must be banned, or vice versa. It is precisely at this juncture that there is regulatory risk – the risk of a regulatory change that may, in a given set of circumstances, harm the interests or frustrate the plans of the operators subject to that change.

The Spanish Supreme Court has defined and specified regulatory risk in several decisions as a regulatory burden or obligation on undertakings operating in regulated markets, in such a way as to derogate from or refine the application of the principle of legal certainty. The decision of 11 June 2001 of the Third Chamber of the Supreme Court[8] adopts this theory of regulatory risk, declaring that:

> "Any process of liberalisation of a sector that has so far been closed to competition, by its very nature, creates certain setbacks or detriments for pre-existing economic operators; but this does not create any duty on the state to pay any damages arising from the change in the regulatory model if, in parallel to such change, the new regulations allow for the survival of the pre-existing operators –which sometimes continue, throughout the transitional period, to enjoy a dominant position in the market– on an equal footing with new operators. In many liberalised sectors the transition to a competitive market regime has not, without more, brought about the recognition of any obligation to pay compensation for the related costs.
>
> In addition, the undertakings operating under closed regimes were, or ought to have been, aware that at least since 1986, when the Kingdom of Spain became a member of the European Communities, there existed some regulatory risk that the electricity market would be opened up to competition…"

These arguments as to the delimitation of the concept of regulatory risk were later brought into play in the Supreme Court decision of 25 October 2006[9] on the electricity production market, which declares that:

8 Rec. 117/2000.

9 Rec. 12/2005.

> "Undertakings that freely decide to enter a market such as the electricity production market, which comes under a special scheme, knowing beforehand that such market is largely dependent on the grant of economic incentives by public authorities, are or ought to be aware that within statutory bounds the authorities may alter the incentives. One of the regulatory risks to which they expose themselves and must have regard to is, precisely, the risk of a change to the parameters determining premia or incentives, which the Electricity Act allays … but does not exclude."

The concept of regulatory risk can be said to be relevant to all economic activities in sectors that, generally as a result of their process of liberalisation, are extensively regulated. Undertakings and entities operating in such sectors are accordingly under a duty to be aware of the degree of instability of the market, in the sense that the regulations are subject to change based on prevailing circumstances and the objectives identified by the regulatory authority. The awareness imposed on operators must arise under reasonable conditions: the knowledge must be available to any undertaking in the market, so that the instability or likelihood of regulatory change can be ascertained without need of any special relationship with the regulatory authority that is the source of change. One of the effects of regulatory risk, therefore, is that undertakings are barred from seeking state liability for any regulatory change arising in their specific regulated sector.

4.3. Regulatory nationalism

One of the objectives of the European Union in the process of liberalisation of regulated markets was gradually to achieve a common internal market for these industries at the European level. While open competition in these markets has been achieved with the entry of new competitors, the same conclusion cannot be drawn as to the creation of a true internal market in each of the regulated sectors.

There are several reasons for this. First, sector-specific economic regulation was largely left to the discretion of national authorities, with the result that undertakings that clearly intended to take on a Europe-wide dimension through mergers and acquisitions in other Member States were prevented from doing so by decisions taken by national regulatory authorities, shaped by a clear intention to protect domestic undertakings and preserve the position of "national champions". For instance, in Spain the intervention of the National Energy Commission

in the attempted takeover of Endesa by EOn frustrated the German-based company's plans by imposing overly onerous conditions on the transaction.[10]

The protectionist stance of Member States, which stands in the way of the gradual liberalisation of regulated sectors, and particularly from the standpoint of the creation of true Europe-wide markets, is also displayed at the very core of these markets, i.e., the infrastructure over which services are provided. Traditionally, infrastructure was designed and developed to meet the needs of domestic markets rather than the European market. A clear example is rail transport: the track infrastructure in each Member State is usually incompatible with that of other Member States, so preventing any genuine liberalisation of these sectors and the rise of a European rail transport market. The same applies in the electricity sector, where the interconnections between different Member States fall short of the capacity required to ensure adequate power exchange. To resolve these issues major investments would be needed to improve existing infrastructure. Particularly in today's economic context, this is a complex and expensive proposition.

[10] As I pointed out previously in the EOn/Endesa case, the European Commission declared the violation of the Merger Regulation 139/2004 by Spain. The facts were the following: On 21 february 2006, Eon announced its intention to launch a cash offer for the acquisition of the entire share capital of Endesa. However, a few days after the announcement, the Spanish Council of Ministers (the Government) adopted a new urgent legislative measure, Royal Decree Act 4/2006, increasing the supervisory powers of the National Energy Commission (CNE). Pursuant to this Royal Decree, the acquisition by any company of more than 10% of the share capital, or any other participation conferring significant influence, in a company (directly or indirectly) active in a regulated sector, or in other certain activities has to be previously approved by the CNE. The CNE had to apply a legal test based on the following general grounds: a) the existence of significant risks or negative effects on regulated activities or certain activities subject to administrative intervention; b) the protection of the public interest in the energy sector and in particular the guarantee of proper maintenance of sector policy objectives, with special consideration given to assets deemed to be a strategic; c) public security; d) the possibility that an entity undertaking regulated activities or certain activities subject to administrative intervention cannot guarantee the exercise of these activities as a result of any other activities of the acquirer of the target entity. On behalf the Royal Decree, CNE adopted a decision submitting this operation to a number of conditions (27 july 2006). On august 10th, Eon lodged an administrative appeal before the Spanish Minister of Industry against the CNE decision, requesting in particular the declaration that the CNE is not competent to impose conditions or; alternatively, that the bid can de unconditionally authorised; or alternatively, that some of the conditions be annulled or modified. On November 3rd, the Minister decided on Eon's administrative appeal and adopted a Resolution partially modifying CNE's conditions. The European Commission adopted a decision (M.4197, 20 december 2006) declaring the violation by Spain of Regulation 139/2004 (art. 21), because Sàin did not communicated the Commission due to art. 21 the adoption of the latter conditions to the Eon/Endesa merger.

4.4. Anticompetitive behaviour of incumbents

The opening up of a regulated network industry to competition does not render that market competitive from the outset. The original monopoly undertaking retains significant market power, enjoying a dominant position.

Incumbents have used their dominant position to obstruct the entry of new operators to the regulated market or prevent it altogether. There are several examples of the abusive practices of former monopoly undertakings in regulated markets, primarily in the domains of energy and telecommunications.

Spain's former competition authority, the *Tribunal de Defensa de la Competencia* ("TDC", nowadays the Comisión Nacional de los Mercados y la Competencia, the "CNMC"), found in several of its decisions that conduct constituting abuse of a dominant position had taken place in the energy market. I shall provide a broad outline of some illustrative examples in the electricity market.

Abuse of a dominant position was declared to exist in the electricity production market in the context of technical constraints, where wholesale electricity bids and sales are matched. In *Empresas Eléctricas*[11], the TDC declared that the leading electricity undertakings –Endesa Generación, Iberdrola Generación, Unión FENOSA Generación and Hidrocantábrico Generación– on certain days on the wholesale electricity market put in unusually high bids in the awareness that they would not be matched on the intraday market, with the result that those bidders would later be called upon to resolve bid and ask asymmetries by means of the technical constraints mechanism in those areas where each respectively formerly enjoyed a monopoly position.

Abuse of a dominant position was also found to exist in related markets, such as installations performance, where incumbents would leverage a dominant position in the market for electricity supply (see *Asinem/Endesa* [12]).

[11] Competition Defence Tribunal Decision Case 552/02 Empresas Eléctricas [2004].

[12] Competition Defence Tribunal Decision Case 606/05 Asinem/Endesa [2006].

A further problematic source of anticompetitive conduct by incumbents is national laws and authorities themselves: on many occasions, the application of competition law is derogated from by virtue of exceptions introduced by statute or by a decision or act of a national regulatory authority.

By way of illustration of this, an undertaking having a dominant position can feasibly defend an allegedly abusive practice that is lacking in express legal justification on the grounds that such practice was directly or indirectly imposed or endorsed by the regulatory authority. In principle, it can be asserted that such conduct ought not to be caught by Article 4 of the Spanish Competition Act[13] if the undertaking having a dominant position does no more than apply a policy specifically adopted by the regulatory authority, because here the undertaking has no discretion in the adoption of the practice under investigation; or if, in general, the undertaking's conduct is directly required by the existing regulatory framework with which the undertaking must comply. One of the leading cases in this area arose in the realm of telecommunications, where dominant telecommunications operators set prices and rates specifically approved and authorised by the regulatory authority, the Comisión del Mercado de las Telecomunicaciones (CMT). It would appear obvious that, insofar as the CMT not only permits but even requires the dominant operator to charge a given regulated rate, Article 4 of the Spanish Competition Law does not apply, owing to the undertaking's having no autonomy or discretion in the matter. But the issue remains unclear. The European Commission fined Telefónica for charging prices that had been previously authorised by the CMT. The underlying problem, of course, is that the objectives of regulatory policy differ from those of competition law, and the issue is which of the two ought to prevail. Here, the Commission took the view that European competition policy must prevail over national sector-specific regulations.

The conclusion can be drawn that the dysfunctions arising from the liberalisation of regulated markets have been gradually resolved by the trenchant intervention of both the European and national com-

[13] Spanish Parliament Act 15/2007 on Competition Defence, (Competition Defence Act) [2007] BOE num. 159, p. 28848-28872.

petition authorities, which have imposed severe penalties on market incumbents for their various anticompetitive practices.

4.5. The interplay between regulation and competition law in liberalised markets

As indicated earlier, the liberalisation of regulated sectors, particularly those based on network infrastructure, has entailed extensive regulatory activity. The critical issue discussed in the courts is whether or not businesses subject to sector-specific regulation are also subject to the general law of competition, primarily having regard to the fact that the transversal nature and purpose of competition law means that its scope encompasses all businesses conducted on the basis of open competition[14].

The consequence of this reality is that one and the same course of conduct is often addressed from two distinct legal standpoints: the regulations specific to the liberalised market under consideration, and general competition law. This situation creates a measure of legal uncertainty for operators doing business in liberalised markets.

In general terms the distinction between economic regulation and competition law is founded on the assumption that the former operates ex ante as a means to regulate sectors with a natural monopoly framework, whereas competition law is used on an ex post control basis to punish some specific types of illegal conduct by the undertakings which operate in competitive markets. Therefore, regulation is supposed to impose positive, prescriptive rules on market players, while competition legislation is assumed to mainly prohibit and punish certain unlawful behaviour. With the progressive liberalisation of network industries competition law began to acquire goals similar to those of regulation. Market regulation and competition law started to serve analogous functions.

[14] See Laguna de Paz JC, 'Regulación Sectorial Y Normas Generales de Defensa de La Competencia: Criterios de Relación' [2010] Civitas. Revista española de Derecho Administrativo 87, p. 89; Montero Pascual JJ, 'Regulación Económica y Derecho de La Competencia. Dos Instrumentos Complementarios de Intervención Pública Para Los Mercados de Interés General', Fundamentos de regulación y competencia (El diálogo entre Derecho y Economía para el análisis de las políticas públicas) (IUSTEL 2009); Lorenzoni L, 'The Role of Competition Law in Network Industries Subject to Sector-Specific Regulation', Derecho de la Competencia Europeo y español. Volumen XI (Dykinson 2013), p. 244.

Despite this apparent convergence of perspectives, it is also true that the objectives pursued by competition law do not coincide exactly with those of economic regulation. Competition law is designed with the aim of preserving competition in a given market, whereas economic regulation is intended to shape the market structure of a liberalised market in order to promote the entry of new players to a former monopolistic market. The divergences in the goals of competition law and regulation lead to different standards of administrative enforcement under the two sets of rules. Regulatory enforcement is not as strict as competition enforcement, given that economic regulation is aimed at promoting entry to a liberalised market while competition law, in principle, is aimed at preserving the existing market structure from being distorted.

This specific reality leads in some cases to problems of overlap between economic regulation and competition law enforcement by different administrative agencies –national regulatory authorities and the European Commission– and has created a serious problem with the principle of legal certainty for undertakings operating in liberalised markets.

Two leading examples of this trend are the *Deutsche Telekom*[15] and *Telefonica*[16] cases. In Deutsche Telekom, the price regulation set by the German regulator left scope for abusive conduct under competition law. The General Court[17] upheld the Commission decision to enforce Article 102 TFEU, on the view that the firm had a sufficient margin of appreciation to adjust prices to avoid abusive conduct. The decision has been criticised for having extended the scope of Article 102 to solve certain regulatory failures of the German telecommunications market. The principal argument adduced by Deutsche Telekom was in fact that its prices were approved by the national regulatory authority; hence the presence of ex ante regulation would have shifted the responsibility for "maintaining the structure of the market from the regulated undertaking to the regulatory authority"[18].

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15 Case C-280/08 P *Deutsche Telekom v Commission* [2010].

16 Case T-336/07 *Telefónica and Telefónica de España v Commission* [2012].

17 Case T-271/03 *Deutsche Telekom v Commission* [2010].

18 See n. 15 above.

The ECJ rejected that claim on the basis that, even though it was possible that the German authorities also infringed Community law, when national law leaves a margin of discretion to undertakings, nothing prevents their behaviour from being subject to competition law enforcement.

The *Telefonica* case is another example of the overlap between economic regulation and competition law enforcement. It is similar to *Deutsche Telekom* except for a critical difference. While in *Deutsche Telekom* the regulatory intervention left scope forabusive conduct, in *Telefonica* the effective national regulatory intervention did put an end to the margin squeeze. The Commission fined the undertaking for abuse of a dominant position despite the previous intervention of the Spanish telecommunications authority which had intervened both *ex ante* and ex post on Telefonica's pricing conduct. On the *ex ante* argument the Commission reasoning was very similar to that in *Deutsche Telekom*, stating that the incumbent operator had sufficient commercial discretion to put an end to the abuse. As for the *ex post* legal analysis, the fact that the Spanish telecommunications regulator was not a competition supervisor but a regulatory authority, and that the measures adopted concerning Telefonica's behaviour were not based on Article 102, was enough for the Commission to exclude a risk of "double jeopardy" and to consider appropriate the competition enforcement. The legal reasoning for its intervention was based on the different methodology used to assess the same behaviour. While the Spanish national authority had intervened on the basis of forecasts, the Commission intervened on the basis of historical data; therefore the two authorities came to different conclusions. The General Court upheld the Commission decision, stating that:

> "[T]he decisions adopted by the NRAs on the basis of the 2002 regulatory framework do not deprive the Commission of its power to take action at a later stage in order to apply Article 82 EC by virtue of Regulation No 17 and, since 1 May 2004, Regulation 1/2003. Nor does any provision of that framework oblige the Commission to establish the existence of exceptional circumstances in order to justify its action in such a case, as the applicants claim."[19]

[19] Case T-336/07 Telefonica and Telefonica de España v. Commission [2012].

5. Some prospects

The process of liberalisation and concomitant regulation of network industries, involving their gradual opening up to competition and the entry of new operators, has brought significant benefits to the citizens of the EU: lower prices, higher quality, technological development, etc. However, as outlined above, a range of problems have emerged from the liberalisation of network industries in the EU as a result of widely different factors, both regulatory and organisational.

From a regulatory standpoint, a determined bid must be made to achieve better regulation, led by the European institutions and bolstered by a vital relationship of coordination and cooperation with national regulatory authorities. The transposition and implementation of future directives regulating these markets must accordingly be swift and effective; in addition, Member States must be prevented from using such implementation as a way to adopt protectionist measures designed to preserve privileges and special rights of former monopoly undertakings which in some markets continue to enjoy a dominant position.

From this legal perspective it is also necessary to clarify the scope and boundaries of competition law and economic regulations. It would appear unreasonable that a lack of clarity as to the scope of each of these two sets of rules should undermine the principle of legal certainty for operators doing business in regulated markets. A stable legal framework should be defined, supported by a measure of regulatory flexibility, so as to allow for the suitable progress of liberalisation in these markets.

Moreover, from the organisational standpoint, the areas of competence and scope of action of national and European regulatory and competition authorities ought to be clearly defined. In this respect, the approach adopted by Spain –merging sector-specific regulators with the competition authority to create a "macro regulator" (CNMC)– should support improved coordination between competition policy and the various regulatory policies. However, I believe that closer integration and higher transparency is still needed in the relationship between national regulatory authorities and the European Commission, specifically its competition arm (DGCOMP), so as to reinforce legal certainty for operators in regulated network industries, which in turn may aid progress in the process of liberalisation.

Part III

Social challenges in the SEM

5

Modernising Social Services in the Single Market: Putting the Market into the Social

ALBERT SÁNCHEZ GRAELLS* **& ERIKA SZYSZCZAK****

ABSTRACT

This paper takes the UK reform and modernisation of health care as a case study to examine how far Member States must pay attention to EU economic law in the reform of public services (SGEI) to modernise such services in the interest of cutting back on public expenditure and introducing efficiency and competition in their supply. This case study is relevant both for Member States (directly) running a national health system (like the UK) and those relying on private medical provision totally or partially funded through insurance mechanisms (such as the Netherlands), since it ultimately reflects on the impact that market competition can have in the effective provision of health care as an SGEI.

KEY WORDS: EU Single Market, Public Procurement, State Aid, Competition, UK Health Care Reform, Social Economy, Services of General Interest, Public Sector Reform.

1. Holding the balance; economic and social values post the Treaty of Lisbon 2009

"The crisis has induced some critical reconsideration of the functioning of markets. It has also enhanced concerns about the social dimension. The Treaty of Lisbon […] makes it explicit for the first time - though the principle was already clearly set

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> out in the preamble of the Treaty of Rome - that "the Union [...] shall work [...] for a highly competitive social market economy". All this calls for a fresh look at how the market and the social dimensions of an integrated European economy can be mutually strengthened."[1]

The Treaty of Lisbon 2009 heralded a re-calibration of the social-economic balance of values in the EU Treaties. In particular a constitutionally entrenched boundary between economic and non-economic activities was created in Article 14 TFEU where a distinction is made between public services, known as Services of General Economic Interest (SGEI) and non-economic services of general interest (NESGI). This distinction is reinforced in Protocol No. 26 on Services of General Interest (SGI), setting a means of dividing competences between the EU and the Member States. The near absence of an EU social dimension in the earlier Treaties had allowed the Member States leeway in developing national policies on public services and protecting these policies from outside competition. This paper will argue that in fact the competence of the Member States to develop national public services is curtailed by the operation of EU economic law, which may restrict and may inhibit the necessary degree of diversity and experimentalism needed to modernise and provide efficient public services in the EU. This mirrors more general constitutional questions linked to the distribution of powers between the EU and the Member States and it can contribute to that debate, although this is not the main focus of this paper. In this paper, the modernisation of health care in the UK is taken as a case study to show the potential constraints faced by a Member State in the redesign of its public service provision. This case study is relevant both for Member States (directly) running a national health system (like the UK, Belgium or Spain, amongst others) and those relying on private medical provision totally or partially funded through insurance mechanisms (such as the Netherlands), since it ultimately reflects on the impact that market competition can have in the effective provision of health care as an SGEI. The UK is a front-runner in the reform of its system for the provision of health care services and, consequently, the lessons that can be extracted from the UK experience may prove valuable for other Member States embarking in similar processes.

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[1] Mission letter from the President of the European Commission, José Manuel Barroso, Preface to *A New Strategy for the Single Market at the Service of Europe's Economy and Society*, Report to the President of the European Commission José Manuel Barroso by Mario Monti (The Monti Report) 9 May 2010. Available at: http://ec.europa.eu/bepa/pdf/monti_report_final_10_05_2010_en.pdf

At EU level, initially, the emphasis upon the social dimension to European integration was boosted by the CJEU providing intellectual leadership by allowing individuals to access public services in another Member State by developing the concept of Citizenship of the Union, replacing the traditional territorial boundaries with a new single market for public services. However, there is a lack of symmetry in this process.[2] In shaping the supply side of public services it has proved not to be as easy to open up cross-border markets, outside of the liberalisation of the networked industries.[3] The CJEU has shown that there can be incentives for competition to materialise in public social services, for example, by allowing patients seeking alternative health care in another Member State to utilise the free movement provisions of EU economic law.[4] However, despite the push for patients' rights and free movement, health care supply side reform is largely underdeveloped. The creation of markets in cross-border health care is the exception with the majority of social public services continuing to be provided within territorial boundaries. At first sight the Member States have been allowed to create a safe, protected, laboratory to experiment with different forms of liberalisation, or marketization, of such services within their own territorial and cultural space. This has been achieved through the use of exemptions and safe havens created in EU secondary law and European Commission soft law communications.[5]

However, the fiscal crisis has created a countervailing pull to the evolution of a national-led social dimension to the EU by focusing the re-shaping and recalibration of public services as "economic" services, guided by considerations of competition and efficiency. The drive for the marketization of social services is taking place not only through demands made by the response to the fiscal and economic crisis but also the marketization processes inevitably have led to the application of competition law to areas of state activity previously shielded from the economic law of the EU. The need, on the one hand, to shield public services from competition, but, on the other hand, to ensure a level

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2 Erika Szyszczak, 'Legal Tools in the Liberalisation of Welfare Markets', Ruth Nielsen *et al* (eds), *Integrating Welfare Functions Into EU Law – From Rome to Lisbon* (DJØF Pub, 2009).

3 See, for example, Case C-70/95 *Sodemare* [1997] ECR I-3395.

4 See generally Johan van de Gronden et al (eds) *Health Care and EU Law*, TMC Asser Press.

5 Erika Szyszczak, 'Soft Law and Safe Havens', Ulla Neergaard et al (eds), *Social Services in the EU*, (TMC Asser Press, 2012).

playing field where significant amounts of public expenditure, as well as access to ancillary markets is concerned, has blurred the boundaries of EU law. Moreover, this is generating strong pressure on some of the 'creative' legal solutions adopted by the CJEU when trying to protect the Member States' space of freedom from the checks and balances derived from EU economic law.

Indeed, the EU approach to addressing the legal issues raised by the increased marketization of social services has been ad hoc and confused. The CJEU has used traditional tools of classifying (and in particular, *not* classifying) social activities as "economic", taking them beyond the reach of EU economic law. Similarly the Member States have fought hard to carve out exemptions, or limitations, from the application of EU secondary law to a number of social services. In contrast the European Commission has created a new form of governance through soft law communications to retain a normative dimension to EU regulation of social services.[6] As we shall discuss in some further detail, some of these 'informal' protections may be about to require a redesign at EU level if the provision of public services is still to enjoy a protected treatment (*ie* if they are to continue outside the scope of application of competition and other EU economic law rules).

2. Reform and modernisation of public services

The current economic crisis has created challenges for the Member States to continue to supply and adapt public services under the existing material and financial structures. Member States are under significant pressure to find new ways of meeting their social duties with increased "efficiency" or, in other terms, under pressure to achieve significant savings that allow them to remain in compliance (or to attain compliance) with financial stability obligations without completely dismantling the welfare state.

Public sector reform initiatives, and specifically those concerned with public service provision, need to be compliant with an increasingly complicated web of EU rules and principles. Despite the increasing relevance of solidarity and the continued treatment of social services

6 Ibid.

as a matter of exclusive legislative competence of the Member States, compliance with secondary EU legislation and with soft law instruments adopted by the European Commission (indirectly) bring social services within the sphere of EU economic law (*lato sensu*).

Recent reforms in State aid and public procurement, emanating from the Monti Report, make it particularly challenging for Member States to 'rethink and redesign' the strategies for the provision and financing of social services.[7] The adoption of 'competition-based' solutions or 'market-oriented' formulae for the provision of social services tend to imply the need to overcome a set of EU regulatory hurdles or controls at different stages of the process. Such controls make it difficult for Member States to seek efficiency gains without resorting to the (private) market and, consequently, limit their strategies as soon as there is any type of private participation (generally, by means of financial transfers, acquisition of ownership or conclusion of contracts). Unless Member States rearrange their schemes for the provision of public services without any private participation whatsoever, EU economic law kicks in and generates a complicated regulatory landscape that may impose significant restrictions on the Member States' competence to autonomously decide how best to provide public services under the new circumstances.

Given the focus of EU policy-making on the identification of good practice, as well as the usefulness of focussing the abstract debates on their implications for day-to-day policy-making, we will concentrate our attention on the initiatives of the UK Government to re-design its public sector in order to better provide public services. We have chosen health care as a case study because it is an area that is undergoing reform across

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7 In particular the Almunia Package up-dating the earlier European Commission Package on *Altmark* which regulates the financing and operation of SGEI: Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, OJ 2012 C8/4; Commission Decision of 20 December on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest OJ 2012, L7 p.3; Communication from the Commission**,** European Union framework for State aid in the form of public service compensation OJ 2012 C8/15; Commission Regulation on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to und ertakings providing services of general economic interest, OJ 2012, L 114/8. European Commission instrument to determine swap rate proxies, available at: http://ec.europa.eu/competition/state_aid/legislation/swap_rates_en.html. See generally, Erika Szyszczak and Johan van de Gronden, (eds), *Financing Services of General Economic Interest: Reform and Modernization* (TMC Asser Press, 2012).

Europe and has attracted the attention of the European Commission, especially in relation to State Aid, alongside generating a steady stream of litigation at the national level, with several cases being referred to the CJEU.[8] Thus the relevance of health care within such a global strategy provides an opportunity to focus, with some detail, on the current reform of the NHS and the recently adopted new National Health Service (Procurement, Patient Choice and Competition) (No. 2) Regulations 2013[9] (hereinafter, 'NHS Procurement, Patient Choice and Competition Regulations 2013').

3. Introducing competition into the NHS

Over the last decade the UK government has introduced a number of incremental reforms to increase the role of competition and improve the quality of health care in the NHS in England. Between 2003 and 2008 Independent Sector Treatment Centres (which are privately owned but treat only NHS patients) were created. Also from 2007 privately owned hospitals were granted access to NHS markets to treat NHS patients alongside private patients. The initial aim of the market-opening was to reduce the waiting lists for NHS treatment but in 2006 patients were given the formal right to choose where to receive out-patient treatment. More recent, and controversial, reforms have opened up the market for NHS elective health care to non-NHS providers established on a "for-profit" basis. The aim of the reforms has been to generate competition between NHS and private health care providers, to enhance patient ("consumer") choice, as well as improving quality and encouraging innovation in the provision of health care in England.[10] One outcome has been that some private health care companies have acknowledged that revenue from

8 Johan van de Gronden and Erika Szyszczak, 'Introducing Competition Principles into Health Care through EU Law and Policy: A Case Study of the Netherlands', (2014) *Medical Law Review* 22 (2): 238-254.

9 2013 No. 500, entering into force on 1 April 2013. For commentary, see A Sánchez Graells, 'New Rules for Health Care Procurement in the UK. A Critical Assessment from the Perspective of EU Economic Law' (February 2, 2014), University of Leicester School of Law Research Paper No. 14-03. Available at SSRN: http://ssrn.com/abstract=2389719

10 C. Naylor and S. Gregory, Briefing: independent sector treatment centres, Kings Fund 2009. http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&ved=0CC8FjAA&url=http%3A%2F%2Fwww.kingsfund.org.uk%2Fsites%2Ffiles%2Fkf%2Ffield%2Ffield_publication_file%2Fbriefing-independent-sector-treatment-centres-istc-chris-naylor-sarah-gregory-kings-fund-october-2009.pdf&ei=jE4wUs__O4ephAfMp4CgAw&usg=AFQjCNEPvraYOwZr-2lCxTiSXcZtkWQsVw&sig2=asRDE8wd6ugWn9dUtKd0RA&bvm=bv.51773540,d.ZG4 (last accessed 11 September 2013).

NHS patients has compensated for falls in demand from private patients as a result of the economic downturn.[11]

The 2011 Open Public Services White Paper set out the blueprint for a significant reform of the public sector in the UK and described the main lines of a strategy for the promotion of new modes of provision of public services.[12] Of its five core principles, those of major relevance from the perspective of EU economic law are that:

> 'public services should be de-centralised to the lowest appropriate level, giving communities more control over public services', and that 'public services should be open to a range of providers in the public, private or voluntary sectors'.

These parallel trends of decentralisation (or local devolution) and privatisation (or, at least, marketisation[13]) of public service provision create a rich field for the analysis—and the lessons to be extracted are equally relevant to Member States with and without a national health system, particularly as local devolution, public management and market competition are affected. Ultimately, EU competition, State aid and public procurement law and policy are all concerned, to a varying degree, with instances of public-public cooperation and public access to service markets.

At first sight, it seems that the declared goals of the UK strategy are well aligned with the market-based approach to the regulation of public services. A key element in the public sector reform strategy is the "spin-off" of public sector units due to be transformed into 'public sector mutuals'.[14], Despite the use of the term 'mutuals', the legal entities to be created as a part of the public sector reform strategy do not match the

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11 S. Arora et al, 'Public Pay and Private Provision: the Changing Landscape of Health care in the 2000s', Nuffield Trust and IFS Research Report, 2013. Available at: http://www.nuffieldtrust.org.uk/sites/files/nuffield/publication/130522_public-payment-and-private-provision.pdf last accessed 2 September 2013

12 HM Government, *Open Public Services White Paper*, July 2011, available at http://files.openpublicservices.cabinetoffice.gov.uk/OpenPublicServices-WhitePaper.pdf last accessed 2 September 2013

13 A Koukiadaki, 'EU governance and social services of general interest: When even the UK is concerned', J-C Barbier (ed) *EU Law, Governance and Social Policy*, European Integration online Papers (EIoP), Special Mini-Issue 1, 2012, Vol. 16, Article 5.

14 The Government is trying to attract interest from civil servants and public employees to set up their own mutuals. See their 'mutualisation portal' at https://www.gov.uk/government/get-involved/take-part/start-a-public-service-mutual, last accessed 2 September 2013.

traditional concept of 'mutual' under UK company law, since those are organisations that are owned by, and run for the benefit of, their current and future members.[15] As recently announced by the Cabinet Office, there is plan for the creation of public sector mutuals entrusted with the provision of public services.[16] In broad strokes, the UK Government is promoting the "spin-off" of a significant number of state-owned services into independent companies that will be jointly owned by the Government, private investors (with a share of up to 50%) and workers (up to 25%), and to which the Government will then guarantee contracts for a number of years coupled with the businesses free to sell their services in the market.[17]

The degree of Government involvement remains unclear. The Cabinet Office indicates that mutuals should be '*free from government control*' and, consequently, fully privately-owned; whereas the Mutuals Taskforce works with a different definition of (public sector) mutuals, which are conceived as:

> 'organisations which: 1. have left the public sector (also known as 'spinning out'), and 2. continue to deliver public services, and 3. in which employee control plays a significant role in their operation'

In any case, given the Government's effort in promoting access to finance for newly established mutuals,[18] as well as the temptation to retain some control or influence on the "spin-off" services may complicate the picture and require Government ownership (or the ability of Government

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15 HM Treasury, *Mutuals*, available at: http://www.hm-treasury.gov.uk/fin_sector_mutuals_index.htm last accessed 2 September 2013. 'Public sector mutuals' will rather be employee-owned companies or businesses and, consequently, will not be subjected to any special regime from a corporate law perspective. This new form of hybrid entity will be relevant for the analysis of this paper.

16 The full plan of the Mutuals Taskforce, 'Public Service Mutuals: The Next Steps', is available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/61776/Public-Service-Mutuals-next-steps.pdf, last accessed 2 September 2013

17 See Mutuals Taskforce, *Report on 'Public Service Mutuals - The Next Steps'*, 25 June 2012, available at http://mutuals.cabinetoffice.gov.uk/documents/mutuals-taskforce-report-public-service-mutuals-next-steps last accessed 2 September 2013. See also O Wright, 'The great Civil Service sell-off: Dozens of services and 75,000 staff set to be transferred to private sector', *The Independent*, 1 May 2013, available at http://www.independent.co.uk/news/uk/politics/the-great-civil-service-selloff-dozens-of-services-and-75000-staff-set-to-be-transferred-to-private-sector-8598188.html last accessed 2 September 2013

18 See Cabinet Office, *Renewed focus on mutuals access to finance*, http://mutuals.cabinetoffice.gov.uk/renewed-focus-mutuals-access-finance, last accessed, 2 September 2013. Indeed, one of the complicated issues derives from the granting of 'advantaged' access to finance by the Government itself, so experts are recommending that '*Government should ensure that 'soft finance' such as grant funding does not crowd out commercial finance*'.

to still influence in a decisive manner the decision-making processes of the "spin-off" public sector mutuals). Moreover, given the clear strategy of 'pre-assigning' contracts to the "spin-off" mutuals, it is hard to consider that these undertakings will be independent from Government, at least during their first years of economic activity, since the 'ear marked' Government contracts will be essential for their consolidation, as clearly indicated in one of the recommendations of the Taskforce on Mutuals,[19] which:

> 'recommends that the Cabinet Office should advise commissioners across the public sector to use the flexibilities available, working within the regulations, to compete and award longer contracts depending on the service being commissioned. Wherever possible it is the view of the Taskforce that contracts should be at least five years in duration to allow providers (including, but not limited to mutuals) to invest in new services and improved delivery.'

The specific steps for the rollout of this strategy remain relatively unclear and a case-by-case approach seems in place. However, there are common unavoidable phases, such as the creation of the new corporate entity and the assignment of the property thereon, the transfer of assets and personnel from the public sector to these newly created entities, the design of the contractual arrangements required for the commissioning or outsourcing of the relevant public service activities, and the design of market strategies for the public and non-public activities of the "spin-off" businesses. Each of these phases, however ordered, raises competition, State aid and public procurement concerns. Even if the final picture is relatively straightforward, and market based, and foresees the existence of a relatively large number of small to medium (independent) providers of local services to the Government or, directly to users,[20] the procedures

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[19] Recommendation No 9, Mutuals Taskforce, *Public Service Mutuals: The Next Steps*, available at http://mutuals.cabinetoffice.gov.uk/sites/default/files/documents/Public%20Service%20Mutuals%20next%20steps.pdf

[20] However, particularly in the health sector industry, both the issues of atomisation of supply and (local) competition can be doubted in view of the preliminary findings in the sectoral inquiry being carried out by the UK Competition Commission on private health care provision. See Competition Commission, *Private health care market investigation—Notice of provisional findings*, 28 August 2013, available at http://www.competition-commission.org.uk/assets/competitioncommission/docs/2012/private-healthcare-market-investigation/130828_notice_of_pfs.pdf, last accessed 2 September 2013. However, three private health care undertakings brought a successful judicial review before the Competition Appeal Tribunal, successfully arguing that the procedures for obtaining confidential information were flawed: Case Number: 1218/6/8/13, *BMI Healthcare Ltd, HCA International Limited, Spire Healthcare Group and Competition Commission and London Clinic* http://www.catribunal.org.uk/167-8199/Judgment-.html

and the decisions on where, and how, to open public competitions (for ownership, for assets, for contracts, or for future business and market interaction) can have a major influence on the legal viability of the strategy.

Some arrangements are unlikely to pass legal muster, since they can imply significant restrictions of the EU fundamental freedoms involved, particularly the free movement of services and free movement of capital, and breaches of State aid and public procurement rules. It is worth stressing that, if these procedures are not structured and timed in the proper manner, the UK could easily fall foul of the relevant rules and exceptions to the current EU public procurement Directives: the *'public-public' cooperation* exception,[21] the *'in-house' provision* exception,[22] and the direct award of contracts on the basis of exclusive rights (which abuse determines the *ineffectiveness of the contracts)*.[23]

It is also worth noting that the new Directive 2014/24 on public procurement includes some potential changes that could contribute to further legal complications, depending on the final calendar for the transposition of the new EU rules for the procurement of social and other services –which in any case need to be transposed by 18 April 2016.[24] Local authorities may also have an additional regulatory incentive to avoid 'market contact' in order to minimise State aid risks. Hence, the rules on State aid to services of general economic interest[25] will also be relevant, particularly once the "spin-off"

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21 See Commission Staff Working Paper concerning the application of EU public procurement law to relations between contracting authorities ('public-public cooperation') - SEC(2011)1169, October 2011, available http://ec.europa.eu/internal_market/publicprocurement/partnerships/cooperation/index_en.htm

22 Which is about to be refined by the CJEU as a result of a pending request for a preliminary ruling from Portugal: Case C-574/12, *Centro Hospitalar de Setúbal and SUCH*. See "Case C-574/12, Centro Hospitalar de Setúbal and SUCH – Teckaling similar control for the 'in-house' exception to EU procurement law" EU Law Radar, 17 March 2013, available at: http://eulawradar.com/case-c-57412-centro-hospitalar-de-setubal-and-such-teckaling-similar-control-for-the-in-house-exception-to-eu-procurement-law/

23 See http://ec.europa.eu/internal_market/publicprocurement/infringements/remedies/index_en.htm

24 For background, see A Morton, 'European Union Public Procurement Law, the public sector and Public Service Provision', *European Public Services Briefings* 4, July 2012, available at http://www.european-services-strategy.org.uk/news/2012/european-public-services-briefing-4-european-u/eu-public-procurement.pdf, last accessed 2 September 2013.

25 See http://ec.europa.eu/competition/state_aid/legislation/sgei.html, last accessed 2 September 2013.

companies start competing in the market and incumbents or new entrants raise claims that public participation and public contracts allow them to cross-subsidise activities and compete unfairly for public and private business. Therefore, a spill-over effect of this mutualisation and 're-financing' phenomena will be the appearance of 'publicly-sponsored suppliers' of services that may enter into competition with existing (or new) private undertakings, hence reshaping market structures and generating a need to ensure competitive neutrality in the markets for the provision of public services.[26]

Indeed, one of the main concerns underlying the adoption of the public sector reform strategy by the UK Government is precisely its compatibility with existing EU economic law. This is a strategy that deserves close scrutiny by the competition watchdog, as anticipated by the then Office of Fair Trading[27] in its 2013-14 Annual Plan, where it stressed that it:

> "may focus on IT and local government issues in particular and work with government partners on a range of issues relating to the public sector reform agenda to ensure that government interventions maintain competitive markets. In addition to advocacy and influencing, [the OFT] will consider using the full range of tools at our disposal to tackle any breaches of competition law identified in public service markets."[28]

A similar close scrutiny can be expected from the European Commission and, more generally, there appear to be clear opportunities for public procurement related litigation, depending on how the strategy is rolled-out and its market effects taken into consideration.

In some areas of the public sector, the need to carry out the reform while maintaining competitive markets may be limited by a political

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[26] See OECD, *Competitive Neutrality: Maintaining a level playing field between public and private business*, 30 August 2012, available at http://www.oecd-ilibrary.org/industry-and-services/competitive-neutrality_9789264178953-en, last accessed 2 September 2013.

[27] The OFT has been fully integrated into the Competition and Markets Authority April 2014.

[28] Indeed, at least from a competition law perspective, there are clear concerns that have prompted the prioritisation of 'public services markets' in the OFT's, *Annual Plan 2013–14*, OFT1462, available at http://www.oft.gov.uk/shared_oft/about_oft/annual-plan13-14/OFT1462.pdf last accessed 14 May 2013. Similarly, issues of compatibility with EU public procurement law are evident in the Cabinet Office and Mutuals Taskforce, *Joint Paper on 'Procuring Services from Public Service Mutuals'*, available at http://mutuals.cabinetoffice.gov.uk/documents/procuring-services-public-service-mutuals-joint-cabinet-office-and-mutuals-taskforce-paper, last accessed 14 May 2013

preference for other policy goals. In the specific case of the health care system (which can be affected, at least partly, by the more general public sector reform), the UK Parliament has enacted a controversial provision whereby, in the scope of the commissioning activities of the NHS, a concept of "patients' interest" can trump competition law considerations, as long as a cost/benefit analysis indicates that the 'net' result of the anticompetitive public sector activity is positive, in terms of the needs of the users of the service, labelled as patients' interests.

Indeed, the recently adopted NHS Procurement, Patient Choice and Competition Regulations 2013 includes a provision authorising anti-competitive behaviour in the commissioning of NHS services, as long as it is in the interest of health care users. According to Regulation No 10:

> 10.–(1) When commissioning health care services for the purposes of the NHS, a relevant body must not engage in anti-competitive behaviour [i.e. behaviour *which would (or* would be likely to) *prevent, restrict or distort competition], unless to do so is in the interests of people who use health care services for the purposes of the NHS which may include–*
>
> *(a) by the services being provided in an integrated way (including with other health care services, health-related services, or social care services); or*
>
> *(b) by co-operation between the persons who provide the services in order to improve the quality of the services.*
>
> (2) An arrangement for the provision of health care services for the purposes of the NHS must not include any term or condition restricting competition which is not necessary for the attainment of–
>
> (a) intended outcomes which are beneficial for people who use such services; or
>
> (b) the objective referred to in regulation 2[29]. (emphasis added)

The only illumination provided in the Explanatory Memorandum[30] of the 2013 Regulations is that:

> 'The Regulations place further requirements on commissioners to ensure accountability and transparency in their expenditure. In particular: [...] not to

[29] Regulation 2, entitled 'Procurement objective' establishes that: '2. When procuring health care services for the purposes of the NHS […], a relevant body must act with a view to—(a) securing the needs of the people who use the services, (b) improving the quality of the services, and (c) improving efficiency in the provision of the services, including through the services being provided in an integrated way (including with other health care services, health-related services, or social care services)'. For discussion, see Sanchez Graells, 'New Rules for Health Care Procurement in the UK', above n 9.

[30] http://www.legislation.gov.uk/uksi/2013/500/memorandum/contents, last accessed 2 September 2013.

> engage in anti-competitive behaviour unless to do so is in the interest of patients. Regulation 10 makes clear that behaviour in the interests of patients may include services being provided in an integrated way or co-operation between providers in order to improve the quality of services. This reflects the Government's firm view that competition is a means to improving services and not an end in itself.'

Generally, then, it seems that under the new NHS public procurement rules, whatever is considered in the 'interest of patients' can trump pro-competitive requirements and allow the commissioning entity to engage in distortions of competition. Even if Regulation 10(2) sets a clear proportionality requirement, the general impression is that this 'anti-competitive authorisation' may be at odds with the general requirements of EU public procurement law and, more specifically, with the principle of competition embedded in the public procurement Directives (recently consolidated in Article 18 of the new Directive 2014/24 on public sector procurement[31]) so that the application of Regulation 10(1) for contracts covered by EU law (*ie* when there is cross-border interest) may result in a breach of those Directives.

In that regard, the enforcement and substantive guidance published by the UK's health care sector regulator *Monitor* is particularly relevant.[32] According to such substantive guidance, *Monitor* will assess the appropriateness of engaging in anti-competitive behaviour on the basis of a cost/benefit analysis. Indeed, it is explained that:

> '*When will behaviour be anti-competitive and not in the interests of users of health care services?*
> Where a commissioner's conduct is in the interests of patients its behaviour will not be inconsistent with the prohibition on anti-competitive behaviour in Regulation 10. In assessing whether or not anti-competitive behaviour is in the interests of health care service users, Monitor will carry out a cost/benefit analysis. Monitor will consider whether by preventing, restricting or distorting competition behaviour gives rise to material adverse effects (costs) for health care service users.

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31 Above n 24. Article 18(1) establishes that "Contracting authorities shall treat economic operators equally and without discrimination and shall act in a transparent and proportionate manner. The design of the procurement shall not be made with the intention of excluding it from the scope of this Directive or of artificially narrowing competition. Competition shall be considered to be artificially narrowed where the design of the procurement is made with the intention of unduly favouring or disadvantaging certain economic operators".

32 See the several documents available at http://www.monitor.gov.uk/regulating-health-care-providers-commissioners/cooperation-and-competition/our-cooperation-and-compe, last visited 2 September 2013.

> If we find that behaviour gives rise to material costs, we will consider whether it also gives rise to benefits that could not be achieved without the restriction on competition.
>
> Monitor will then weigh the benefits and costs against each other.'

The methodology for the cost/benefit (both clinical and non-clinical) analysis is explained and, at the bottom line, when weighing the relevance, *Monitor* will take into consideration that

> 'This is not a mathematical exercise, but rather a qualitative assessment. Relevant benefits might outweigh costs when, for example, as a result of a commissioner's actions there is a reduction of competition between a small number of providers, but a significant number of other providers of the relevant services remain and the clinical benefits of the initiative are significant and well evidenced.'

Given the very open-ended methodology described in the document and this final consideration, the impression is that the analysis to be carried out by *Monitor* may err on the side of allowing for an excessive amount of anti-competitive behaviour, particularly in view of the potential relevance given to qualitative (and, hence, difficult to measure, benefits). Such a lenient approach is not exactly matched when *Monitor* indicates the type of factors it will take into consideration when assessing whether a commissioner has engaged in disproportionate or unjustified anti-competitive behaviour, which include examples such as whether the commissioner:

> 'has limited the extent to which providers are able to compete to attract patients to their services, for example, by limiting the total number of patients a provider can treat or the income a provider can earn, or by restricting the providers to whom a provider can refer patients for further treatment, without objective justification; has restricted the ability of providers to differentiate themselves to attract patients, such as, for example, by imposing minimum waiting times that providers must adhere to or restricting opening hours without objective justification; and has reduced the incentives on providers to compete, such as, for example, by disclosing commercially sensitive information belonging to one provider to a different provider without objective justification.'

Therefore, it seems that the substantive guidance is strict in terms of promoting (or not reducing) competition of providers in their interface with patients, unless the cost/benefit analysis indicates a (qualitative) advantage for patients that derives from any restriction of competition, such as vertical or horizontal integration of services, joint provision, or

standardisation of conditions [as indicated by Regulation 10(1)]. After reading the substantive guidance, it is not clear whether the structurally strict approach of Regulation 10(2) will restrict the 'anti-competitive authorisation' of Regulation 10(1) or, on the contrary, if Regulation 10(2) will also be affected by the 'qualitative' approach of Regulation 10(1). In that regard, it would be desirable for *Monitor* to make it clearer if it intends to use Regulation 10(1) only exceptionally and in cases where the cost/benefit analysis is clearly positive, or if it envisages a more lenient approach. We would favour the first option, since the authorisation of anti-competitive behaviour in public procurement is prone to generate clear social losses derived from the direct and knock-on effects that non-competitive public procurement generates, whereas the (qualitative) benefits sought are hard to measure and to realise.

These issues exceed the strict sectoral-approach of the activities of *Monitor*. In a recent speech on Competition in Public Services,[33] the OFT Chief Executive expressly mentioned the need to address market design issues in the current reform of the provision of public services and, more specifically, in health care services. It is worth noting that the OFT considers that:

> 'Market design needs to flow from the public policy objectives intended from opening up a market. For example, in health it has been considered necessary to fix price tariffs and allow competition to focus on quality to avoid competition focusing on price at the expense of quality. In this context, quality is partly about clinical outcomes, partly about other things like access and service. But articulating clear objectives can be difficult when *the purpose of introducing choice and competition itself varies: sometimes to address concerns about quality, choice or innovation; in others to reduce costs. Weighing up these points is an important first step in market design*' (emphasis added).

As should be expected, it appears that the approach of the OFT to the reform of health care provision is based on the premise that competition is still the best mechanism to achieve the desirable levels of quality. But this seems difficult to reconcile with the provisions of the NHS Procurement, Patient Choice and Competition Regulations 2013, which precisely allow NHS commissioners to engage in anti-competitive

[33] Clive Maxwell, Chief Executive, Office of Fair Trading (OFT), 'Competition in public services', 23 May 2013, available at http://www.oft.gov.uk/shared_oft/speeches/2013/06-13_Competition_in_public1.pdf, last accessed 2 September 2013.

behaviour (*ie* in distortions or restrictions of competition) in order to achieve desired quality improvements (*ie* as long as it is in the patients' interest).

With this in mind, it looks difficult to reconcile the substantive guidance given by the sectoral regulator *Monitor*—which has advanced that qualitative assessment is not a mathematical exercise and that quality improvements can justify reductions in competition (although some marginal competition is expected to be protected) with the warning issued by the OFT Chief Executive stressing that the OFT will seek direct enforcement of the competition provisions in the health care sector where appropriate, as its recent enforcement track record shows:

> 'For example, last summer we secured voluntary assurances from eight NHS Hospital Trusts that they will no longer exchange commercially sensitive information about their Private Patient Unit (PPU) prices, to ensure they comply with competition law. We have urged all Trusts to take steps to ensure compliance with competition law when engaging in commercial activity.'

One can wonder whether this type of enforcement activity will still be possible when NHS Commissioners argue that the (either independent, or induced) anti-competitive behaviour of health care providers is justified on the basis of Regulation 10(1) of the NHS Procurement, Patient Choice and Competition Regulations 2013, since it was carried out in the patients' interest, measured in qualitative terms. This will offer valuable insights and potential lessons to be learnt by other enforcement agencies when they try to balance economic and non-economic considerations related to competition enforcement in the health care sector.

As should have transpired from this overview, the enforcement of competition law in this area is growing more and more complicated precisely at a moment where the reform of the provision of public services may have a significant impact on market structure and competitive dynamics. Therefore, it is to be welcome that the OFT has prioritised this area in its strategic plan for 2013-14 and that this focus is likely to gain equally important strategic relevance for the future Competition and Markets Authority. However, closer coordination with the sectoral regulator *Monitor* may be necessary at this point in order to prevent sending mixed messages to the actors in the field and, more importantly, to prevent situations where an excessively broad interpretation of

regulatory exclusions of competition could take place. The market structure resulting from the current wave of public sector reform is likely to influence market dynamics for a relatively long time in the future. Consequently, getting the process right is of utmost importance.

Moving back to a broader perspective, given the need to ensure that public sector reform is conducted in such a 'competition-conscious' manner, even when social services are concerned, it is often argued that EU rules are a straightjacket[34] that limit the ability of the Government (of the UK, but equally of other Member States) to adopt innovative solutions in order to face the challenges posed by the current economic crisis and, more generally, to modernise and adapt public service provision to the needs of the 21st century. However, some of these claims remain at a very general level and rarely engage in the technical details of such complicated areas of EU economic law as competition, State aid and public procurement. Therefore, a critical appraisal of whether that is the case seems timely and highly relevant, particularly in view of the potential litigation before the CJEU should the European Commission take issue with any of the changes required for the reform of the UK public sector and the new ways for the provision of public services (particularly, health care), or with the procedures required for their implementation.[35]

Moreover, the case of the UK will be of relevance to the appraisal of similar policies in other Member States, which are likely to follow closely the British experience and to extract lessons from the best practices or, reversely, alleged infringements of EU economic law tested by the European Commission or private litigation. Consequently, the UK public sector reform is a good case study to assess the fitness of EU competition, State aid and public procurement rules to consolidate and further promote the single market without impinging on the Member States'

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[34] On the increasing relevance of EU competences and regulation in the area of health care, see U Neergaard, 'EU Health Care Law in a Constitutional Light: Distribution of Competences, Notions of "Solidarity", and "Social Europe"' in JW van de Gronden et al (eds), *Health Care and EU Law*, Legal Issues of Services of General Interest (The Hague, TMC Asser Press/Springer, 2011) 19-58. See also N Fiedziuk, *Services of general economic interest in EU law: The role of the 'public service' exception in the light of recent developments in EU law* (AH Oisterwijk, Wolf Legal Publishers, 2013) 71-102.

[35] Given the breadth of the reform, which can affect the entirety of the UK public sector, the financial interests at stake can be very significant if the European Commission pushes for fines under Art 260 TFEU.

Governments ability to react to current challenges in the provision of public services in the EU.

We will focus on more technical aspects of this case study in the following sections. We will assess the restrictions and requirements derived from EU law for the implementation of a strategy that, in its basic elements, seeks to promote the creation and "spinning-off" of (public sector) mutuals, (directly) award them contracts for the provision of (social) public services and promote competition between them and against (other) private undertakings in the market, unless other public policy reasons (mainly, 'patients' interest' in the health care sector) require a restriction or distortion of such competition. Our analysis will necessarily be streamlined but, hopefully, we will provide a broad account of the applicable rules and the ensuing (potential) legal difficulties.

3.1. 'Stage 1': "Spinning-off" publicly owned service providers

In the case of 'privatisation' or 'spin-off' of social services providers, the first control regards the selection of the private investor and the establishment of public-private entities. These cases require compliance with State aid rules (given the risk of an implicit grant of illegal aid in case the price for the privatisation is too low or the conditions under which the private investor accesses the ownership or capital of the spun-off social service provider are too favourable) and with free movement of capital. Moreover, the general principles derived from the TFEU in the area of public procurement, particularly transparency and non-discrimination, need to be complied with and, ultimately, the Government needs to ensure that there is a 'sufficient degree' of competition for the acquisition of the full or partial ownership of the public services provider. Moreover, the decision on the percentage of capital that remains under public ownership (if any) and the degree of involvement of the public sector in the management of the 'privatised' public services provider will determine whether it can be considered an 'in-house' unit for the purposes of the commissioning or tendering of future contracts for the provision of the social services concerned. We can identify a number of issues that may need to be addressed

- An analysis of requirements for the sale of shares of capital

- An emphasis on the application of the 'private investor test' and valuation of 'spin-off' of companies
- An analysis of the complex issue of mutuals and how to treat workers' acquisition of capital (such capital is just as much private capital as any other capital in the EU: would the earmarking of capital for workers of the mutuals be a breach of EU law or can it be justified?)
- An analysis of the implications of the spin-off in terms of employee protection, particularly under the Transfer of Undertakings Directive[36] and the domestic rules concerned with this issue
- An analysis of the impact in terms of breaking any public-public or in-house exceptions and, therefore, potentially implying the need to tender contracts for ALL of the activities already carried out by the 'spin-off' companies/mutuals—unless the competition created for the selection of the investor was deemed sufficient to exclude the need to run procurement procedures for those contracts

3.2. 'Stage 2': Awarding social services contracts to 'spin-off' mutuals

Secondly, and related to this stage of commissioning or tendering of contracts for the provision of services, the public sector needs to comply with both competition and public procurement rules[37].

3.2.1. Competition rules

The case of compliance with competition law may seem simpler than it actually is, given that 'pure procurement' or 'commissioning' of social services is generally not considered an economic activity for the

[36] Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses [2001] OJ L82/16. See C Barnard, *EU Employment Law*, 4th edn (Oxford, OUP, 2012) chapter 12.

[37] This will only apply in Member States running a national health system. Those that run an insurance-based system will not be concerned with public procurement rules.

purposes of competition law.[38] However, depending on the competitive landscape that follows from privatisation strategies, if the public sector goes beyond the mere acquisition of goods or contracting out of services, it may fall under the EU competition rules.[39] There is, perhaps, a need to reassess *FENIN* and *BetterCare* in a scenario where entities entrusted with the provision of social services may not be restricted to 'acquiring' services or where they can offer social services for remuneration, particularly in cases of mixed system of sponsorship whereby beneficiaries could be made to pay part of the cost of the service. There may be a need to reassess the case law of the CJEU in relation to the definition of "economic activity" and "undertaking" as Member States experiment with a new mix of public-private ownership of entities delivering social services. For example, if there is actual patient choice (as there is in the English NHS case, for instance) and the entities that manage the services need to compete for patients may they now be classified as "undertakings" for the purposes of EU competition law? If so, this would imply (an implicit) repeal of the *FENIN* doctrine and, consequently, the full subjection of these entities to EU competition rules. If this is not seen as desirable outcome, the CJEU or Member States will have to find an alternative way to create a safe haven for health care related activities, which may well be derived from a further extension of the exclusion given to *social* activities[40].

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38 Case C-205/03 P. *Federación Española de Empresas de Tecnología Sanitaria (FENIN) v Commission of the European Communities* [2006] ECR I-6295. See also the finding in the Competition Commission Appeal Tribunal (CCAT) judgment in *BetterCare Group Limited v Director General of Fair Trading* (Case 1006/2/1/01), *(BetterCare II*) and OFT Policy Note: Policy note 1/2004 The Competition Act 1998 and public bodies, August 2004, OFT443. See also R Hancock and M Hviid. Hviid, (2010) *Buyer Power and Price Discrimination: The Case of the UK Care Homes Market*, CCP Working Paper 10-17.

39 For discussion concerning the case in the UK, see L Goulding, 'Is the NHS subject to competition law?', 19 July 2013, *EUTopiaLaw* http://eutopialaw.com/2013/07/19/is-the-nhs-subject-to-competition-law/, last accessed 28 August 2013. See also A Sanchez Graells, 'Why are NHS Commissioners 'undertakings' and, consequently, subject to competition law?', 2 June 2014, How to Crack a Nut http://howtocrackanut.blogspot.co.uk/2014/06/why-are-nhs-commissioners-undertakings.html, last accessed 18 June 2014.

40 For an interesting discussion on the delineation of the concept of 'undertaking' in the *grey zone* in between economic and social activities, see J Baquero Cruz, 'Beyond Competition: Services of General Interest and European Community Law' in G De Búrca (ed), *EU Law and the Welfare State: In Search of Solidarity* (Oxford, Oxford University Press, 2005) 169.

3.2.2. Public procurement rules

The applicability of public procurement rules are not less controversial, despite the fact that the soon to be transposed revised public procurement Directives cover contracts for the provision of public services and create a new light-touch regime for social, health and other services listed in Annex XIV[41] (with a contract value of more than EUR 750,000). Recital 114 of Directive 2014/24 tries to make it clear that Member States retain the competence to decide which social (and special) services to outsource, to organise their compulsory social security systems as they see fit, to retain restrictions on the liberalisation of certain services as per Articles 1(2) and 1(6) of Directive 2006/123/EC, and to regulate any of those services as services of general economic interest (SGEIs); as well as to stress that non-economic services of general interest should not fall within the scope of the procurement Directive, which:

> without prejudice to the power of national, regional and local authorities to provide, commission and finance services of general economic interest in accordance with Article 14 TFEU and Protocol No 26 on Services of General Interest annexed to the TFEU and to the Treaty on European Union (TEU).

Therefore, the Directive 'merely' aims to set up a light-touch approach to the regulation of a particular procurement regime for social and other specific services.

Articles 74 to 77 set out such 'light-touch' regime, which applies to contracts of a value above EUR 750,000 (approximately GBP 640,000) included in any of the fifteen categories listed in Annex XIV of Directive 2014/24. The light-touch regime mainly seeks to create transparency and to create both a set of general principles for the award of these contracts and a special rule for the award of reserved contracts for some

[41] These include 1. Health, social and related services; 2. Administrative social, educational, health care and cultural services; 3. Compulsory social security services (unless they are organised as non-economic services of general interest, in which case they are not covered by the Directive); 4. Benefit services; 5. Other community, social and personal services including services furnished by trade unions, political organisations, youth associations and other membership organisation services; 6. Religious services; 7. Hotel and restaurant services; 8. Legal services [to the extent not excluded pursuant to point (d) of Article 10 of the Directive]; 9. Other administrative services and government services; 10. Provision of services to the community; 11. Prison related services, public security and rescue services [unless covered by Article 10(ca) of the Directive]; 12. Investigation and security services; 13. International services; 14. Postal services; and 15. Miscellaneous services.

types of health, social and cultural services. The 'disclosure' regime in Article 75 provides contracting authorities with two options to publicise their notices and calls for competition (either through a 'regular' contract notice or a 'prior information notice', unless a negotiated procedure without publication could be used) and requires that they publish contract award notices for each contract awarded, although they can do so by grouping them and publishing a 'global' award notice on a quarterly basis.

Article 76 sets out the principles for the award of these contracts, although their regulation is left to the Member States provided that they take measures 'to ensure contracting authorities comply with the principles of transparency and equal treatment of economic operators. Member States are free to determine the procedural rules applicable as long as such rules allow contracting authorities to take into account the specificities of the services in question'. A key element to take into consideration will be the need to further comply with the (more) general principles of procurement set out in Article 18, which requires that procurement also complies with the principles of competition and proportionality, and that economic operators participating in public procurement comply with applicable obligations in the fields of environmental, social and labour law. Given that Article 18 is nested in Title I and that the procurement of social and other specific services is regulated in Title III, Article 76(1) may be seen as a *lex specialis* that would de-activate the requirements for proportionality and undistorted competition in their procurement. However, such interpretation may not be welcome by the CJEU.

With a permissive tone, Article 76(2) continues to regulate that:

> 'contracting authorities may take into account the need to ensure quality, continuity, accessibility, affordability, availability and comprehensiveness of the services, the specific needs of different categories of users, including disadvantaged and vulnerable groups, the involvement and empowerment of users and innovation. Member States may also provide that the choice of the service provider shall be made on the basis of the tender presenting the best price-quality ratio, taking into account quality and sustainability criteria for social services'.

The drafting of the last sentences leaves an open question as to the obligation to choose the awardee of the contract on the basis of the most economically advantageous tender (MEAT), although (functionally) it

seems to be out of the question, and the provision should simply be seen as allowing for the introduction of 'specific' criteria in the determination of the MEAT, such as quality and sustainability.

The novelty that better suits the regulatory needs implicit in the UK public sector reform strategy has been introduced in Article 77, which allows contracting authorities to reserve for the participation of given types of organisations (such as 'public sector mutuals', for instance) the award of contracts for certain services included in specific categories of the Common Procurement Vocabulary[42] in the areas of health, social and cultural services,[43] which basically comprise all, or the most relevant, medical services, personal services, educational and training services (including eLearning), sports and cultural services. In such cases, the contracting authority will need to make sure that the (type of) organisation chosen to be awarded the contract meets the following requirements:

> (a) its objective is the pursuit of a public service mission linked to the delivery of the services [to be contracted];
> (b) profits are reinvested with a view to achieving the organisation's objective. Where profits are distributed or redistributed, this should be based on participatory considerations;
> (c) the structures of management or ownership of the organisation performing the contract are based on employee ownership or participatory principles, or require the active participation of employees, users or stakeholders; and
> (d) the organisation has not been awarded a contract for the services concerned by the contracting authority concerned pursuant to this Article within the past three years.

Moreover, the maximum duration of the contract shall not be longer than three years and the call for competition shall make reference to this Article, so that there is sufficient transparency on the use of this special regime.

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[42] See the consolidated version available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2002R2195:20090807:EN:PDF, last accessed 2 September 2013.

[43] The specific references are 75121000-0 (Administrative educational services), 75122000-7 (Administrative healthcare services), 75123000-4 (Administrative housing services), 79622000-0 (Supply services of domestic help personnel), 79624000-4 (Supply services of nursing personnel), 79625000-1 (Supply services of medical personnel), 80110000-8 (Pre-school education services), 80300000-7 (Higher education services), 80420000-4 (E-learning services), 80430000-7 (Adult-education services at university level), 80511000-9 (Staff training services), 80520000-5 (Training facilities), 80590000-6 (Tutorial services), from 85000000-9 to 85323000-9 (fundamentally, all types of medical services), 92500000-6 (Library, archives, museums and other cultural services), 92600000-7 (Sporting services), 98133000-4 (Services furnished by social membership organisations), and 98133110-8 (Services provided by youth associations).

Therefore, under this special rule within the light-touch regime, contracting authorities seem almost completely free to decide to award the contracts to public service mutuals (and, most likely, to a specific public sector mutual, given their initial lack of capacity to tender for contracts to be awarded by contracting authorities other than the one they have just "spun-off"). However, this seems to create a significant risk of 'sweet deals' aimed at supporting, fostering and consolidating the creation of public sector mutuals, which may well end up resulting in (3-year long, local) monopolies for the provision of those services in the hands of the newly spun-off public sector mutuals, which may extend their dominance beyond that point in time as incumbency advantages pile up. That would result in distortions of competition similar to those recently identified by the UK's Competition Commission in the market enquiry on private health care services and, as such, it is an undesirable prospect.[44]

However, public procurement rules can be applicable beyond the regulated cases, as the CJEU has been expanding the coverage of the procurement regime and systematically imposed certain obligations to the tendering of contracts not, or not-fully, covered by the Directives.[45] This situation has been resisted by Member States (particularly, Germany), which have tried to minimise the impact of EU rules and principles for procurement below the EU thresholds. However, as we shall see, the European Commission is willing to go beyond the red lines intended by the Member States and to reintroduce through the backdoor of the State aid rules some of those requirements, which the Member States have tried to limit in the very recent round of revision of the public procurement rules. In general, then, it seems that State aid rules (and the soft law adopted by the European Commission for their interpretation and enforcement) may end up imposing more stringent public procurement requirements than those rules themselves.

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44 Private healthcare market investigation, available at: http://www.competition-commission.org.uk/our-work/directory-of-all-inquiries/private-healthcare-market-investigation

45 Note: Judgment of 8 May 2013 in Joined Cases C-197/11 & C-203/11 *Libert and Others*, where the CJEU appears to show 'excessive' deference towards social services and, particularly, social housing conducted through planning documents different from a contract.

3.2.3. State aid rules

The interplay of public procurement rules and State aid control, particularly, as part of the *Altmark* test, fourth condition, and the expansion of the mandate for public procurement procedures in the Almunia package,[46] can complicate the picture and promote 'excessive voluntary' compliance with public procurement rules (even despite the light touch regime just discussed) in order to avoid regulatory risks in the contracting out or commissioning of social services. Under the 'Almunia Package', aid given to health care providers can be considered exempted, regardless of its value, by Article 2(1)(b) or (c) of the Decision for the exemption of social services.[47]

In principle the Decision does not affect the applicability of procurement rules and, consequently, aid given to beneficiaries not chosen as a result of a public procurement procedure (compliant with EU rules) would still be exempted. However, if all conditions in the Decision are not met (for instance, due to an absence or shortcomings in the entrustment act, or due to excessive compensation), then the aid needs to be assessed under the Framework for State aid in the form of public service compensation.[48] In that regard, it is worth stressing that the Framework clearly pushes for, what we would argue, is over-compliance with public procurement rules (including general principles), when it sets up a tight connection between compliance with EU public procurement rules and compatibility with Article 106(2) TFEU [and, indirectly, with Article 107(1) TFEU] and indicates that:

> 19. Aid will be considered compatible with the internal market on the basis of Article 106(2) of the Treaty *only where the responsible authority, when entrusting the provision of the service to the undertaking in question, has complied or commits to comply with the applicable Union rules in the area of public procurement.* This includes any requirements of transparency, equal treatment and non-discrimination resulting directly from the Treaty and, where applicable, secondary Union law. *Aid*

[46] Supra n. 7.

[47] Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2012] OJ L 7/3.

[48] Communication from the Commission — European Union framework for State aid in the form of public service compensation (2011) [2012] OJ C 8/15.

> *that does not comply with such rules and requirements is considered to affect the development of trade to an extent that would be contrary to the interests of the Union* within the meaning of Article 106(2) of the Treaty (emphasis added).

Any contracting authority that identifies a risk of not being covered by the Decision and that, consequently, may find its aid decisions under scrutiny in accordance with the Framework will tend to comply (voluntarily) with public procurement rules. In that case, it is also doubtful that the European Commission can be satisfied with compliance (only) with the light touch regime of Articles 74 to 76 of the new Directive—not to mention with Article 77 if the contract has been reserved for a given (type of) awardee. There is clear indication by the Commission that the guidance under the 'Almunia Package' will be reassessed once the new public procurement Directive is adopted and, consequently, compliance with public procurement rules (beyond the mandatory level) may become an unavoidable requirement in order to minimise the risk of infringing State aid rules.[49]

3.2.4. 'Stage 3': (Future) Competition between public sector mutuals and other (alternative) providers

Thirdly, once the 'privatised' public service providers or any other providers that receive financing under the State aid rules (*ie* the operators that receive public financial support for the discharge of the relevant public service obligation, 'pso') compete with other undertakings for the provision of the same or similar services in the private market, the rules on competition will regain relevance. The difficulty of maintaining competitive neutrality and the need to ensure that there are no illegal cross-subsidies between publicly-supported social services and other services will generate a permanent regulatory risk in any market-driven scheme of provision of social services. We can envisage different landscapes emerging, for example, where providers can offer additional services on top of the pso 'minimum' and the additional services are covered by

[49] Which will tend to inseparably twin both types of analysis in State aid litigation. See A Sanchez Graells, 'Enforcement of State Aid Rules for Services of General Economic Interest before Public Procurement Review Bodies and Courts' (June 12, 2013), "Competition and State Aid Litigation – The Effect of Procedures on Substance," CLaSF/University of Luxembourg Conference, 19-20 September 2013. Available at SSRN http://ssrn.com/abstract=2271674.

public financial support. Another scenario could be whether an internal market for public services may emerge. We can envisage internal market concerns arising from cross-border activities of undertakings that receive financial support in some Member States but not in others. Maintaining truly effective and undistorted competition at this stage will be highly relevant for an efficient provision of public services. Regardless of the strategy adopted by Member States for the provision of health care (*ie* both for those with and without a national health system), this will be the real challenge in order to spur high standards of care, innovation in the provision of these services, and a level of (private and public) prices or costs that tends to ensure the financial viability of the welfare state.

4. Conclusions

An aim of this paper was to discuss how the evolution of the Single Market initiatives to foster growth applies in practice to a case study of the reform and modernisation of the English NHS – a social SGEI. The initiatives to modernise the Single Market programme seized upon the need to reform and modernise the law and policy relating to SGEI, especially through the modernisation of the competition and procurement rules. The result was an emphasis upon competition, efficiency, transparency and good governance. Thus, we argue that market values were introduced into the choice and provision of SGEI, circumscribing the manner in which modernisation processes can take place.

The Single Market initiative was affected by the immediate economic and fiscal crisis and the responses to this crisis have obliged the Member States to cut back on public expenditure, hastening the processes of marketisation of public services that were evident before the crisis took hold. EU law continues to pay lip service to the notion that the choice of public services remains with the Member States but the Almunia Package, reforming the financing of public services, goes much further in imposing restraints and constraints on how a public service is defined and entrusted, as well as how it is financed.

Our case study of public sector reform in the UK, focusing upon reform of the NHS in England, reveals that the scope for experimentation modernising and reforming a social service, namely health care, in

England may be circumscribed by EU economic law when the service is opened up to competition and marketisation. After finishing a draft of this paper our predictions concerning the potential for the reforms to be scrutinised under the competition rules were confirmed by a statement at a conference by the CEO (Jill Watts) of a private health care provider (Ramsay Health Care UK) who argued that the April 2013 reforms did not result in uniform changes to the way the private sector is viewed by commissioners throughout England and she predicted that complaints will be launched with Monitor, (the competition regulator of the NHS) over the next three years following the UK government reforms. [50] Indeed, *Monitor* has already initiated two investigations into anti-competitive conduct, with allegations of breach of the competition and procurement rules.[51] In our view, such a 'new wave' of decisions and precedents will continue to offer a valuable source of practical knowledge for other Member States embarking upon the reform of their health care and other public services, and they will also put pressure on some of the existing legal solutions at EU level, which may result in a further round of reform in the regulation of SGEIs.

[50] Reported by Crispin Dowler, 'Further complaints to NHS competition watchdog 'almost guaranteed'', (2013) Health Service Journal 11 September 2013, available at: http://www.hsj.co.uk/news/finance/further-complaints-to-nhs-competition-watchdog-almost-guaranteed/5063001.article?blocktitle=News&contentID=8805

[51] See the Monitor Press Releases: Monitor investigates cancer surgery commissioning in Greater Manchester, published on: 8 August 2013, available at: http://www.monitor-nhsft.gov.uk/home/news-events-publications/latest-press-releases/monitor-investigates-cancer-surgery-commissionin; Monitor seeks comment on its findings in relation to the conduct of Cornwall and the Isles of Scilly NHS Primary Care Trust, published on: 15 May 2013, available at: http://www.monitor-nhsft.gov.uk/home/news-events-publications/latest-press-releases/monitor-seeks-comment-its-findings-relation-the-

6

Privatisation of Public Service Delivery in the EU: Where lay the public service obligations in social service provision?

JIM DAVIES*

ABSTRACT

The expression of Public Service Obligations (PSO) in the network sectors of SGEIs are defined by the normative values of a good administrative protocol with sectoral rules set out in EU legislation. The Europeanisation of these sectors provides a coherent base which informs the national approaches in providing for acts of entrustment and the establishment of independent national regulatory agencies. This paper examines the development of this model and provides a comparison with the approach taken in economic social services sectors where Member States face a developing imperative to designate essential SSGI as SGEI. This is a social services environment in which a growing Public Service Industry is increasingly seeing private sector economic actors enjoy a general advantage over third sector not-for-profit and charity entities, in the public procurement processes. The comparison highlights the significant differences in the way that PSOs are expressed between the network SGEIs and the 'social' SGEIs and raises a question of whether it is time to consider, in at least some social services sectors, whether the expression of PSOs should be re-modelled in such a way as to replicate those in the network SGEI sectors. .

KEY WORDS: Public Service Obligation, Social Services, Quality, Entrustment, SGEI, SSGI, Essential Services, Private Sector, Public Service Industry, Public Service Governance

1. Introduction

There is a developing Public Service Industry (PSI) that is increasingly providing social services of general interest (SSGI) within an economic

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business model at arm's length from State actors. Such an economic model suggests that, according to the developed case law of the Court of Justice (CJEU), the provision of the 'social' public service task will be defined as a service of general economic interest (SGEI) and that the model for designating a public service task as a SGEI is moving, at least to some degree, away from one based on solidarity and citizenship towards one based on market failure.[1] Important to the analysis of these developments is a discussion of where may lay the monitoring, evaluation, and quality tools of good administrative practice and governance that are an essential adjunct to the Public Service Obligations (PSO) that define the SGEI and that are entrusted to the service providers by the public authorities. This is relatively straightforward in the SGEIs of the oligopolistic network and natural monopoly sectors that are defined by EU level legislation and extensive national regulatory systems but somewhat more challenging in the economic social service sectors where the legal and regulatory frameworks lack the same high level structure. The central theme of this chapter is then concerned with a comparison of the administrative and governance systems applied to PSOs in those network and natural monopoly sectors and those found in the social service sectors that are increasingly subject to liberalisation and privatisation; and that are typically subject to outsourced provisioning by economic actors in an emergent public service industry (PSI).

In those network and natural monopoly sectors where the public-sector involvement is driven by supply side activity the monitoring, evaluation, and quality tools have developed into operational norms for the private-sector service providers and for the sector specific regulatory agencies that also operate at arm's length from the state. The model becomes more complex where demand side imperatives are satisfied by public-sector involvement in the commissioning of private-sector provision of diverse SSGI: not only may acts of entrustment be performed by official state actors at national, regional and local levels (depending on the nature of the service), but the act of entrustment must carry legal force in national law and create an obligation that the service provider 'cannot refuse to provide the services requested by the citizen.'[2] Such acts

1 See however, Tony Prosser, 'EU competition law and public services' in E Mossialos and others (eds) Health Systems Governance in Europe (CUP, Cambridge, 2010), 315.

2 Richard Polacek and others 'Study on social services of general interest' (2011) European Commission, Brussels, Belgium, last accessed 25 July 2013 at http://eprints.lse.ac.uk/43342/ , 310.

of entrustment take different forms, but where such an act identifies a mission of general interest and creates a PSO, it will generally provide for the SSGI to be categorised as a SEGI and to benefit from the exemptions to the competition and state aid rules.[3]

Following a brief discussion of the SGEI and SSGI concepts and their relationship to the provision of 'public services', this chapter continues with a review of the development of PSOs as mechanisms for the achievement of public interest objectives. What emerges from this evolution of PSOs in the networks and natural monopolies sectors is a relatively standard cross-sectoral model in which well defined obligations are imposed on the provider of a service by the public authorities in order to ensure the achievement of public interest objectives. In section four, the discussion moves to a review of the economic social services, the growing imperative to define economic SSGI as SGEI, and the compensation payments made by the public authorities to the service providers in respect of the PSOs they are required to deliver. Section five then summarises four social sector case studies of the governance and quality frameworks applied to the PSOs and outlines the development of the Public Service Industry that includes large, private sector, economic social service providers; raising a question of whether some of the governance and regulatory aspects of the PSOs found in the network SGEIs could become relevant to emerging social markets and cross-border service provision.[4]

2. Public services, SGEI and SSGI

Acknowledging the lack of a common understanding or definition of what a 'public service' actually is, Finger and Finon have recently articulated something of the diverse political, economic and administrative traditions that hinder any discussion of public services at the EU level.[5]

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3 See, since 2005 the Altmark or Monti Kroes Package, Commission Decision on the application of Article 86(2) of the EC Treaty of 28 November 2005, OJ L312/67, and the Community Framework for State aid in the form of public service compensation, 2005, OJ C 297/4; and subsequently the Almunia Package (discussed below, Section 4).

4 The narrative acknowledges the role of not for profit, social enterprise, charity and other third sector actors in the delivery of SSGIs but highlights the rapid growth of the for-profit PSI.

5 Matthias Finger and Dominique Finon 'From the "public service" model to the "universal service" obligation', (2011)last accessed 25 July 2013 at: http://www.centre-cired.fr/IMG/pdf/Finger_Finon_Public_service_Universal_service.pdf

For the present analysis, 'public services' are distinguished from 'public sector' or 'public organisation' and identified as:

> ...any service provided for large numbers of citizens, in which there is a potential significant market failure (broadly interpreted to include equity as well as efficiency) justifying government involvement—whether in production, finance, or regulation.[6]

This definition, drawn from an economic assessment, accommodates on the one hand those services for which the rationale for public-sector involvement is primarily driven by a supply side in which networks and natural monopolies require intervention to prevent market failure, or abuse of a dominant position through price and quality regulation. On the other hand, the definition is equally applicable to those diverse services where the rationale for intervention is on the demand side, including 'non-excludable public goods, such as law enforcement...' and that extends inter alia to education and health where merit-good (need) and equity arguments justify public intervention in consumption decisions.[7]

From its earliest days, the EU has sought to balance some degree of national autonomy in the control of 'public services' with exemption from the full application of the internal market provisions through the concept of services of general economic interest (SGEI).[8] Member States are afforded a broad discretion in identifying SGEIs whilst the Court of Justice of the European Union (CJEU) has developed the criterion for SGEIs at the EU level.[9] From a legislative perspective, the classification of SGEI in the Treaty prompted litigious attacks, based on EU competition and free movement provisions,[10] that has seen public-sector involvement

6 P. Grout and M. Stevens 'Financing and Managing Public Services: An Assessment', CMPO Working Paper Series 03/076 (2003) last accessed 25 July 2013 at http://economics.ouls.ox.ac.uk/11842/1/wp76.pdf

7 Ibid, 1.

8 Article 90(2) EEC, and see Erika Szyszczak 'Introduction: Why do Public Services Challenge the European Union?' in E Szyszczak and others (eds), Developments in Services of General Interest (The Hague, TMC Asser Press, 2011) 2 , concerning the introduction, in 1957, of the new nomenclature of SGEI as the beginning of a Europeanisation process for public services.

9 See the guidance provided for by the General Court in Case T-289/03 BUPA v Commission [2008] ECR II-18, and M Ross 'A Healthy Approach to Services of General Economic Interest? The BUPA Judgment of the Court of First Instance' [2009] 34(1) ELRev 127.

10 See (n8) per Erika Szyszczak, 4.

in the network and natural monopoly services reduced to a responsibility for the definition of PSOs in the entrustment of missions of general interest to third party private-sector providers,[11] and the establishment of independent regulatory authorities.

The inherent assertion in the above definition, that the potential for significant market failure is the justification for the creation of public services, is however open to challenge with no clear legal clarity of the extent to which public services are characterised by, on the one hand competition and the rules of the internal market in particular in relation to state aid and public procurement, and on the other hand the extent to which public services are characterised by the principles of solidarity and citizenship. The tensions between a market based approach and that of an approach rooted in solidarity towards SGEI are reflected in the 'fundamental divergences in attitudes to the treatment of public services between different Member States' and the principles underpinning both approaches appear in Union law.[12] It is beyond the scope of this contribution to analyse in any depth the detail of this complex and contested aspect of EU law but perhaps useful in the present context to contrast Prosser's analysis of the EUs primary law concerning SGEIs and the General Court's recent decision on compensation for public service costs in *Colt Telecom*.[13]

In his analysis of competition law and public services Prosser examines the relationship between the exception from the competition rules for SGEI in Article 106(2) TFEU, where such rules would obstruct the performance of the public service task, and the provisions of Article 14 TFEU together with Article 36 of the Charter of Fundamental Rights. He draws on the inherent emphasis found in the objectives of these provisions that promote the importance of social and territorial cohesion, social rights, citizenship rights and good governance as parameters for the definition of SGEI.[14] The judgment in Colt provides us with an example of a contrasting rationale for the existence of a SGEI and concerns the challenge

11 Including, Universal Service Obligations (USO) discussed below.

12 Tony Prosser (n1) 317 and 318.

13 Case T-79/10 Colt Telecom France v Commission, judgment of 16 September 2013.

14 Op. cit. n1, 331-333.

to a Commission decision authorising compensation payments for the accommodation of universal coverage, technological neutrality and standard charges in the provision of a high speed telecommunications network.[15] The Commission confirmed in this case that its decision was based on an assessment of the circumstances of the public service elements of the high speed network and that they had met the criteria set by the Court of Justice in its *Altmark*[16] judgment such that the compensation payment would escape classification as State aid.[17] In the present case, the General Court dismissed the challenge to the Commission decision and endorsed the Commissions approach to determining the presence of a SGEI on the basis of market failure.[18] In reaching its conclusions, the court noted that market failure as a criterion for determining the existence of an SGEI was mentioned in the earlier case law of the General Court,[19] and in Commission guidelines and communications.[20]

In contrast to the legal concept of SGEI, social services of general interest (SSGI) are a construct of the Commission, joining the EU taxonomy in 2001[21] and subsequently characterised in terms of their general interest criteria, the organisational conditions and modalities applying to them and their predominantly demand side rationale for public-sector involvement. The distinction between SGEI and SSGI, and their assimilation with the supply side and demand side rationales for public-sector involvement, is however not straightforward. At the EU level, SSGI are defined as 'statutory and complementary social security schemes, organised in various ways (mutual or occupational organisations), covering

15 Case T-79/10 Colt Telecom France v Commission, judgment of 16 September 2013, para 14.

16 Case C-280/00 Altmark Trans GmbH [2003] ECR I-7743.

17 See, Vassilis Hatzopoulos 'Public procurement and state aid in national health care systems', in in E Mossialos and others (eds) Health Systems Governance in Europe (CUP, Cambridge, 2010), 381-420, at 386-391 for a discussion of formal links between state aid and public procurement and the reversal of the Court's case law in Altmark from a 'state aid' approach to one in favour of a 'compensation' approach.

18 Case T-79/10 Colt Telecom France v Commission, judgment of 16 September 2013, para 154.

19 Citing, Case T-8/06 FAB Fernsehenaus Berlin GmbH v Commission of the European Communities ECR II-0196 and Case T-21/06 Federal Republic of Germany v Commission of the European Communities ECR II-0197.

20 See, Case T-79/10 Colt Telecom France v Commission, judgment of 16 September 2013, paras 150 and 151.

21 COM (2001) 598, Commission Report to the Laeken European Council, Services of General Interest.

the main risks of life, such as those linked to health, ageing, occupatinal accidents, unemployment, retirement and disability...[and] other essential services provided directly to the person.'[22] They are also defined by the 'criteria of general interest' which embraces inter alia, the principles of universality, transparency, continuity, and accessibility and that are shared with, and developed from, the PSOs that have evolved with the network SGEIs.[23] Where SGEI constitute a distinct legal category in EU law SSGI exist only as a policy category, but a policy category in which Member States are increasingly encouraged to designate social services as a SGEI where that service is held to fulfil an essential function within the national economy (discussed in Section 4 below).[24]

3. The evolution of public service obligations

3.2. Telecoms takes the lead for network SGEI

In a report for the Centre on Regulation in Europe (CERRE), Waddams et al provide a definition for PSOs which they identify as applying to all firms operating within a particular sector and that relate to minimum levels of quality, service standards and specific consumer rights.[25] The focus of their report is drawn from analysis of PSOs in the network and natural monopoly sectors where privatisation and liberalisation has been accompanied by the emergence of a common set of general obligations in EU legislation that provide for user rights as aspects both of substantive legislation and as principles of service provision. These dual aspect rights first appear in a series of telecoms directives from the late 1980s and early 1990s and that are characterised by user involvement in the policy process, the unbundling of tariffs, guarantees of equal treatment, non-discrimination in service access, and contract

22 See, COM (2006) 177 final, Communication from the Commission, Implementing the Community Lisbon programme: Social services of general interest in the European Union, section 1.1.

23 Ibid, section 3.1.

24 Johan van de Gronden 'Social Services of General Interest and EU Law', in E Szyszczak and others (eds), Developments in Services of General Interest, (The Hague, TMC Asser Press, 2011) 158.

25 Catherine Waddams, Michael Harker and Antje Kreutzmann 'Public Service Obligations and Competition' (2013) last accessed 25 July 2013 at http://www.cerre.eu/sites/default/files/130318_CERRE_PSOCompetition_Final.pdf

termination rights.[26] These were followed by a number of common service quality measures that have since become familiar, providing inter alia for ease of contact with the service provider, transparency of processes and procedures and user rights to arbitral and conciliatory processes.[27]

In 2002 the universal service directive was introduced as part of a package of five sector specific directives that came with the objective of recasting the regulatory framework and increasing competition.[28] These brought a restatement of the user rights that provided a paradigm for services provision whereby transparency of terms and conditions was to be complemented by quality of service monitoring by national regulatory authorities in a competitive market environment and where switching between service providers was to be made easier for the end user.[29] The new regulatory institutions provided a channel for agency with an obligation to 'take account of the views of end-users, and consumers (including, in particular, disabled users)...on issues related to all end-user and consumer rights...'.[30] The end-user and consumer were to be given a voice, with the support of the regulatory authorities, in improving the general quality of service provision by inter alia developing and moni-

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26 See, in particular, Directive 88/301/EEC of 16 May 1988 on competition in the markets in telecommunications terminal equipment; Council Directive 90/387/EEC of 28 June 1990 on the establishment of the internal market for telecommunications services through the implementation of open network provision, Articles 2(10), 4(d), 9 and Annex II 3(b); Directive 90/388/EEC of 28 June 1990 on competition in the markets for telecommunications services, Article 8 and Para 31 of the Preamble.

27 Directive 92/44/EEC of 5 June 1992 on the application of open network provision to leased lines, Articles 2, 4, 6, 8, 9, and 12, and Directive 98/10/EC of 26 February 1998 on the application of open network provision (ONP) to voice telephony and on universal service for telecommunications in a competitive environment, Articles 2, 10(1), 10(2), 11(2) and 26.

28 Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive), accompanied by: Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive); Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (Access Directive); Directive 2002/20/EC of the European Parliament and of the Council of 7 March 2002 on the authorisation of electronic communications networks and services (Authorisation Directive); and Directive 2002/58/EC of the European Parliament and of the Council of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communications).

29 Directive 2002/22/EC, Chapter IV, End-user interests and rights.

30 Ibid, Article 33.

toring codes of conduct and operating standards,[31] whilst the regulatory authorities and the consumer agencies of civil society began to establish new networks, new relationships and new processes of governance that would include the user/consumer in the policy process.[32]

Following Telecoms, the PSO model for postal services was built on transparency of process and quality objectives, non-discrimination, and simple and inexpensive complaints procedures overseen by independent national regulatory authorities tasked with ensuring compliance with the obligations arising from the Directives.[33] A similar approach to defining PSOs in the energy sector has taken three successive legislative packages to date in an attempt to overcome an uneven implementation among the Member states related to discriminatory management of network access and high levels of market power in the encumbent energy companies.[34] The original 'common rules' directives did however introduce a paradigmatic shift from a monopolist and state-interventionist approach to one in which liberalised market mechanisms were to be balanced by new national regulatory structures.[35] The problems associated with the transition of the energy market led to a second package of measures in 2003 that introduced the by now familiar concepts of enhanced consumer protection through PSOs and a developing regulatory environment.[36]

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31 Ibid.

32 See, Jim Davies The European Consumer Citizen in Law and Policy (Basingstoke, Palgrave Macmillan, 2011) 186.

33 Directive 97/67/EC of the European Parliament and of the Council of 15 December 1997 on common rules for the development of the internal market of Community postal services and the improvement of quality of service, Recitals 6, 11 and 12 of the Preamble and see Articles 3 and 19. Also, Directive 2008/6/EC of the European Parliament and of the Council of 20 February 2008 amending Directive 97/67/EC with regard to the full accomplishment of the internal market of Community postal services, Article 1(20) amending Article 22 of the earlier Directive.

34 See, P Cameron (ed) Legal Aspects of EU Energy Regulation (Oxford, OUP, 2005) 9.

35 P. Cameron Competition in Energy Markets: Law and Regulation in the European Union (2nd ed., Oxford, OUP, 2007) 35, and Directives 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity, and 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas.

36 Comprised of Directive 2003/54/EC concerning common rules for the internal market in electricity (the Electricity Directive), Directive 2003/55/EC concerning common rules for the internal market in natural gas (the Gas Directive) and Regulation (EC) 1228/2003 on conditions for access to the network for cross-border exchanges in electricity. A further regulation was added in 2005 on gas transmission networks (Regulation (EC) 1775/2005) that formed the final part of this second round of liberalisation legislation. See also, Cameron, P., (ed) Legal Aspects of EU Energy Regulation (Oxford, OUP, 2005) 11.

The third legislative package for energy was subsequently adopted in 2009, providing for the establishment of an Agency for the Cooperation of Energy Regulators (ACER) that inter alia would, as a policy objective, act in the consumer interest.[37]

3.3. Public Interest Objectives and Essential Services

Early uncertainty over the survival of basic essential public services in liberalised markets and a concern to maintain relationships with vulnerable consumers underpinned the ring fencing of SGEI's on a sector by sector basis and the interpretation of what is now the exception in Article 106(2) TFEU. As a consequence, PSOs were introduced as a mechanism for the protection of 'essential services' throughout the territory: at an affordable price; with similar levels of quality of service; and irrespective of the profitability of the individual operations. The legislative base for SGEI and their inherent PSOs has now been supplemented by Protocol 26 of the Lisbon revisions which reflects the general nature of the PSOs developed in the network sectors and brings a change of emphasis in the rhetoric that we can associate with the general interest mission: from one based on principles to one based on values associated with 'a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights.'[38]

Market information, transparency, affordability, accessibility, quality, and essentialness have become the key words attaching to the latest generation of PSOs. For the network sectors they epitomise the normative ideas that have evolved and that have helped to articulate the public interest objectives inherent in the PSOs imposed to guarantee missions of general interest. At the EU level market monitoring, consumer surveys and the establishment of consultation networks now provide the tools for evidence based policy making.[39] At the Member State level obligations are characterised by the establishment of sector specific regulatory autho-

[37] Comprised of Regulation (EC) No 713/2009, Regulation (EC) No 714/2009, Regulation (EC) No 715/2009 Directive 2009/72/EC and Directive 2009/73/EC.

[38] Article 1, Protocol 26 TEU/TFEU.

[39] Developed following the 2007 Single Market Review, market monitoring and has started to provide inputs into the policy process and is epitomised through the Consumer Markets Scoreboard, Eurobarometer surveys and general and sector specific consumer consultation bodies.

rities, the setting of sectoral performance targets, the establishment of out of court dispute mechanisms, the monitoring of retail tariffs, and the requirement for contractual transparency. For the user, managed competition in oligopolistic markets with regulated third party (service provider) access to supply networks has, with some variable levels of success between sectors, been a driver for efficiency and innovation. The operational paradigm for service providers in the network SGEI sectors is now characterised by organisational unbundling of service content from delivery and accounting transparency; the development of business processes and systems that support the delivery of effective complaint handling; the monitoring and reporting of quality of service performance; and a responsibility to identify vulnerable consumers.

The balance between achieving the public interest objectives as discharged through a mission of general interest and the imposition of PSOs on the one hand and, on the other hand, the internal market objectives of competition and the economic freedoms, relies on the exception provided for in Article 106(2) TFEU. It is a provision that allows derogation from the general market rules of the Treaty whereby public authorities may attach public interest objectives to all service providers in a particular sector, or to one or a number of providers within a sector. As Simmonds asserts, the application of Article 106(2) to SGEIs rests on the underlying principles of neutrality, subsidiarity and proportionality, identifying Article 343 TFEU as the legal base for the Unions neutral stance in respect of the public or private ownership of service providers; Article 5 TEU as the legal base for the application of the principle of subsidiarity; and that, with regard to proportionality, the means used to fulfil the general interest mission do not create unnecessary distortions of trade.[40]

It is at this point that we depart from the review of the development of PSOs as normative mechanisms in network SGEIs in order to consider the role of PSOs in a broader context and the potential for a growing imperative to include SSGI within the SGEI model. It has been argued elsewhere that there is a constitutional approval of the social impo-

[40] G. Simmonds 'Consumer Representation in Europe, Policy and Practice for Utilities and Network Industries: Universal and Public Service Obligations in Europe' (2003), last accessed 9 August 2013 at http://www.bath.ac.uk/management/cri/pubpdf/Research_Reports/15_Simmonds.pdf, citing European Commission (2000) Services of general interest in Europe, COM/2000/580 final.

tance of SGEIs and that it is from a constitutional perspective that the generality of the values inherent in Article 106(2) TFEU, and confirmed by Article 14 TFEU, are a prerequisite to the realisation of the European social model.[41] Notably, in the context of this chapter, the Commission as long ago as 1996, and echoing the shared values mantra of Article 14 TFEU draws a connection between those values and access to services of general benefit.[42]

4. State obligations and economic SSGI

4.1. State obligations: defining economic SSGI as SGEI

A distinction in EU law is drawn between those services of general interest (SGI) having an economic nature and those that do not. SGEI, by definition, fall into the former category whilst SSGI may constitute either an economic activity or a non-economic activity. It is settled case law that these classifications are a matter for EU law: that where there is economic activity the service provider in question will constitute an economic entity and be subject to both the competition and free movement provisions of the Treaty.[43] The Treaty, in its Lisbon revisions, further reinforced this economic / non-economic distinction, emphasising in Protocol 26 that the provisions of the Treaties do not affect in any way the competency of Member States to provide, commission and organise non-economic services of general interest.[44]

It is the Court of Justice (CJEU) that has over many years developed the concepts of 'undertaking' and 'economic activity' both in relation to competition law and, more particularly in respect of SGEI, to State aid and the regulation of compensation payments. These have now been set out by the Commission in a series of instruments idiomatically known

41 Bekkedal T., 'Article 106 TFEU is Dead. Long Live Article 106 TFEU', in E Szyszczak and others (eds) *Developments in Services of General Interest* (The Hague, TMC Asser Press, 2011) 98-99.

42 Commission Opinion, Reinforcing Political Union and Preparing for Enlargement COM (96) 90, 3, and see ibid, 100.

43 See, van de Gronden. J., 'Free Movement of Services and the Right of Establishment: Does EU Internal Market Law Transform the Provision of SSGI?', in Neergaard et al (eds), *Social Services of General Interest in the EU* (The Hague, TMC Asser Press, 2013), 123 et seq.

44 Protocol 26, Article 2, emphasis added.

as the Almunia Package and that now provide the important parameters for Member States to consider when providing, commissioning and organising SGEI under the wide discretion afforded to them in Article 14 TFEU and Article 1 of Protocol 26.[45] This becomes even more relevant as public authorities in the Member States choose to adopt competitive tendering or other contestable procurement mechanisms in order to secure 'value for money' service provision contracts. As van de Gronden identifies, in attaching '...great value to the abstract question of whether the SSGI concerned can be provided for on the market' the Court stressed that 'every service, which is normally provided for economic consideration, should be regarded as a service in the sense of Article 57 TFEU.'[46] For example, the exclusion of 'social housing' from the provisions of the Services Directive does not eliminate the provision of social housing, as a SSGI, from categorisation as a SGEI.[47]

This approach is also reflected in *Hartlauer*,[48] a case concerning prior authorisation schemes for dental outpatient clinics, where the CJEU judgment provides for a wide margin of appreciation by Member States in organising their SSGI *provided that* the Member State draft their SSGI regulations systematically and consistently on transparent and non-discriminatory principles. This is an approach that van de Gronden finds has a great advantage in balancing national autonomy with the EU free movement rules but that also may bring problems, either as a result of national political constraints or where a SSGI is delegated to regional or local authorities, and therefore potentially subject to inconsistent

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45 The Almunia Package of 2012 updates the Commission's Altmark Package on State aid and compensation payments made to undertakings providing SGEI. The new package contains a Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, OJ 2012 C8/4; a Communication from the Commission, European Union framework for State aid in the form of public service compensation OJ 2012 C8/15; a Commission Decision of 20 December on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest OJ 2012, L7 p.3; and a Commission Regulation on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid granted to undertakings providing services of general economic interest, OJ 2012, L 114 p.8.

46 van de Gronden. J., 'Free Movement of Services and the Right of Establishment: Does EU Internal Market Law Transform the Provision of SSGI?', in Neergaard et al (eds), *Social Services of General Interest in the EU* (The Hague, TMC Asser Press, 2013) 127.

47 See, Case C-567/07 Sint Servatius [2009] ECR I-9021 and particularly, para 35.

48 Case C-169/07 Hartlauer [2009] ECR I-1721

provision. For this contribution, the important conclusion drawn by van de Gronden is that social services, considered to fulfil essential functions and subject to EU internal market law should be modelled as SGEI,[49] and the *Hartlauer* judgment confirms the Member State obligation to 'draft their national SSGI regulations in line with good administration-type principles' comprising of 'consistent and systematic drafting, transparency and non-discrimination.'[50]

The EU rules on state aid, public procurement and the internal market provide that the act of entrustment is necessary in order to set out the terms of the organisation of a public service task: that it is the official act which entrusts the provision of an SGEI to the service provider; that it spells out the task of general interest; and that the scope and the general operational conditions of the SGEI.[51] This is reinforced in the Commission decision associated with the Almunia package that requires the act of entrustment take the form of one or more official acts having binding legal force under national law with the specific form of the act determined by the Member State. Whilst the form of these national acts has been left to the Member States, the Commission, with some reference to CJEU case law, has set out examples of a broad range of instruments that it suggests may comprise acts of entrustment based on its own Decisions: concession contracts and tender documents;[52] ministerial programme contracts;[53] ministerial instructions;[54] laws[55] and acts;[56]

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49 Van de Gronden 'Free Movement of Services and the Right of Establishment: Does EU Internal Market Law Transform the Provision of SSGI?' in U Neergaard and others (eds) *Social Services of General Interest in the EU* (The Hague, TMC Asser Press, 2013) 158.

50 Ibid, 146-147.

51 SEC (2010) 1545, Commission staff working document – Guide to the application of the EU rules on state aid, public procurement and the internal market to services of general economic interest, and in particular to social services of general interest, para. 3.4.1.

52 Commission Decision in case N 562/05 - Italy - Proroga della durata della concessione della Società Italiana del Traforo del Monte Bianco (SITMN), OJ C 90, 25.4.2007.

53 Poste Italiane SpA: compensation by the Member State for universal postal service obligations 2000-2005 (Case N 51/06 – Italy) Commission Decision [2006] OJ C 291/17.

54 Government rural network support funding to Post Office Limited (Case N166/05 – UK) Commission Decision [2006] OJ C 141/2.

55 Case T-289/03 *BUPA and Others v Commission* [2008] ECR II-741, paragraphs 182 and 183 and Financiamento de las medidas de reducción de plantilla de RTVE (Case NN 8/07 – Spain) Commission Decision [2007] OJ C 109/2.

56 Loan guarantees for social infrastructure schemes funded by the Housing Finance Agency (HFA) (Case N 395/05 – Ireland) Commission Decision [2005] OJ C 77/1.

yearly or multiannual performance contracts;[57] legislative decrees;[58] and *any kind* of regulatory decisions, as well as municipal decisions or acts.[59]

4.2. State obligations and compensation payments

Whilst historically most social services were provided directly by the state, more recently, and with some significant variation across the Member States and between different sectors, private and third sector service providers are increasingly being commissioned. This has led to a growing Public Services Industry (PSI) that operates at both local and national levels in the Member States and that increasingly demands more SSGI provisioning to be categorised as SGEI.[60]

The revised emphasis on SGEI in the Treaty revisions at Lisbon, coupled with the CJEUs *Altmark* judgment and the subsequent Almunia reform, position public service compensation as an exempt category of State aid, defined by the entrustment of the PSOs in a SGEI to the service provider, that is compatible with the internal market and exempt from Article 107(1) TFEU and the notification requirements of Article 108(3) TFEU.[61] The Commission decision in the Almunia package adopts a far broader approach to the inclusion of social services, recognising that 'in the present economic conditions and at the current stage of development of the internal market, social services may require an amount of aid beyond the threshold in this Decision'.[62] An exemption that allows for Member States to provide unlimited compensation where 'social services ...[are] clearly identified services, meeting social needs as regards health and long-term care, childcare, access to and reintegration into the labour

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57 Laboratoire national de métrologie et d'essais (Case C 24/2005 – France) Commission Decision [2007] OJ L 95/25.

58 See the judgment of the Court (Third Chamber) in Case C-451/03 *Servizi Ausiliari Dottori Commercialisti v Giuseppe Calafiori* [2006] ECR I-2941.

59 SEC (2010) 1545, para. 3.4.2. emphasis added.

60 Discussed below in section 5.

61 See, Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, OJ 2012 C8/4, para 4.3 and Commission Decision of 20 December 2011, on the application of Article 106(2) to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, 2012, OJ L 7/3, Article 1.

62 Ibid, Recital 11.

market, social housing and the care and social inclusion of vulnerable groups.'[63]

With the exception of the transport sector, this exemption from the funding limit for economic SSGI is balanced by a reduction in the compensation threshold, from €30 million to €15 million, for other SGEI activity and that is accompanied by an obligation for the Member State to inform the Commission.[64] Whilst the form of an act of entrustment is left to be determined by the Member State, the Decision requires that such an act 'shall include', the content and duration of the public service obligations; the undertaking, and where applicable the territory concerned; the nature of any exclusive or special rights assigned to the undertaking; a description of the compensation mechanism and the parameters for calculating, controlling and reviewing the compensation; and, the arrangements for avoiding and recovering any overcompensation.[65] In addition to such basic transparency requirements, Member States are also required to provide bi-annual reports of their application of the Commission decision and to keep available, for 10 years beyond the period of entrustment, all necessary records for determining the compatibility of compensation paid with the decision.[66] Where compensation exceeds the new threshold for any undertaking with activities that are outside the scope of the SGEI, the Decision places a further obligation on the State to publish the act of entrustment, or a summary of it, and the annual amounts of compensation granted to the undertaking.[67]

5. Economic SSGIS and private sector provision

5.1. Economic SSGI and Service Provider Obligations

In a recent study on SSGI, the Commission draws on analysis of four selected social services sectors from 22 EU/EEA Member States: long

63 Ibid.

64 Ibid, Article 2(1)(a), citing the requirement for notification in Article 108(3) TFEU that provides for the Commission to assess the compatibility of the granting of aid with the rules of the internal market.

65 Ibid, Article 4 and recital 14.

66 Ibid, Articles 8 and 9.

67 Ibid, Article 7.

term care, early childhood education and care services, employment services, and social housing.[68] Although only providing a focus on four sectors, the study highlights the complexity that arises from the diversity and specificity of the different national systems of social services: from the lack of any common understanding of terms applied to key concepts and definitions; from a lack of official data and statistics in some sectors; from regional variations in social services provision within Member States; and from the frequent changes to the legal provisions on social services across all sectors and in all countries.[69]

Where, in the regulatory frameworks and operational objectives of the network SGEI sectors we find the dominant focus on quality of service provision for the user/consumer, the common element found across the four social service sectors provides a sharp contrast with a focus on the contractual obligation of the service provider towards the public authority. We also find in these case studies that in the contract to deliver the public interest service, albeit with some exceptions, '...public authorities usually do not formally entrust service providers with "a mission of general interest"' or '...appear to use the language of "entrustment of missions of general interest".[70] It is the various national public instruments, the 'acts of entrustment' described above, together with constraints provided for in tender processes that generally appear to limit the autonomy of service providers. The delivery of PSOs in these sectors relies, not on a regulatory quality framework, but on the individual contractual detailing of the tasks, quality parameters, and missions to be carried out.[71] The following very brief sectoral summaries of the Commission's study illustrate however the significant variation in the approaches to service quality and governance structures that apply to these contractual arrangements.

5.1.1. Long term care

In the large majority of Member States the public authorities act in a commissioning role where services are to be provided by external

68 Richard Polacek and others (n 2) 'Study on social services of general interest' (2011) European Commission.

69 Ibid, 26-27.

70 Ibid, 159.

71 Ibid.

providers, contractually specifying the tasks to be carried out but without appearing to equate these tasks with the formal entrustment of a mission of general public interest. The obligation placed on the external service provider is consequently limited to the contractual terms of the individual contract. There is however a significant variety between the Member States with regard to the quality frameworks and tools that may be associated with such contracts and whilst some encompass accessibility and sustainability standards this is not systematically found everywhere. Other measures, including the skills and qualifications of employees, and their working conditions, may or may not be included or may be regulated in separate legislation.[72] In most of the Member States these quality tools (standards and frameworks), are backed up formally by legislation at the national level or, with a 'significant disparity in approach' at the regional level in federal states.[73]

The report identifies two broad categories of quality tools employed, the largely generic measures that focus on long term care as a whole and those that provide for a more targeted approach with the objective of improving the quality of a specific service or a group of services. The overall focus of these measures is however identified as being concentrated on residential care as opposed to 'community-care (e.g. day care services) or home based services.'[74] The report finds that legislative responsibility for long term care is typically divided between ministries responsible for health and ministries responsible for social care services 'with the ministry of health responsible for long-term medical nursing care and social services responsibility for non-medical services that help individuals with basic activities of daily life (dressing, washing, eating etc).' Approaches to the legal enforceability of public sector quality procedures are diverse, or in a few countries nonexistent, and responsibility for monitoring the standard of service provision may be transferred to independent agencies.

Overall, there is significant variety in the scope of quality frameworks with some focussing solely on residential care with no consideration for

72 Ibid, 12, 23 and 56

73 The Report singles out Poland as the only Member State where there are no specific long term care measures in place, see ibid, 215 and 218.

74 Richard Polacek and others (n 2) 216.

community or home based care services. In the majority of countries subject to the survey the quality systems were concerned with improving accessibility, although national approaches were again distinct, and in only five countries was there any concern over service sustainability.[75] Complaint procedures are available in all countries with the majority embedded within quality frameworks but, the report notes, 'a small number of cases from different countries, in respect of the rights of individuals [in long term care]...have also been brought to the European Court of Human Rights where redress has not been possible at national level.'[76]

The wide range of approaches to quality management for long term care is additionally complicated by a generic focus on, primarily residential, social care and/or health care services rather than any holistic focus on long term care per se. The lack of attention paid to community care and home-care services is identified as 'a significant limitation, given that the personalisation of services may mean that more individuals have the opportunity to remain at home for as long as possible' rather than enter long term care facilities. It is apparent however that many countries are reviewing their quality systems within a general trend towards the use of performance assessment and a need for greater levels of economic efficiency, the adoption of best practice models, and 'an even more acute concern to protect the human rights of what is considered to be a vulnerable group within society.'[77]

5.1.2. Early Childhood Care

Irrespective of whether the service provider, is a public authority, an outsourced provider acting for a public authority, or a private sector entity the tasks are typically set out in legislation, regulations or standards applicable to the sector: as is any authorisation, licensing or accreditation requirements for external or outsourced service providers. Yet, in a large majority of countries, public authorities who outsource early childcare services again do not appear to equate these tasks to the for-

[75] Ibid, 225.

[76] Ibid, 232.

[77] Ibid, 233.

mal entrustment of a mission of general interest[78] The generally implicit nature of any entrustment of a general interest mission rests, most often, on the primary obligation to 'run the service' and is, 'in almost all cases', a contractual arrangement subject to the national or municipal legislative/ regulatory framework that may often require 'quality criteria and some developmental objectives for children at the end of each school year'.[79]

Within the study, fifteen countries were identified as having some form of quality assurance in place for early childhood care but again, these varied considerably and very few countries were found to have 'comprehensive and coherent legislation for quality frameworks' for the sector.[80] Conceptually child care services were found to encompass 'a variety of meanings, values expectations and standards across Europe' and, generally, quality tools were found to be regulated in multiple legal instruments as a consequence of the separate administration and regulation of on the one hand care services and on the other hand early education services. The variety of approaches are influenced by different perspectives that stretch from a view that 'frameworks need only be very general and value-orientated' to a view where 'every aspect of quality must be articulated in detail through legislation and guidance…'. [81]

The report highlights the lack of legal consistency between countries, identifying that in some countries, quality tools may be developed without recourse to any legal instrument; in others very specific and detailed quality standards will be enshrined in law; and in yet others the law will merely provide frameworks for quality. It also identifies that for many countries service accessibility is included within the quality system and is more likely to be guaranteed for children over three, although accessibility may depend on what parents can afford to pay. In countries where accessibility is guaranteed the quality frameworks specify fee structures whereas in countries where services are marketised, conditions of access and fee capping are outside the quality frameworks.

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78 Denmark is cited as an exception with independent day care centres entrusted with a mission of general interest.

79 Richard Polacek and others (n 2) 79.

80 Norway was distinguished with its quality tools as laid down in the 2005 Kindergarten Act as a possibly an 'exceptional case of a homogenous and structured quality framework'.

81 Richard Polacek and others (n 2) 235-236.

In these countries competition between for-profit providers is recognised as the controlling mechanism for price and quality.[82]

5.1.3. Employment Services

The report finds that the public authorities typically specified the tasks to be carried out by external providers but without any formal entrustment of a mission of general interest. Instead, it identifies that the general interest objective may be entrusted to external providers, 'because of the nature of the contracts that they draw up with them' but, because of the nature of the contractual language used, without any clarity of the public service obligation in terms of the general interest objective. The contractual terms reflect the specifications published by the public authorities and the tasks to be undertaken by the private service provider: for most countries these do not allow for initiative and, the report suggests, this is a lack of autonomy that 'runs counter to the concept of an act of entrustment of a mission of general interest.'[83]

5.1.4. Social Housing

Again, the sector is marked by significant variation in the models of social housing provision and for some countries, the report notes; social housing may be non-existent or marginal. The public authorities define the tasks to be carried out by the service providers according to the provisioning model. The most common amongst these include the provision of housing by public authorities, although not all public provision should be regarded as social housing; the allocation of owned and managed housing stock by private social housing providers; the provision of housing by approved or regulated housing providers providing a specific, social business model; and public funding schemes whose function is the granting of financial compensation in the financing of social housing provision. Social housing will also include the letting of property in old housing stock.[84]

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82 Ibid, 240, 243 and 246-247.

83 Ibid, 106-107.

84 Ibid, 112-113.

The entrustment of a specific mission of general interest in the sector is allocated according to general rules and compliance requirements as set out within a legal framework that often includes public supervision and sanction mechanisms where the service is contracted to an approved provider. Under public funding schemes such entrustment is provided for in the general legal framework of regulations and conditions and in project specific conditions as they apply to the public funding aspect of a scheme. From an internal market perspective it is interesting to note that the report identifies that '[m]ost of the approval/funding schemes require providers to be domestic (based in the country).'[85]

5.2. The rise of the Public Service Industry

In its first biennial report on SSGI, the Commission identified common features in the modernisation and reform of the organisation and management of SSGIs across Member States, with the general aim of increasing efficiency and effectiveness of service provision.[86] Amongst these it identified an increased utilisation of performance measurement tools, user empowerment and involvement mechanisms, integration of services and decentralisation. Parallels with the early developments in the network SGEI sectors are obvious and the report 'also observes a shift from public programming towards a market-based regulation approach'.[87] This is a shift of approach that has been accompanied by the emergence of a Public Service Industry (PSI), made up of private (for profit), social enterprise and other third sector not-for-profit and charitable enterprises.[88]

These enterprises are involved in the provision of residual public services that typically encompass health, education, and social insurance at the national level, or social and community care, welfare and social housing at a more local level.[89] Although subject to sectoral varia-

85 Ibid, 137-138.

86 SEC(2008) 2179, Biennial Report on social services of general interest.

87 Ibid, 8.

88 This definition is drawn from DeAnne Julius, Public Services Industry Review, BERR (2008), last accessed 10 April 2013 at http://www.bis.gov.uk/files/file46965.pdf, 5.

89 Leaving aside the essentially pure public goods of law enforcement, defence and public administration.

tions, and influenced by national traditions, the not-for-profit and third sector actors play an important role in the delivery of SSGI,[90] but these are market actors increasingly challenged by a modernisation process in which the complexity and costs of procurement and tendering processes, together with a focus on results based payments, militates against the third sector and suggests the potential for an implicit bias toward large, mainly private sector providers.[91] In the UK, with its well developed PSI, such a bias is already witnessing an emerging trend for its voluntary sector organisations to sub-contract with the private sector 'in order to side step cash flow issues.'[92]

It is beyond the scope of this chapter to explore or discuss in any detail the wide range of services provided by this growing PSI, but attention is drawn to the size of the PSI and its potential to provide cross-border services. In the UK the PSI increased its turnover between 1995 and 2008 by some 126 per cent to reach a 2008 level of £79bn, representing 5.7 per cent of UK GDP: this compares to 6 per cent of national GDP for the PSI in Sweden and just less than 3 per cent for France and Spain.[93] Within the PSI sectors are substantial market actors and the UK PSI review identifies the increasingly global nature of this market and the recognition within national governments of 'the benefits of using private and third sector organisations to deliver public services.'[94] The review also identifies that 'private sector providers of public services compete in each other's markets [but]...also make choices about where they bid for new contracts, depending in part on the reputation developed by different governments for competitive neutrality...'.[95] This growth in the PSI provides for private service providers that are able to exploit economies of scale in service delivery, at least at the national level but the concern expressed in the review over market closure perhaps calls for

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90 The role of non-profit providers has legal recognition in several Member States. See, SEC(2010) 1284 final, second Biennial Report on social services of general interest, 120.

91 See, for a UK example, Civil Exchange, *The Big Society Audit 2012*, available at http://www.civilexchange.org.uk/wp-content/uploads/2012/09/THE-BIG-SOCIETY-AUDIT-2012finalwebversion.pdf, 71.

92 Ibid.

93 DeAnne Julius, *Public Services Industry Review* (n 95) 8.

94 Ibid, 60.

95 Ibid.

further research from an EU internal market perspective and the general desire to increase cross-border trade. Such a study could also address issues that could arise within the context of traditional subsidiarity based approaches towards local provision in particular social services sectors.

One imperative for considering a 'scaling up' of the approach to social service provision, at least in the long term care sector, is the recognition at the EU level of the growing demand predicated on the aging European population.[96] The growing demand in this sector and the general shift towards a market-based regulatory approach are accompanied by a growing attention to quality in social services, whilst a debate on quality is also triggered by the potential for growth in cross-border provisioning.[97] Whilst 'currently very limited', cross-border provision of social services is 'expected to increase, in particular in the area of long-term care…[and] will require a greater level of service comparability and transparency'.[98] Acknowledging the reluctance for any systematic application of EU rules to the organisation, financing and provision of SSGI,[99] increasing cross-border provision and the potential for a growing market presence by the private sector increase the pressure for market opening and perhaps the need for the entrustment and regulation approaches of PSOs in this social SGEI sector to perhaps be more closely aligned with those of the network SGEIs.

6. Conclusions

Underpinned by Treaty provisions, and reinforced with the Lisbon revisions, the principles and values associated with the PSOs developed in the network SGEI sectors have become defined by the normative values inherent in good administrative behaviour that applies to all actors: at the EU level; at the state level, including both the state itself and independent regulatory agencies; and at the service provider level. Sectoral rules are set out in directives and regulations, and interpreted by the CJEU at the EU level; these rules then inform the Member States of

96 SEC(2010) 1284 final, 20.

97 Ibid, 38.

98 Ibid.

99 Ibid, 120.

the requirements in providing for an act of entrustment, in establishing a compensation regime; and in establishing independent national regulatory agencies. The rules will also inform the standards adopted by the regulatory agencies, and the operational characteristics and quality frameworks to be adopted by private sector service providers. Ex-post monitoring of the mission of general interest, and service provision more generally, in terms of transparency, affordability, accessibility, quality, and user (consumer) satisfaction has become a norm at all levels.

There is also a developing imperative for Member States to designate essential SSGI as SGEI and a growing Public Service Industry in which private sector economic actors may enjoy a general advantage in the public procurement processes. Where social services are to be associated with tasks of general economic interest, the EU rules require them to be clearly identified by the Member State and for the Member State to set out the scope and task of general interest in a formal act of entrustment. It is here that the model of PSO delivery for the social services sectors offers far greater flexibility than is the case for network SGEIs with considerable discretion afforded to the Member states in choosing the form of any such act. Case law of the CJEU does however require that state actors at all levels, when entrusting a mission of general interest to an SSGI, must abide by good administration-type principles and set out, in advance, any objective and non-discriminatory discretion they chose to reserve for themselves.

For the service providers, the discharge of PSOs in the social SGEI sectors appears generally contingent on the specifications included in the commissioning arrangements and the contractual details agreed with the commissioning authority. Responsibilities are however fragmented and there is significant variety in the scope and legal enforceability of the quality frameworks, both between sectors and between national traditions. It is also notable that the reviews of the quality frameworks that are taking place in the social SGEI sectors have an economic efficiency and best practice perspective that echoes the approach in the network SGEI sectors.

A number of underlying themes have been drawn out in the discussion that can be summarised as: a developing imperative for Member States to classify SSGI as SGEI; a less than focussed and

fragmented approach to the expression of the PSO that is in part reliant on any kind of regulatory decision or municipal act, and in part reliant on the contractual detail between the commissioning authority and the service provider; and a developing Public Services Industry with a growing bias towards the private sector. Together, these themes raise the question of whether it is time for the expression of PSOs, in at least one social services sector, to be modelled similarly to those in the network SGEI sectors. Europeanisation of the network SGEIs was developed on a sector by sector basis and such an approach here could reinforce the coherence of the internal market in social SGEI, perhaps given the anticipated growth in cross-border provision for long term care and the key driver of an aging population, a pilot sector is self selecting?

Part IV

Other key challenges for the SEM

7

Towards a single public procurement market in the EU

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ABSTRACT

Public procurement is one of the main activities of the European economy where more than 15% of the GDP depends on it, serving also as guidance and budget management of many public policies. Their regulation in the EU focuses on the domestic market and the introduction of competition.

A new legislative package must be adopted in 2014 in order to advance in the single market public procurement (and regulated) in the EU. The main novelty of the new regulation is the incorporation of the concessional legal regime, as well as the deepening of inter environmental policy and public procurement, the development of e-procurement and a timid advance in the necessary Governance in public procurement.

KEY WORDS: Public Service Obligation, Social Services, Quality, Entrustment, SGEI, SSGI, Essential Services, Private Sector, Public Service Industry, Public Service Governance

1. Introduction

Public procurement is a major economic activity for the State and highly regulated industries and sectors. The regulation of public procurement represents best practice in the delivery of public services by the State

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and its organs and facilitates the observance of the well-embedded principles such as accountability for public expenditure[1].

The opening up of government procurement, with the purpose that any European company may carry out works, provide supplies or deliver services in other Community countries, is an objective which wasn't a part of the Treaty of the European Community (TEC) or its following amendment Treaties. The only reference found at that foundational moment of the European Economic Community about government procurement in the Treaty of Rome is regarding the regulation of transport policy and in a tangential reference, therefore without making any reference to any general or substantial legal procurement system.

When at the end of the decade of 1970 the European Community (EC) finds some clear indications that in the majority of the member countries, public agencies award administrative contracts to national companies, thus implementing a kind of "national protectionism" against other more competitive bids from companies from other member countries, a proposal was raised to liberalize or open these contracts so no national discriminations are made. And, not only contracts signed by Public Administrations, but also in a subsequent legal development, contracts signed by public or private bodies from the sectors of energy, transportation, telecommunications or drinking water supply, considering their public service nature, or their classification as "general interest service"[2] and "universal service" and in general, their dependence, control or intervention by Public Administrations, even partial but decisive.

The regulation of public procurement has multiple dimensions, as a discipline of European law and policy, directly relevant to the fundamental principles of the common market and as a policy instrument in the hands of Member States. Its purpose is to insert a regime of competitiveness in the relevant markets and eliminate all non-tariff barriers to intracommunity trade that emanate from preferential

1 Bovis C, EU Public Procurement Law (2012).

2 See, among many others, Lianos I, *La Transformation Du Droit de La Concurrence Par Le Recours a L'analyse Economique: L'exemple Des Restrictions Verticales,* vol 60219 (Bruylant 2007) Also, Kovar R, 'Marché intérieur et politique de concurrence' (1989) 15 Droit et pratique du commerce international 230.

purchasing practices which favor national undertaking[3]. The regulation of the public procurement in the European Union has been clearly and significantly influenced by the internal market process[4].

So, then, this opening process of procurement is directly connected with the ban of nationality-based discrimination, with the transparency principle, with the free movement of goods and services, but mainly it is a concrete expression of competition law.

Government procurement constitutes an important instrument of economic policy used by public authorities and regulated entities, both for procuring required material means and to encourage, in the first of the assumptions mentioned, the whole of the economic activity in various sectors. It is also an instrument of the industrial, work, regional, research and development, standardization, pro-small and medium enterprise and particularly competition policies within the domestic market. Therefore, public authorities use public contracts not only as an instrument to buy and drive their tasks and procurement of goods and services cheaper, but also as a tool to intervene in the social, economic and politic life of a community.

Therefore, it shall be necessary to examine how the process of opening the contracts of public entities to the competition of any European entity and company has been conducted, and how the so-called regulated contracting has developed and which is its current regime, that is, the contracting that affects the aforementioned sectors, which are called "excluded" or "special", corresponding to the strategic sectors in the economic sphere which, in the three last decades, started the process of moving towards the de-monopolization of their activities and free competition in Europe, and which are rightly qualified as "services of economic general interest".

The legal system that rules the policy on government procurement already has a significant body of laws. There are several so-called "legisla-

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3 See S. GONZALEZ-VARAS IBAÑEZ, Tratado de Derecho administrativo, 6 tomos, tomo 4, contratación administrativa editorial Civitas Madrid 2013 segunda edición. *Bovis C, EU Public Procurement Law* (2012).

4 See, The White Paper for the Completion of the Internal Market; the significant references to the non-public procurement opening up to competition in the EEC internal market, in Ceccini P, Catinat M and Jacquemin A, 'The European Challenge 1992: The Benefits of a Single Market' (European Commission 1988).

tive packages" that have been issued from Community institutions since the decade of 1970. This regime has received in the last stage a double significant impulse: in 2004 and in 2011. Thus, it has received a significant boost with the approval in 2004 of a new legislative package of secondary legislation via corresponding Directives: those currently valid, which partially amend both dispositions relative to the general system or that of Public Administrations, and to the special system or so-called "excluded sectors"[5]. After this legislative package, the current horizon presents us with a new set of amendments, already approved as proposals, which shall update the contractual regime of the public sector and the special sectors and which shall inaugurate, foreseeably, that of the regime of concessions from Community regulation.

From the perspective of the primary or original legislation, little has been done to advance in the express definition of a Community-level policy regarding public procurement. In the Treaty of Nice, and particularly in the adoption of the Treaty of Lisbon, a good opportunity was lost, from our point of view, to incorporate public procurement policies to the already large catalogue of European policies. The list of policies included in the Treaty on the Functioning of the European Union is closed with the policy listed as "of Administrative Cooperation", a public procedure which has a more instrumental character than an authentic European shared policy. Nevertheless, procurement has both economic reasons of huge significance as well as a substantial legal system, with a Community-harmonizing nature, which should have received the attention of the European legislator so as to incorporate it to the roster of Community policies. In the next Inter-government Conference to be held for the amendment of the current TEU and TFEU, there should be a calm and constructive analysis about this issue and the various related circumstances, which are clearly relevant for a modern conception of public policies in the EU.

Therefore, the Treaty of Lisbon does not expressly incorporate public procurement as "policy", although currently it is possible to include this system within the framework of necessary policies for the proper functioning of the internal market, also related to the establishment of

5 See, López-Ibor Mayor V, 'La Contratación en los "sectores excluidos"' [2010] Noticias de la Unión Europea 3.

competition regulations, with the same purpose. Likewise, the precept of Article 106 of the Treaty on the Functioning of the European Union (TFEU) would be applicable to public procurement, which establishes that "member States shall not adapt or hold, with respect to public companies and those to which they grant special or exclusive rights, any measure contrary to the Treaties".

We must remember that the Community policy of opening public procurement starts during the decade of 1970, with the approval of a series of regulations in works and supply contracts[6].

With a view to achieve the Single Market in 1992 and on the grounds of the White Paper the Commission submits to the Council on June 28-29, 1985 a new package of legislative reform[7].

As of 2004, the applicable legal framework is the established in Directive 2004/18/EC of the European Parliament and Council, of 31-3-2004 (DO L 134 of 30-4-2004), on coordination of the awarding procedure of public work, supply and service contracts, which partially amends the previous ones, notwithstanding the legislation regarding the system of resources or guarantees, which remains invariable[8].

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6 Directives: 71/305/EEC, of July 21, on work contracts, and 77/62/EEC, of December 21, on supply contracts.

7 This legislation can be summarized thus:

- An amendment of the Directives on work and supply contracts, in order to ensure a greater transparency in awarding procedures.
- A reinforcement of compliance control of regulations in force through the approval of a new resources Directive.
- Opening the contracts in the services sector, which originally had been left aside.
- The approval of new Directives for the sectors that had been excluded up to that point: energy, transport, telecommunications, and supply of drinking water.
- And finally, as mentioned in the previous item, adoption of a new legislative package that partially amends the contract Directives, both of Public Administrations and of the "excluded" sectors.

So, from the perspective of secondary legislation, the following legislative packages have been passed:

A) Work contracts are governed by Directive 97/37/EEC of June 14, which merges in a single text the two previous Directives (71/305 and 89/440).
B) Supply contracts are governed by Directive 93/36/EEC of June 14, which merges in a single text the two previous Directives (77/62 and 88/295).
C) Service contracts are governed by Directive 90/50/EEC of June 18.
D) The remedies Directive is 89/665, of December 21.

8 Directive 2004/18/EC has been modified by Directives 2005/51/EC (DO L 257 of 1-10-2005); 2005/75/EC (DO L 323 of 9-12-2005); and 2006/97/EC (DO L 363 of 20-12-2006). And by Regulation (EC) 2083/2005 (DO L 333 of 20-12-2005).

Council Directives 89/665/EEC of 21 December 1989, and 92/13/EEC of 25 February 1992, which have the respective purposes of coordinating the laws, regulations, and administrative provisions that refer to the application of review procedures for the award of public works, public services and public supply contracts as well as the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors. In reality, Directives 89/665/EEC and 92/13/EEC aim to guarantee the effective application of Directives 2004/18/EC and 2004/17/EC, such that they may be said to constitute the guarantee of their efficacy[9], through remedies system and "interim measures"[10]

The Green Paper on modernization of the public procurement policy of the EU "Towards a More Efficient European Market of Public Procurement" was a reminder of how the public procurement policy fits in the 2020 EU strategy.

Indeed, the Europe 2020 strategy for "intelligent, sustainable and inclusive growth" offers a vision of the competitive social market economy of Europe for the next decade based on three interrelated and mutually reinforcing priorities: development of an economy based on knowledge and innovation; encouraging a low carbon emission economy, which uses resources more efficiently and which is competitive; and encouraging a high-employment level economy with social and territorial cohesion.

Public procurement has a key role in the Europe 2020 strategy as one of the market-based instruments to be used in order to meet these goals[11].

The Europe 2020 strategy also emphasizes that public procurement policies must guarantee the most efficient use of public funds and

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9 A comparative approach in Greco G, Il sistema della giustizia amministrativa negli apparotti pubblici in Europa (Giuffrè Editore 2010); and Treumer S and Lichère F, Enforcement of the European Union Public Procurement Rules (Djof Publishing 2011).

10 See, Gimeno Feliu JM, Novedades de La Ley de Contratos Del Sector Público, de 30 de Octubre de 2007, En La Regulación de La Adjudicación de Los Contratos Públicos (Civitas 2010) p. 297.

11 More specifically, the Europe 2020 Strategy demands that public procurement:

- improves general conditions conducive to innovation on behalf of companies, making full use of the demand policies;
- supports change towards a more resource-efficient economy with low carbon emissions, for example, therefore encouraging the generalization of an environmental committed public procurement,
- and improves the corporate environment, particularly for innovative SMEs.

that public procurement markets must continue having a dimension that includes the entire EU, optimal results from procurement through efficient procedures is crucial, within the context of drastic budget limitations and economic difficulties prevailing in many member states of the EU. For that reason, such challenges demand a European market of public procurement which is operational and effective and able to fulfill these ambitious objectives.

The current generation of Directives on public procurement, Directives 2004/17/EC and 2004/18/EC are the last step of a long evolution that started in 1971 when Directive 71/305/EEC was adopted. The main purpose of these Directives, by ensuring some transparent and non-discriminatory procedures, is to safeguard that economic operator's benefit fully from the fundamental freedoms in the arena of public procurement. Next to that, a series of objectives related to the integration in this framework of other policies is incorporated, such as those regarding the protection of the environment and social regulations and to regulate measures avoiding conflicts of interests and corruption practices.

Considering the key role played by public procurement to face the challenges of this time, it is necessary to modernize available tools and methods so as to make them more appropriate to respond to the evolution of the politic, social and economic context. Several supplementary objectives must be fulfilled. The first one is to increase the efficiency of public spending. Bidders must be offered the opportunity to compete in equal conditions and the distortions of the competition must be avoided. At the same time, it is crucial to increase the rationalization of procurement procedures, with simplification measures that are specifically adapted to the particular needs of the smaller awarding authorities. More efficient procedures will benefit all economic players and they shall facilitate the participation of the SMEs and cross-border bidders and the development of PPP's formulas, meaning by it public service or services of general economic interest projects in which the private agents undertakes the project construction, assumes total or partial risk and participate in the operation stage.

2. The new legislative package. The concessions directive

Today we highlight the character and nature of the new legislative package to be adopted in the Member States in 2016. The new regulation follows the same principles and legal techniques than the foregoing regulation, but deepens in some respects. Thus, the objective area of the Directives applies exclusively to contracts for works, services and supplies held by the mentioned public bodies. And such a classification, reflects both a historical categorization as well as a purpose of clarification of the different types of contracts, although there are border areas or with contractual intersection called "mixed contracts", developed in particular in the case-and collected to date in Guideline 2004/18/EC, which is also the basic criterion that has been defined, "where a contract contains elements relating to different types or categories, the rules should be determined by the main purpose of this contract".

It has also been raised by the doctrine and the European institutions, in some cases, the need to simplify the current contractual structure, comparing it to that in the ACP regime, although no concrete steps have been taken yet, from the regulatory perspective in these cases, except in relation to the unification of the distinction between service contracts into two categories, but that they keep an evident temporary nature from the moment of its conception[12].

The new "general" guideline introduces under the name of "Mixed Contracts" (art. 3), the contracts aimed at two or more types of procurement (works, services or supplies) that will be awarded in accordance with

[12] They are excluded from this general rule:

- Those contracts that do not exceed the thresholds established. "Procurement" is defined as "the onerous contracts and concluded in writing between one or more economic operators and one or more contracting authorities and having as their object the execution of works, the supply of products or the provision of services in accordance with this Guideline ". And these contracts can be of three types: works, supplies and services.
- The contracts awarded in the fields of water, energy, transport and telecommunication sectors are covered by their specific regulations;
- Contracts declared to be secret;
- The contracts whose performance must be accompanied by special security measures, and
- The contracts concluded under an international agreement or a particular procedure of an international Organization.

the provisions applicable to the procurement category that characterizes the main object of the contract in question.

The three basic types of procedures imported from the national legislations of public procurement have traditionally been: a) the open procedure, by which any supplier, contractor or service provider concerned may submit tenders; b) the restricted procedure, in which any contractor or service supplier concerned may ask to take part but the only candidates that may submit tenders are the ones invited by the contracting authority; c) the negotiated procedure, by which the contracting authority consults with contractors, suppliers or service providers of its choice and negotiates the terms of contract with one or more of them.

In the regulation of the different types of contracts and of the contractual modes it has been done following the said scheme reflected in the European Directives both for the public and the special sectors or "regulated". In the second legislative package for "partial codification", in the sense of grouping both types of contracts as well as resource systems, it has been incorporated as a novelty, the process of "competitive dialogue", referred to for particularly complex contractual relationships in which the power authority needs the technical capacity of the experts, in the "market" to not only solve the proposals, but also in making them, largely reconditioning the character of the submitted offers.

In the new proposal, now raised by the Community institutions, the "innovation partnership" is added to the previous regime procedure as well as open procedures, restricted, competitive procedure with negotiation and competitive dialogue, and the use of the negotiated procedure without prior publication, but framing it in the "compatitive dialogue procedure". The concrete definitions are as follows:

a) *Tender procedure with negotiation*, in which any economic operator may request to participate in response to a call for tender by providing the requested information for qualitative selection.

In the tender notice or in the invitation to confirm interest, the contracting authorities will describe the contracting and minimum requirements to be met and the award criteria specified, so that

economic operators can identify the nature and scope of the contract and decide whether to apply to participate in the negotiations. Contracting authorities shall indicate in the technical specifications which parts of these define the minimum requirements.

The deadline for the receipt of requests to participate shall be 30 days from the date of announcement of the tender notice.

b) *Competitive dialogue procedure* applicable to the case of particularly complex contracts, such as the implementation of an integrated transport infrastructure or large computer networks or projects involving complex and structured, financial and legal design which cannot be defined in advance, establishing the possibility of opening of a dialogue with all the candidates to bid.

c) *Procedure at innovation partnership*, in which only those economic operators invited by the contracting authority may submit research and innovation projects in response to identified needs[13].

It is, in short, a special form of restricted procedure, with specific purpose, focusing on the promotion and development of innovative activities, desirably within SMEs. Naturally this procedure should be articulated in a particularly cautious way with the risk of infringement of conduct or anti-competitive practices, so that in its design and realization it is not hindered, distorted or restricted by operators who attend under this procedure to submit the corresponding offers, and with full respect to the intelectual and industrial property rights.

Another key factor of the new procurement package and its major modification is the regulation of the concession contracts.

First of all, we must highlight that currently concessions of public works are governed by the Directives of the European Union on public

[13] There are many contributions to link procurement and industrial policy and correlates industrial policy with innovative processes and measures. Geroski wrote that "procurement policies can be used to create a demand of new products or processes, or at least to make latent consumer demands more manifest. Innovation occurs as part of the process by which firms push back technological frontiers to meet user needs, and a procurement policy which clearly stimulate the development of those capabilities. Procurement policy can also stimulate innovation by providing and early testing ground for new products". Geroski PA, 'Procurement Policy as a Tool of Industrial Policy.' (1990) 4 International Review of Applied Economics 182.

procurement 2004/18/EC of the European Parliament and of the Council, of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, and 2004/17/EC of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors. Likewise, concessions of services are excluded from the Directives of the European Union regarding public procurement and their regulation is based solely on the principles of the Treaty of the European Union, specified by the case law of the Court of Justice of the European Union[14]

According to the Commission, the absence of clear regulations at Union level, and the lack of legal certainty involved, creates severe distortions of the domestic market by limiting access of companies, particularly small and middle-sized, to concession contracts. Therefore, the European institution announced the intention to adopt a legislative initiative regarding concessions in its Communication of 13 April 2011 "Single Market Act". Thus, and under this purpose of "regrouping" or "consolideting" the concession legislation to the European public contractual legislation, the Directive of Concessions has been proposed by the Commission to the Parliament together with new proposals of Directives in the field of public procurement.

Several reasons seem to justify this initiative. On one hand, the fact that in the current situation of severe budgetary limitations and economic difficulties of many States of the EU, the intention is to contribute to a more efficient assignment of public funds, which combined with an increased use of private capital participation in public infrastructures and proceedings, enables the legal use of the concessional system, as more appropriate under these premises.

[14] It is recalled that in Spain, there is Law 2/2011 of 4 March on sustainable economy. In this Law (mainly through the Sixteenth Additional Provision), TRLCSP changes are introduced. Besides a new regulation regarding the power of amendment of public contracts that extends to every awarding authority, no matter whether it is Public Administration (amending Article 20 LCSP to that end), it introduces several changes of a peculiar nature. And among them, it intends to encourage efficiency in public procurement and public-private cooperation. Thus Article 37 of this Law establishes the principle of efficiency and maintenance of the terms agreed upon in the execution of public procurement processes, encouraging the streamlining of procedures, and intending to encourage the participation of small and medium-sized companies and free access to information (the decision is made for the provisional guarantee to be exceptional, as a means to saving costs, amending Article 91 LCSP).

Thus and as expressly manifested by the Community proposal, its main objective is to reduce legal uncertainty regarding the awarding of concession contracts favoring public authorities and economic operators in order to reduce the risk of diverse interpretations of the principles of the Treaty of the EU by national legislators and disparities among legislations of the Member States. There is an intention to clarify the legal framework applicable to the awarding of concessions, as well as to define precisely its scope of application: a) A definition of the concession contract is introduced, including the concept of "operational risk" of the concessionaire; b) Risks related to the usage of the works or the demand of the delivery of the service; or risks related to the availability of the infrastructures provided by the concessionaire; c) References are added regarding the maximum timeframe of the concessions, remaining limited to the time that is calculated as necessary for the concessionaire to recover the investments made to exploit the works or services, together with a "reasonable return"; d) Pursues inclusion of duties of the Treaty of the EU in secondary legislation, extending to all service concessions most duties that govern the awarding of work concessions [15].

Nevertheless, when the value of the amendment can be expressed in monetary terms, it shall not be considered substantial except if its value exceeds 5 million Euros or 5% of the price of the original contract. Nor

[15] Special attention must be given to the regulation introduced by this Directive proposal regarding the modification of concessions during its validity period, according to which every substantial amendment of dispositions of a concession during its validity period shall be considered as a new award to the purposes of the Directive and it shall imply the need to process a new award procedure, except when all following conditions concur, in which case it will only be necessary to publish an announcement in the DOUE with the amendment that has been made:

- That the need for an amendment is derived from circumstances which a diligent awarding power or awarding authority could not foresee.
- That the modification doesn't change the global character of the concession.
- In the case of concessions awarded by awarding powers, that the increase of the price doesn't exceed 50% of the value of the original concession.

  To these purposes, an amendment of the concession shall be considered as substantial when any one of the following conditions is met:
- That the amendment implies an imposition of new conditions which, in case they would have been considered in the original awarding procedure, would have generated a different selection of participation requests or an awarding of the concession to a different bidder.
- That the amendment changes the economic balance of the concession in favor of the concessionaire.
- That the amendment extends significantly the scope of the concession covering supplies, services or works which were not originally included.

shall those amendments which were clearly, precisely and unequivocally considered in the concession documents, be deemed as substantial[16].

Lately and in order for a contract to be considered a concession, it is necessary that the concessionaire takes on cumulatively either demand risk or availability risk. The principle of sufficient remuneration is not expressly recognized, while Article 16 of the Project sets forth that: "the duration of the concession shall be limited to the time calculated to be necessary for the concessionaire to recover the investments made to exploit the works or services, plus a reasonable return of the invested capital". Nor is the principle of maintenance of the economic-financial equilibrium of the concession mentioned, which, as a right of the concessionaire, should be made compatible without replacing the principle of risk and responsibility.

3. Three essential trends: Environmental issues considerations; e-procurement; Governance

One of the chapters that has been more thoroughly attended by the Community legislator in the reform of the legal system of public procurement since the end of the decade of 1990, is that related to lack of consideration of the environmental aspects in the contractual framework. So the "concern" to increase the degree of insertion of sustainable elements or criteria from an environmental prism in works, products, supplies and services that are the target of contractual awards in Community territory, would have a concrete normative translation. Therefore, already the Recitals of the Directives 2004, both from the public sector and that destined to regulate excluded sectors, highlighted the need to consider Community case-law in the subject:

> "This Directive is based on Justice Court case-law, particularly that relative to awarding criteria, which clarifies the possibilities of the awarding authorities to res-

[16] The Directive proposal considers that concessions shall not be amended in the following cases:

- When the purpose of the amendment is to settle the deficiencies of the concessionaire to fulfill its duties or the consequences that might derive from these deficiencies. In this case, measures that bring into effect the compliance of contractual duties must be implemented.
- Whenever the purpose of the amendment is to compensate the risk of price increase due to price fluctuations which might substantially influence the execution of the contract and which had been covered by the concessionaire.

> pond to the needs of affected citizens, without the exclusion of the environmental or social area, as long as these criteria are linked to the purpose of the contract, don't give the awarder an unlimited freedom of choice, are expressly mentioned and abide by the fundamental principles... contained in the Treaty and particularly the principles of free movement of goods, the freedom of establishment and freedom to provide services, as well as the principles derived from these liberties, such as the principle of equal treatment, the principle of non-discrimination, the principle of mutual recognition, the principle of proportionality and the principle of transparency"

The Concordia Bus Finland sentence was particularly relevant to this purpose, in which the Court of Justice declared that Article 36, Section 1, Letter a), of Directive 92/50 cannot be construed in the sense that each one of the awarding criteria adopted by the awarding authority with the purpose of identifying the most economically convenient bid must be necessarily of a merely economic nature. Thus, next we shall review some extremes of the aforementioned Sentence, the reach of which has been resulting determinant in the regulation of this matter[17].

The Court of Justice admitted that when the awarding entity decide to award a contract to the contractor that has presented the offer that is economically most advantageous, it may take into consideration environmental criteria, as long as these criteria are related with the purpose of the contract, they don't give that awarding entity an unconditional freedom of choice, they are mentioned specifically in the tender of particular administrative clauses or in the offer announcement and they respect all fundamental principles of Community Law, particularly the non-discrimination principle.

The EVN and Wienstrom Sentence is also relevant[18], where the same position is established. It is thus that the case law which is previous to the corresponding case is held, highlighting that the Community

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17 The Austrian Government, also legitimized based on the litigious proceeding, held that Directives 92/50 and 93/38 establish two essential restrictions to the selection of awarding criteria for public contracts. On one side, the criteria selected by the awarding authority must have a relationship with the contract to be awarded and must enable to determine the offer which is economically more convenient for that entity. And, on the other side, it pointed out that such criteria must enable to point the power of recognized assessment to the awarding authority objectively and they must not contain elements of arbitrary selection. Also, as per this Government, awarding criteria must be directly related with the object of the public contract, they must have effects which can be measured objectively and which are economically quantifiable.

18 Case C-448/01 EVN and Wienstrom (2003) ECR-I 14558.

regu-lations regarding public procurement are not against that an awarding authority defines, for the determination of the economically most advantageous offer with the purpose of awarding an electricity supply contract, a criterion that consists of requiring the supply of electricity generated from renewable energy sources, as long as this criterion is related to the purpose of the contract, doesn't give the awarding entity an unconditional freedom of choice, manifestly mentions in the tender of particular administrative clauses or in the bid announcement and respects all fundamental principles of Community Law, particularly the principle of non-discrimination. More specifically, it is stated that it cannot be considered an awarding criterion referring exclusively to the amount of electricity that comes from renewable energy sources, which exceeds the foreseeable annual consumption established in the bid, is related to the purpose of the contract.

The two final legislative packages of public and regulated procurement have expressed particular concern about making available to the legal system and the operation of Community public procurement, the advantages of ease of use, simplification, flexibility, low cost and transparency that may facilitate new information and communication technologies, through direct access or through electronic platforms and the general use of the Internet. Firstly, it is important to note that, to this purpose, we may define as "the use of electronic media in the treatment of operations and in communication by government institutions and other bodies of the government sector when it is time to acquire goods and services or to bid public works."

E-procurement (the term e-purchasing has a narrower scope) refers to the use of Internet-based (integrated) information and communications technologies (ICTS) to carry out individual or all stages of the procurement process including search, sourcing, negotiation, ordering, receipts and post-purchase review[19].

E-procurement has the potential to promote operating efficiency in public sector procurement and provide significant cost savings.

[19] Croom S and Brandon-Jones A, 'E-Procurement: Key Issues in E-Procurement Implementation and Operation in the Public Sector', Proceedings of the 13th International IPSERA Conference, Month and Dates, Catania, Italy (2004)

As per the European Commission, three are the advantages which may be derived from this action in the area of public procurement: a) Significant improvements in the efficiency of concrete acquisitions; b) Global management of public procurement; and c) Operation of markets within the area of State contracts.

So, within the European policy for the design and implementation of a European Digital Agenda, creation of interconnected electronic procurement infrastructure, it constitutes one of its main pillars.

Advantages of the use of public procurement for the process of realization of an internal market of public procurement are, in our opinion, substantial, both in order to achieve a greater transparency by allowing a greater revealing of its phases and processes and to facilitate a better follow-up and potential increases of contractors or providers; likewise, in order to reduce administrative costs and to relieve unnecessarily long periods of time, in some cases, it will enable a larger integration and rationalization of activities related to procurement (stock control, contract management), thus promoting a greater efficiency in the development of the contracting and enabling a greater simplification in common contractual action, and modernization and flexibility of its procedures[20].

Despite the remarkable advantages that the use of electronic procurement would offer for a greater integration and efficiency in the operation of the domestic market of public procurement regulated from the EU, the results of its implementation are, until now, disappointing. It must

[20] But it must also be highlighted that the Communication from the Commission C(2011)9404 final on the Application of the European Union State Aid Rules to Compensation Granted for the Provision of Services of General Economic Interest 2011 indicates, among other extremes, that the main measures for flexibilization and simplification proposed by the Commission are: a greater possible use of negotiation through the procedure with negotiation and prior publication; simplified proceedings for the local and regional procurement bodies, and it is possible to replace the publishing of a general announcement of its procurement plan for next year; a decrease of documentation requirements, particularly through the mandatory acceptance of "self-declarations", the prohibition to the contracting authorities of requiring the economic operators to present documents which were already presented to them inside the previous four years in an earlier procedure and that continue to be valid; or measures in electronic procurement with the purpose of full electronic communication in public procurement in a term of two years, since the limit time for application of the adopted Directive.

be considered that already in 2005 the European Council of Ministers[21] expressed its will that "in 2010, at least 50% of all public procurement that exceeds the threshold of public procurement of EU is conducted electronically". The Action Plan for this task was the reply, precisely, to that[22]. Nevertheless, in the present time, the degree of insertion of these practices and modalities in European public procurement barely exceeds ten per cent of the ambition expressed by Community authorities, in the aforementioned statements and texts. It is true, nevertheless, that certain countries of the EU have been creating excellent platforms for the development of economic procurement, and that this contributes gradually to the penetration of this objective. Such may be the cases of the Austrian Federal Agency about public procurement, the Portuguese legislation in the matter, or certain initiatives created in the United Kingdom, but the whole of the work performed at Community level continues to be insufficient in relationship with the size and need of the change objectives that have been mentioned.

In terms of governance, the first drafts of the proposals contained the possibility of designating a separate independent administration (Independent Regulatory Entity) in public procurement, as in the sectors of energy and telecommunications. In the final wording that scope has, regrettably, decreased.

Thus, where monitoring authorities or structures identify by their own initiative or upon the receipt of information specific violations or systemic problems, they shall be empowered to indicate those problems to national auditing authorities, courts or tribunals or other appropriate authorities or structures, such as the ombudsman, national Parliaments or committees thereof.

In the view of the EU legislator, the current position indicates that Member States shall transmit to the Commission every three years, a

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21 'The Manchester Declaration' (3rd Ministerial eGovernment Conference 2005) Ministerial Declaration; Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on i2010 eGovernment Action Plan: Accelerating eGovernment in Europe for the Benefit of All 2006 (COM (2006) 173 final).

22 Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions on 'Action Plan for the Implementation of The Legal Framework for Electronic Public Procurement' 2004.

monitoring report covering, where applicable, information on the most frequent sources of wrong application or of legal uncertainty, including possible structural or recurring problems in the application of the rules, on the level of SME participation in public procurement and about prevention, detection and adequate reporting of cases of procurement fraud, corruption, conflict of interest and other serious irregularities.

Likewise, Member States shall ensure that: a) Information and guidance on the interpretation and application of the Union public procurement law is available free of charge to assist contracting authorities and economic operators, in particular SMEs, in correctly applying the Union public procurement rules; and b) That support is available to contracting authorities with regard to planning and carrying out procurement procedures.

Besides, Member States shall, without prejudice to the general procedures and working methods established by the Commission for its communications and contacts with Member States, designate a point of reference for cooperation with the Commission as regards the application of public procurement legislation.

8

Company Law in the Single European Market: Trends and Challenges

JUSTIN BORG-BARTHET*

ABSTRACT

The CJEU's treatment of choice of corporate law favours a liberal model of the internal market by granting autonomy to dominant actors in companies. In contrast, the general scheme of the TFEU suggests that the authors of the treaties were not in agreement concerning this particular economic model. Further, secondary legislation favours the introduction or retention of protective mechanisms for the benefit of minority shareholders, creditors and employees. This is not merely a matter of historical interest. The tensions in the regulation of companies that were evident at the time of the adoption of the Treaty of Rome remain relevant today. Indeed, the failings of the legislative process stem from disagreement among the Member States concerning the goods to be furthered by corporate law.

There is therefore a pressing need to create a clear framework for the mobility and governance of companies. There remain a number of gaps in the law that the judiciary is unable to fill. Further, and perhaps more importantly, notwithstanding the EU's gradual acceptance of judicial lawmaking, it remains true that the legitimacy of the lawmaking process requires input from the legislator. It is submitted, therefore, that the adoption of legislation should not be a purely technical exercise but one that is the product of thorough political engagement in which the Commission, the Member States and the Parliament consider the diversity of approaches to company law and do justice to different approaches. In this context, Communitarisation should not be viewed as an end in itself, but as an instrument for better transnational law-making.

KEY WORDS: Freedom of Establishment; Company Law; Harmonisation; *Societas Europaea*; Choice of Law.

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1. Introduction

The story of the development of company law in the EU is not made up of a single narrative, but of a number of seemingly unrelated developments in three distinct areas, namely (i) the harmonisation of national law; (ii) the establishment of supranational corporate forms; and (iii) choice of corporate law. Legislative intervention has been most prolific in the context of the harmonisation of substantive national laws. There has also been some legislative activity concerning the establishment of business vehicles under EU law. Harmonisation of the private international law of companies, on the other hand, has been driven primarily by the judgments of the CJEU. There are, however, a number of commonalities and discernible trends in the development of the law. In particular, there has been a tension between Communitarisation and national policy choices. This tension is often manifested in the form of traditional political conflicts between free market liberalism and protectionist social constructs of companies.

This paper provides an overview of the current state of EU law in matters related to company law and discusses what is left to be done in order to complete the internal market. It includes suggestions about what a completed internal market should look like. The conventional view that it is a sine qua non that the internal market should be entirely free is questioned. However, nor does it follow that supranationalisation of the law is necessarily a desirable outcome. It is argued instead that it is neither necessary nor desirable for an internal market in company law to be entirely free of Member State control and that the continued development of company law requires a more nuanced approach to the role of the law in establishing an internal market in corporate law matters. In particular, it is suggested that the private international law of companies requires legislative intervention that would strike an appropriate balance between the rights of market actors to enjoy market freedoms and the residual rights of Member States to govern their socio-economic affairs.

The discussion is divided into four main parts. First, an overview of the harmonisation of substantive law is provided. This is followed by a brief discussion of supranational business vehicles. The third section addresses questions concerning choice of corporate law. This

is the area in which harmonisation is developing most rapidly, and it is the area in which it is submitted that legislative intervention is most urgent. The fourth and final substantive section considers the possibility of introducing legislation that would strike a balance between the autonomy of promoters of companies and the Member States' views about the socio-economic purpose of companies.

2. Harmonisation of substantive national laws

Since legal persons are central to the conduct of business, it was inevitable that the Treaty of Rome should include some provision concerning the treatment of company law. The content of that provision, however, is not a foregone conclusion but a policy choice concerning the balance to be struck between competing interests in the governance of companies. Indeed, theorists disagree about the nature of corporations,[1] as well as the implications of different understandings of the company for corporate law[2] and the private international law of companies.[3] These differences are borne out in diverse national laws concerning the regulation of companies, both in relation to their domestic activity and their cross-border mobility[4]. The framers of the Treaty of Rome were therefore

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1 See for example RH Coase, 'The Nature of the Firm' (1937) *Economica,* 386, 386-405; MC Jensen and WH Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) *Journal of Financial* Economics 305, 305-360; AA Alchian and H Demsetz, 'Production, Information Costs and Economic Information' (1977) *The American Economic Review* 777, 777-795; MA Eisenberg, 'The Structure of Corporation Law' (1989) *Columbia Law Review*, 1461, 1461-1525; EF Fama, 'Agency Problems and the Theory of the Firm' (1980) *Journal of Political Economy* 288, 288-307; ML Weitzman, 'Increasing Returns and the Foundations of Unemployment Theory' (1982) *The Economic Journal* 787, 787-804; OE Williamson, *The Economic Institutions of Capitalism* (Free Press, New York 1985); OE Williamson, 'The Theory of the Firm as Governance Structure: From Choice to Contract' (2002) *Journal of Economic Perspectives* 171, 171-195.

2 For an account of the spectrum of theories of the firm and their potential deployment in company law, see for example J Paterson, 'The Company Law Review in the UK and the Question of Scope: Theoretical Concerns, Practical Constraints and Possible New Directions' in R Cobbaut and J Lenoble (eds), *Corporate Governance. An Institutional Approach* (Netherlands, Kluwer Law International, 2003) 141, 141-179; J Dine, *The Governance of Corporate Groups* (Cambridge, CUP, 2000) 1-36; A Belcher, 'The Boundaries of the Firm: The Theories of Coase, Knight and Weitzman' (1997) *Legal Studies* 22, 22-39.

3 Dine (n 2) 67; RR Drury, 'The Regulation and Recognition of Foreign Corporations: Responses to the Delaware Syndrome' (1998) *Cambridge Law Journal* 165, 182-183; WF Ebke 'The "Real Seat" Doctrine in the Conflict of Laws' (2002) The International Lawyer 1015, 1027-1029; J Borg-Barthet, The Governing Law of Companies in EU Law (Hart, Oxford 2012) 13-72.

4 See generally Borg-Barthet (n 3) 49-72.

presented with a choice between the liberalisation of corporate law and a more cautious approach to integration.

The free market ideals of the Community might suggest that a liberal approach would be adopted. However, the general scheme of the Treaty and accounts of the negotiating process indicate that liberalisation was to be a managed process. It was not intended that the Treaty itself could provide the necessary legal basis for integration. Instead, it was agreed that the Commission and the Member States would pursue a legislative programme that would approximate company laws and thereby facilitate the establishment of the internal market. Accordingly, Article 50(2)(g) TFEU was included in order to provide a legal basis for the adoption of legislation in corporate law. This article provides that in order to attain freedom of establishment, the legislator shall adopt directives 'coordinating to the necessary extent the safeguards which, for the protection of the interests of members and others, are required by Member States of companies or firms… with a view to making such safeguards equivalent throughout the Union'.[5]

During negotiations prior to the adoption of the Treaty of Rome, France was particularly vocal about a number of concerns regarding corporate law. The French government argued that economic integration could result in its corporate law standards being undermined by those of other Member States.[6] A further worry was that economic actors from other Member States would have an unfair advantage as a consequence of more accommodating laws.[7] What is more, France was concerned that a free internal market would result in the emigration of companies to the more accommodating jurisdictions. The French government was therefore keen to include mechanisms in the Treaty that would prevent

5 The original French text refers to 'les intérêts tant des associés que des tiers' which might have been more faithfully translated to 'the interests of members and third parties'. The reference to third parties is noteworthy in that it indicates a dichotomy between shareholders, who have contractual interests that are internal to the firm, and third parties to whom some undefined fiduciary obligation may be owed.

6 S Grundmann, 'The Structure of European Company Law: From Crisis to Boom' (2004) European Business Organisation Law Review 601, 605; CWA Timmermans 'Company Law as Ius Commune?' (2002) Walter van Gerven Lecture, Leuven Centre for a Common Law of Europe <http://www.law.kuleuven.ac.be/ccle/pdf/wvg1.pdf> accessed 21 October 2013, 5.

7 Grundmann (n 6) 605; Timmermans (n 6) 5.

the emergence of a European Delaware.[8] Clearly, therefore, the framers of the Treaty viewed the harmonisation of company law as a central plank in the establishment of a single market, and they saw the establishment of a level playing field through the raising of corporate law standards as a prerequisite for corporate mobility.[9]

As a consequence of the importance attached to equalisation of standards in company law, this was the first area of civil law to be harmonised, and remains, arguably, the most intensely harmonised area of private law, other than competition law.[10] The Commission's proposals concerning company law differ to some extent from the concerns of the French negotiators in that they are predicated on the need to allow market actors to transact with companies from other Member States without exposing themselves to undue risk. It was understood that common standards in company law would facilitate cross-border trade.[11] In particular, harmonisation of core areas of company law was intended to facilitate the granting of credit to corporations whose form was unfamiliar to lenders, and therefore posed an additional risk and barrier to cross-border trade.[12] Latterly, the legislative programme has included a number of modest attempts to respond to governance failures associated with the financial crisis.[13]

The directives which have been adopted and implemented successfully have ensured the following, among other matters: (i) minimum capital requirements, disclosure obligations and accounting regulation,[14]

8 Timmermans (n 6) 5; J Wouters, 'European Company Law: Quo Vadis?' (2000) Common Market Law Review 257, 269-270.

9 Timmermans (n 6) 5; J Wouters, 'European Company Law: Quo Vadis?' (2000) Common Market Law Review 257, 269-270.

10 Grundmann (n 6) 605.

11 B Pasa, GA Benacchio and L Orme (tr), The Harmonization of Civil and Commercial Law in Europe (Central European University Press, Budapest 2005) 264-272; Wouters (n 8) 289-290.

12 See Wouters (n 8) 268-272.

13 For academic commentary see J Armour and W-G Ringe, 'European company law 1999-2010: Renaissance and crisis' (2011) Common Market Law Review 125, 169-173.

14 Council Directive (EEC) 1989/666 concerning disclosure requirements in respect of branches opened in a Member State by certain types of company governed by the law of another State [1989] OJ L395/36; Directive of the European Parliament and of the Council (EC) 101/2009 on coordination of safeguards which, for the protection of the interests of members and third parties, are required by Member States of companies within the meaning of the second paragraph of Article 48 of the Treaty, with a view to making such safeguards equivalent [2009] OJ L258/11; Directive of the European Parliament and of the Council (EC) 102/2009 in the area of company law on single-member private limited liability companies [2009] OJ L258/20; Directive of the European Parliament

(ii) a minimum of worker representation and participation in undertakings of a 'Community-scale',[15] (iii) stipulating conditions governing mergers, divisions and takeovers of companies,[16] (iv) the protection of certain shareholder rights;[17] and (v) financial market regulation.[18]

and of the Council (EU) 76/2010 amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies [2010] OJ L329/3; Directive of the European Parliament and of the Council (EU) 17/2012 amending Council Directive 89/666/EEC and Directives 2005/56/EC and 2009/101/EC of the European Parliament and of the Council as regards the interconnection of central, commercial and companies registers [2012] OJ L156/1; Directive of the European Parliament and of the Council (EU) 30/2012 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 54 TFEU, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent [2012] OJ L315/74; Directive of the European Parliament and of the Council (EU) 34/2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC [2013] OJ L182/19.

15 Directive (EC) 2009/38 of the European Parliament and of the Council of 6 May 2009 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees (recast) [2009] OJ L122/28.

16 Sixth Company Law Directive (EEC) 82/891 based on Article 54(3)(g) concerning the division of public limited liability companies [1982] OJ L378/82, amended by Directives 2007/63 and 2009/109; Directive of the European Parliament and of the Council (EC) 2004/25 on takeover bids [2004] OJ L142/12; Directive of the European Parliament and of the Council of 26 October 2005 (EC) 2005/56 on cross-border mergers of limited liability companies [2005] OJ L310/1; Directive of the European Parliament and of the Council (EC) 63/2007 amending Council Directives 78/855/EEC and 82/891/EEC as regards the requirement of an independent expert's report on the occasion of merger or division of public limited liability companies [2007] OJ L300/47; Directive of the European Parliament and of the Council (EC) 109/2009 amending Council Directives 77/91/EEC, 78/855/EEC and 82/891/EEC, and Directive 2005/56/EC as regards reporting and documentation requirements in the case of mergers and divisions [2009] OJ L259/15; Council Directive (EC) 133/2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States [2009] OJ L310/34; Directive of the European Parliament and of the Council (EU) 35/2011 concerning mergers of public limited liability companies [2011] OJ L110/1.

17 Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain of shareholders in listed companies [2007] OJ L184/17.

18 Directive of the European Parliament and of the Council (EC) 2003/6 on insider dealing and market manipulation (market abuse) [2003] OJ L96/16; Directive of the European Parliament and of the Council (EU) 2013/50 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market, Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and Commission Directive 2007/14/EC laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC [2013] OJ L294/13.

However, the directives have not harmonised a number of aspects of company law that reflect strong legislative choices on the part of a number of Member States. The Commission's more ambitious proposals met with resistance and have been variously viewed as unpalatable or unnecessary. Especially noteworthy is the Fifth Directive[19] concerning the structure, powers and obligations of public companies which was never adopted despite efforts to do so in the seventies, eighties and nineties. The original draft was rejected because it was based on the West German model, which included employee participation in a two-tier board system.[20] This was particularly unpalatable to the United Kingdom and Ireland whose corporate law tradition was perhaps furthest from that of West Germany.[21] Despite a number of compromise drafts that followed, the Member States failed to agree on a unified approach to the governance structures of companies.[22] Similarly, the Ninth Directive concerning groups of companies[23] did not command sufficient support because it would have introduced a regime with which the vast majority of market-actors in the Union were unfamiliar.[24] More recently, efforts to introduce gender equality in listed companies have been delayed in the face of resistance by Member States that have a more contractarian approach to company law.[25]

It is therefore not entirely surprising that the successes of the harmonisation programme have been described as 'trivial' in the context of the more ambitious goals embraced in the failed directives.[26]The

19 Draft Fifth Directive on the structure of public limited companies and the powers and obligations of their Organs [1972] OJ C 131.

20 Pasa, Benacchio and Orme (n 11) 365-366.

21 See for a contemporary discussion CM Schmitthoff, 'Company Structure and Employee Participation in the EEC – the British Attitude' (1976) International and Comparative Law Quarterly 611, 611-620; Pasa, Benacchio and Orme (n 11) 365.

22 Ibid 365-367.

23 Draft Ninth Directive on links between undertakings and in particular on groups. Not published.

24 Pasa, Benacchio and Orme (n 11) 370.

25 See Council of the European Union, 'Proposal for a Directive of the European Parliament and of the Council on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures - Progress Report' 16347/13 SOC 956 EGC 24 ECOFIN 1034 DRS 202 CODEC 2633.

26 See generally L Enriques, 'EC Company Law Directives and Regulations: How Trivial Are They?' (2006) *University of Pennsylvania Journal of International Economic Law* 1, 1-75.

harmonisation that has been achieved to date has done little to give the companies of the Member States a truly European character, for there is little agreement as to what that European character should be. Indeed, it is arguable that traditional disagreements concerning contractual liberty in company law remain as relevant today as they were 60 years ago.[27] Accordingly, while the harmonisation process may have been successful to the extent that it allows market actors a degree of confidence in transacting with foreign corporate forms, it does not yet eliminate diversity and thereby create a level playing field between companies established under the laws of the 28 Member States.

3. Supranational business vehicles

In parallel with the harmonisation of national laws, the Union legislator has embarked upon an ambitious project which would supplement, or perhaps substitute, national companies with supranational business vehicles. As in the case of the harmonisation of national laws, legislative ambition concerning EU corporate forms has been curtailed as a consequence of divergent views of the nature and purpose of companies.

The *Societas Europaea* (SE) was established by a Council Regulation in 2001.[28] It took forty years for the institutions to agree the final architecture of the SE.[29] The time spent might usefully have been dedicated to formulating an attractive alternative to national business vehicles. Instead, the SE is a product of an elaborate compromise, with the inevitable result that it is unpalatable to most. Indeed, the SE is perhaps most representative of the difficulties associated with harmonisation and unification of company laws and private international law of companies in the EU. The vast distance between the protective corporate law priorities of some Member States and the liberal internal market ambitions of the Commission resulted in a business vehicle that is difficult to understand, expensive, and perceived to be vastly inferior to the corporate forms offe-

[27] See Borg-Barthet (n 3) 8-11. For a contrasting view, see H Hansmann and R Kraakman, 'The End of History for Corporate Law' (2001) Georgetown Law Journal 439.

[28] Council Regulation (EC) 2157/2001 on the statute for a European company (SE) [2001] OJ L294/1.

[29] See S Lombardo and P Pasotti, 'The Societas Europaea: a Network Economics Approach' (2004) European Company and Financial Law Review 169, 171-72.

red by national law. The principal shortcomings of the SE include high start-up costs, the fact that it is only accessible to existing companies rather than natural persons,[30] and the limited mobility of such companies.[31] These practical flaws are compounded by a lack of familiarity with this business vehicle, as well as cultural and psychological hesitance to employ a corporate form that diverges from the corporate cultures of the Member States.[32] Indeed, rather than engendering excitement and high demand for a new type of company with a European brand, the business and legal communities' response to the SE has been tepid. As a consequence, there has been little take-up of SEs since this corporate form was made available.[33]

Notwithstanding the difficult birth of the SE,[34] the Commission attempted to develop a further supranational corporate form through its proposal to adopt a statute for a European private company (SPE). This too has encountered difficulty. The Council reached political agreement regarding an amended draft in May 2011,[35] but there remains some distance between the Member States.[36] In particular, the Member States have divergent views concerning employee participation and the manner in which Member States may limit evasion of obligations which would arise from incorporation in a more closely connected Member State. Accordingly, it is clear that, notwithstanding legislative progress, there remains significant divergence regarding the extent to which EU law should grant autonomy to incorporators of companies, as well as the manner in which power is distributed within companies.[37]

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30 Art 2.

31 Arts 7, 8 and 64(2). For academic commentary see WG Ringe, 'The European Company Statute in the Context of Freedom of Establishment' (2007) *Journal of Corporate Law Studies* 185, 188.

32 See WJ Bratton, JA McCahery and EPM Vermeulen, 'How Does Corporate Mobility Affect Law Making? A Comparative Analysis' (2008) ECGI Law Working Paper No 91/2008 <http://ssrn.com abstract=1086667> accessed 21 October 2013 15-16.

33 In the first five years in which the SE was available there were only 176 incorporations of SEs: H Eidenmüller, A Engert and L Hornuf, 'How Does the Market react to the Societas Europaea?' (2010) European Business Organization Law Review 35, 37. Current estimates place the number at just over 2000: http://ecdb.worker-participation.eu/ (accessed 29 January 2014).

34 Commission (EC) Proposal for a Council Regulation on the statute for a European private company COM (2008) 396/3 (hereinafter 'Draft SPE Statute').

35 Council of the European Union, 'Proposal for a Council Regulation on a European private company – Political agreement' 1061/11 DRS 84 SOC 432 (hereinafter 'Revised Draft SPE Statute').

36 Ibid recital 6a.

37 Revised Draft SPE Statute (n 35) 2.

4. Choice of corporate law

As a consequence of legislative failings, the principal question concerning companies in a Single European Market concerns choice of company law, which is often referred to as a problem of 'corporate mobility'. Indeed, the language of discussion concerning the free movement of companies in the EU is somewhat misleading in some respects. To talk of free movement of companies suggests that companies are denied access to markets in goods and services when they are denied freedom of movement. Yet there is not, and there has never been, a significant problem concerning the ability of companies to benefit from the internal market any more than there has been for natural persons. The question is really whether there is a free internal market in corporate forms, rather than a free internal market for corporations. In other words, the central question is whether freedom of establishment confers the right to choose from among the corporate forms available in the Member States, or whether the establishment of companies should remain a matter for the national laws of the Member States; or in more cynical terms, whether there exists a right to use letterbox companies as a means to avoid the onerous requirements of relevant national laws.

To grant freedom of choice of company laws would fit the basic economic logic of the single market in that it would create a level playing field by affording the same economies to entrepreneurs throughout the Union.[38] However, the idiosyncrasy of freedom of establishment lies in the fact that, historically, it has been the Member State of a company's nationality that denied that company the benefits of adopting a more accommodating corporate form. Barriers to freedom of establishment have been set up principally, though not exclusively, by adherents of the real seat theory, which prescribes that companies are to be established under the laws of the state in which said companies have their operational headquarters.[39]

[38] Tröber (n 9) 57. In support of this view, see AG La Pergola in Case C-212/97 *Centros Ltd v Erhvervs-og Selskabsstyrelsen* [1999] ECR I-01459 para 20.

[39] The real seat theory requires companies having their operational headquarters within a given Member State to be established under the laws of that State. Most continental jurisdictions traditionally adopted this theory. Other States, most notably the United Kingdom, adopted the incorporation theory, which favours party autonomy in choice of corporate law. This approach allows companies to be governed by the law of the State in which they are incorporated, notwithstanding the fact that there might not be any factual connection with that jurisdiction. For an overview of the two theories, see S Rammeloo, *Corporations in Private International Law: A European Perspective* (OUP, Oxford 2001) 11-20; E Rabel, *The Conflict of Laws: A Comparative Study. Volume 2* (2nd edn University of

In other words, Member States that restricted 'mobility' most vigorously have not been motivated by a desire to grant unfair advantages to economic actors in their own territories, but by a desire to deny avoidance of policy choices enshrined in their own more onerous laws.[40]

Choice of corporate law in the EU therefore retains a central place in discourse concerning companies and the internal market. Indeed, it is arguable that the extent to which market actors should be granted free choice is presently the most pressing question to be resolved in this sector. In order for companies to benefit from choice, it is necessary to have a system for the recognition of companies and their cross-border mobility. In other words, EU law must stipulate that companies may be established under any of the diverse national laws and may revise that choice from time to time. To date, the TFEU does not provide clear solutions to questions concerning the recognition of companies. There therefore remains a complicated interaction between national competence and the limitations imposed on the exercise of that competence by EU law.

Article 293 ECT, which has now been repealed by the Treaty of Lisbon,[41] provided that the conditions governing the recognition of companies and their cross-border mobility could be determined through secondary legislation. However, the 1968 Convention on the Mutual Recognition of Companies and Bodies Corporate[42] never entered into force because it was not was not ratified by the Netherlands as a consequence of disagreement concerning the limits placed on autonomy in corporate choice of law.[43] As a consequence of the failure of this

Michigan USA 1960) 31-46; FJ Garcimartín Alférez, 'Cross-Border Listed Companies' (2007) 328 *Recueil des Cours de l'Académie de Droit International* 13, 48-55; Borg-Barthet (n 3), 4-6, 13-14.

40 WF Ebke 'Centros – Some Realities and Some Mysteries' (2000) *The American Journal of International Law* 623, 635; Ebke 2002 (n 3) 1028.

41 Legislative authority remains in Article 81 TFEU, which provides competence generally in matters concerning judicial cooperation in civil matters.

42 EC Convention on the Mutual Recognition of Companies and Bodies Corporate of 29 February 1968, Bulletin of the European Communities, Supplement 2/69, 7-18.

43 For academic commentary, see Drury (n 3) 181-182. T Ballarino, 'Sulla mobilità delle società nella Comunità Europea. *Da Daily Mail* a *Überseering:* norme imperative, norme di conflitto e libertà comunitarie' (2003) *Rivista delle società* 669, 670; E Stein, 'Conflict-of-Laws Rules by Treaty: Recognition of Companies in a Regional Market' (1970) *Michigan Law Review* 1327, 1337; A Santa Maria, *European Economic Law* (Kluwer, Netherlands 2009) 10; Borg-Barthet (n 3) 106-109.

Convention, choice of corporate law in the EU was untouched by EU Law until the end of the twentieth century.[44] Member States remained at liberty to restrict choice of law, and most Member States did so in order to protect their particular view of the goods to be achieved by company law.[45] It was not until market actors attempted to exploit their rights as they saw them under the Treaty that choice of corporate law became a reality.

4.1. The Development of the Case Law

The judgments of the CJEU now allow corporate decision-makers to choose the law under which to establish their companies, and to revise that choice from time-to-time. The extent of choice is limited, however, by the Member States' ability to prescribe the connecting factors required of companies established under their laws. Thus, while Member States must recognise companies established elsewhere in the Union, they are not obliged to provide access to their own corporate forms to companies having their headquarters outwith their territories.

The net effect of the judgments is liberalising, favouring the prescriptive autonomy of corporate decision-makers over the authority of the state. Nevertheless, the movement towards a liberal construct of the private international law of companies has not been unproblematic. In particular, the Court has been mindful of the fact that companies are established by national law.[46] It follows that the regulation of substantive company law and the private international law of companies remains a national competence. When considered in the context of ambiguous

[44] M Goldman, 'La nationalité des sociétés dans la Communauté économique européenne' (1969) *Travaux du Comité français de droit internationale privé* 215, 219-226; Stein (n 43) 1329-1331.

[45] Santa Maria (n 43) 11; Rammeloo (n 39) 36-37; Stein (n 43) 1330; T Ballarino, 'From *Centros to Überseering:* EC Right of Establishment and the Conflict of Laws' (2002) *Yearbook of Private International Law* 203, 208.

[46] Case 81/87 The Queen v H. M. Treasury and Commissioners of Inland Revenue, ex parte Daily Mail and General Trust plc. [1988] ECR 5483 para 19, Case C-210/06 Cartesio Oktató és Szolgáltató bt [2008] ECR I-9641 para 104; Case C-378/10 VALE Építési kft [2012] ECR 00000 para 27.

Treaty provisions,[47] the Court has been less strident than proponents of liberalisation might have hoped.

Indeed, in its first judgment on the matter of corporate mobility, *Daily Mail*,[48] the ECJ found that a Member State could refuse to allow a company established under its laws to move its operational headquarters to another Member State. The Court reasoned that, in the absence of harmonising legislation, it remains for the Member States to decide which connecting factors are required for a company to be established and remain in good stead under their laws. This was not well received by some authors, with one going so far as to suggest that the judgment constituted 'a setback to the entire process of European integration'.[49] Nevertheless, this judgment was repeatedly confirmed, but subsequently qualified in *Cartesio*[50] and *Vale*.[51] These later judgments established the principle that companies may break the connection with a State and relocate elsewhere if they choose to also change their governing law to that of

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47 The relevant provisions are Articles 49 and 54 TFEU. Article 49 provides a general prohibition on restrictions to the freedom of establishment of nationals of Member States in the territory of other Member States:

> Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be prohibited. Such prohibition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.
>
> Freedom of establishment shall include the right to take up and pursue activities as self-employed persons and to set up and manage undertakings, in particular companies or firms within the meaning of the second paragraph of Article 54, under the conditions laid down for its own nationals by the law of the country where such establishment is effected, subject to the provisions of the Chapter relating to capital.

Article 54 TFEU extends the benefits of article 49 TFEU to companies and firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union:

> Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Union shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States.

48 Daily Mail (n 46).

49 Ballarino 2002 (n 45) 208.

50 *Cartesio* (n 46).

51 *VALE* (n 46).

another Member State.[52] In the latter case, the Member State under which the company is established may not restrict mobility, and the Member State to which the company wishes to 'emigrate' may not discriminate against the cross-border transformation.[53]

The more liberal approach in *Cartesio* and *Vale* was made possible, and perhaps necessitated, by the *Centros* line of judgments in which the Court softened the sharper edges of the *Daily Mail* judgment and extended the principle of mutual recognition to company law. These judgments distinguished the situation in *Daily Mail* from one where a company established under the laws of one Member State was to operate primarily in another State. In this situation, states that employ the real seat theory might not recognise the pseudo-foreign company because their own private international law dictated that the company should be established under their laws. The ECJ found that, notwithstanding the lack of harmonisation, Member States must recognise companies lawfully established under the laws of other Member States regardless of the requirements of national law.[54]

The effect of *Centros* was to create a market for incorporations by granting choice of corporate law to promoters of companies.[55] It was only logical that a market for reincorporation would then follow. This was made possible first through the judgment in *Sevic Systems,*[56] where the Court found that cross-border mergers could not be denied where Member States allowed domestic mergers. This meant that companies could establish shell companies in other jurisdictions and then absorb the original company in the foreign subsidiary through a reverse vertical merger, thereby changing the governing law of the first-established

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52 Ibid paras 32-33.

53 Ibid.

54 Case C-212/97 *Centros Ltd v Erhvervs-og Selskabsstyrelsen* [1999] ECR I-01459; Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919; Case C-167/01 *Kamer van Koophandel en Fabrieken voor Amsterdam v. Inspire Art Ltd* [2003] ECR I-10155.

55 For empirical evidence, see: M Becht, C Mayer and HF Wagner, 'Where do Firms Incorporate?' (2008) *Journal of Corporate Finance* 241, 242. Becht et al note that the United Kingdom experienced a 400% increase in incorporations of companies that had their headquarters in other Member States after *Centros*.

56 Case C-411/03 *SEVIC Systems AG* [2005] ECR I-10805.

company.[57] Subsequently, it was found in *Vale* that companies could change their governing law in a single step through a cross-border transformation.[58]

In sum, therefore, EU law grants a great degree of choice of law in company law. Promoters of companies can choose the law under which to establish a company under *Centros,*[59] and they can revise that choice from time to time through a cross-border merger[60] or a cross-border transformation.[61] However, Member States retain the authority to restrict the physical transfer of a company's seat where that company wishes to remain in good stead under their laws.[62] In addition, subject to the G*ebhard* test,[63] Member States may refuse to recognise a company established under foreign law in the event of fraud.[64]

5. Conclusions: problems, and possible solutions

In general, the CJEU's treatment of choice of corporate law favours a liberal model of the internal market by granting autonomy to dominant actors in companies. In contrast, the general scheme of the TFEU suggests that the authors of the treaties were not in agreement concerning this particular economic model in corporate law matters. As noted above, it is a matter of historical record that the drafting of articles 49, 50 and

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57 See MM Siems, 'SEVIC: Beyond Cross-Border Mergers' (2007) European Business Organization Law Review 307, 312-313; MM Siems, 'The European Directive on Cross-Border Mergers: An International Model?' (2005) Columbia Journal of European Law 167, 179-181; LL Hansen, 'Merger, Moving and Division Across National Borders – When Case Law Breaks through Barriers and Overtakes Directives' (2007) European Business Law Review 181, 196-198; FM Mucciarelli, 'Company 'Emigration' and EC Freedom of Establishment: Daily Mail Revisited' (2008) European Business Organization Law Review 267, 276-277.

58 *VALE* (n 46) paras 32-33.

59 *Centros* (n 54).

60 *SEVIC Systems* (n 56); Directive 2005/56/EC (n 16).

61 *VALE* (n 46).

62 *Daily Mail* (n 46) para 23; *Überseering* (n 54) para 40; *Cartesio* (n 46) para 110; Case C 371/10 *National Grid Indus* [2011] ECR I 0000 para 27; VALE (n 46) para 29.

63 *Centros* (n 54) para 34.

64 *Centros* (n 54) para 38.

54 TFEU was intended to guard against the encroachment of corporate forms that did not conform to standards accepted in France.[65] Further, the substantive company law directives, the Cross-Border Merger Directive and the SE statute all, to varying degrees, favour the introduction or retention of protective mechanisms for the benefit of minority shareholders, creditors and employees.[66] This is not merely a matter of historical interest. The tensions in the regulation of companies that were evident at the time of the adoption of the Treaty of Rome remain relevant today.[67] Indeed, the failings of the legislative process stem from disagreement among the Member States concerning the goods to be furthered by corporate law.[68]

There is therefore a pressing need to create a clear framework for the mobility and governance of companies.[69] There remain a number of gaps in the law that the judiciary is unable to fill, particularly insofar as the conditions governing seat transfers are concerned. Reliance on the Court results in a piecemeal approach to harmonisation whereby the law develops without sufficient clarity and in the shadow of the vagaries of formulae such as the *Gebhard* test.[70] Further, and perhaps more importantly, notwithstanding the EU's gradual acceptance of judicial lawmaking, it remains true that the legitimacy of the lawmaking process requires input from the legislator. It is submitted, therefore, that the adoption of legislation should not be a purely technical exercise but one that is the product of thorough political engagement in which the Commission, the

65 See section 2 above.

66 See Borg-Barthet (n 3) 85-103.

67 Revised Draft SPE Statute (n 35) 2; Council of the European Union (n 25).

68 Pasa, Benacchio and Orme (n 11) 355-356; Revised Draft SPE Statute (n 35) 2.

69 See for example Conseil allemand pour le droit international privé, 'Proposition du Deustcher Rat für Internationales Privatrecht en vue de l'adoption d'une réglementation du droit international des sociétés au niveau européen/national' (2006) *Révue Critique* 712, 712-734; EM Kieninger, 'The Law Applicable to Corporations in the EC' (2009) *RabelsZ* 607, 619-620; C Timmermans, 'Impact of EU Law on International Company Law' (2010) *European Review of Private Law* 549, 566; E Wymeersch, 'Is a Directive on Corporate Mobility Needed?' (2007) *European Business Organization Law Review* 161, 166; AW Wiśniewski and A Opalski, 'Companies' Freedom of Establishment after the ECJ *Cartesio* Judgment' (2009) *European Business Organization Law Review* 595, 621-623; P Beaumont and P McEleavy, *Anton's Private International Law* (3rd edn SULI/W. Green 2011) 25.31.

70 Case C-55/94 *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4565 para 37; Centros (n 54) para 34.

Member States and the Parliament consider the diversity of approaches to company law and do justice to different approaches. In this context, Communitarisation should not be viewed as an end in itself, but as an instrument for better transnational law-making.

Part V

EU Competition policy as a key tool to promote growth

9

Stealth Licensing - or Antitrust Law and Trade Regulation Squeezing Patent Rights

NICOLAS PETIT*

ABSTRACT

A "stealth licensing" paradigm is emerging across the globe. It can be seen through subtle interventions from policy makers, judicial organs and administrative agencies. Those interventions seek to facilitate compulsory licenses outside the TRIPS agreement exceptions and/or to water down those exceptions. Altogether, they ramp up pressure on patent owners to give away their freedom – it is actually a "right" – to exploit their innovations as they see fit. The present paper submits that stealth licensing is a significant phenomenon that adversely impacts the social welfare functions of the patent system. It risks undermining investment in technology, technology creation and the dissemination functions of the patent system at a critical juncture in time, as new critical technologies like green technology, the internet of things, machine to machine technology, smart medical devices or biotechnologies are being called for, and rolled out, across the globe. Moreover, stealth licensing is occurring despite the fact that both private and public investment in R&D is critical to help developed economies back on the path to growth, competitiveness, employment and prosperity.

KEY WORDS: EU competition law; intellectual property; patents; stealth licensing; TRIPS

1. Introduction

This paper explores the concept and policy of "stealth licensing". To that end, it first surveys the literature on the social functions of the patent system, and in particular, on the role of patents to incentivise (risky) R&D

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efforts and to disseminate successful technological innovations[1] (2). In this context, it recalls that whilst divided on the exact function of patent law, scholars broadly concur that patents have social utility. This paper then shows the emergence a "stealth licensing" paradigm adversary to the social functions of the patent system. To aid understanding, it starts with a definition of the concept of "stealth licensing" (3). It then describes its emergence in international trade regulation where a "flexible" interpretation of the TRIPS compulsory licensing exceptions is making way (4); and in antitrust law, where a distinct though equally problematic "undercover" licensing paradigm is gaining prominence (5). Finally, it explains the perils of squeezing patent rights through stealth licensing with two metaphors: that of a black swan (6) and that of a butterfly (7).

2. Goals of the Patent System

2.1. Survey of the Economic Literature

The literature assigns several functions to the patent system. The first is to incentivize innovation or, more accurately, innovation investments (*eg,* R&D expenditures). The theory goes as follows: inventive knowledge is costly to produce; yet, given its intangible nature, it is comparatively cheap and risk-free to imitate. Absent economically affordable means to appropriate their investments (*eg,* through the secret protection of their innovation), inventors renounce to innovation investments ex *ante*[2] anticipating that they will face *ex post* the competition of free riding imitators who enjoy a drastic cost advantage, as they do not need to recoup the sunk costs of R&D expenditures.[3] There is underinvestment in socially desirable activities.

Patent protection is the governmental attempt to address this problem. With a patent, innovators can fence off *ex post* free-riders. And

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1 The term "innovation" is used, in this paper, to mean the industrial exploitation of a patented invention, following research and development efforts.

2 Arrow, K. J., The Economic Implications of Learning by Doing, The Review of Economic Studies, Volume 28, Issue 3, 1962, 155-173.

3 Landes, W. M., Posner, R. A., The Economic Structure of Intellectual Property Law, Harvard University Press, 2003, 442 p.

welfare enhancing investments are not deterred ex ante. This theory has received many labels: *Schumpeterian* innovation, *"incentive model", "reward theory"*, etc. Whatever the label, the underlying argument is the need for innovators to recover the costs necessary to bring an invention to the market[4], as well as the costs of failed R&D attempts and the cost of risk capital. This theory, though intuitively appealing, remains theoretically and empirically disputed[5].

The second function ascribed to patent protection is to enable technology dissemination. As aptly put by Gallini and Winter, by *"protecting property rights, patents here open the market for trade in technological information"*[6]. In brief, patents make contracts possible between inventors and third parties (producers but also innovators).[7] A patent, which is the legal emanation of a specific technology, provides a legal construct that creates a necessary level of legal certainty to incentivise patent owners to share their inventions and know-how. Absent patents, technology transfer would be fundamentally undermined. No innovator would disclose an inventive idea or its functioning to third parties, for once disclosed, he would have nothing left to sell[8]. And no purchaser would ever buy an invention that he can imitate freely. The patent system solves this basic *"disclosure paradox"* issue[9]. It incentivizes innovators to trade –and before it to disclose– information to the benefit of society. This, in turn, *"makes a contribution to innovation which is pluralistic and increasingly collaborative"*.[10] Indeed, the patent system provides the incentive to transfer the knowledge and know-how often required to correctly implement, maintain and upgrade complex patented technology.

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4 Scherer, F.M., *Industrial Market Structure and Economic Performance*, Rand McNally Pub. Co, Chicago, 1980, 632 p.

5 Lemley, M. A., "The Myth of the Sole Inventor", *Michigan Law Review*, 110, 2011, p. 1-104, Available *at* http://ssrn.com/abstract=1856610.

6 Gallini, N. T. and R. A. Winter, "Licensing in the theory of innovation", *RAND Journal of Economics,* 16, 1985, pp. 237-52.

7 This is the less well-known, though equally as important, *"Coasian"* function of the patent system (after the name of Nobel Prize economist Ronald Coase, the father of transaction costs theory).

8 Käseberg, *T., Intellectual property, antitrust and cumulative innovation in the EU and the US,* Oxford, Portland, Oregon, Hart Publishing, 2012, 301 p.

9 Arrow, K. J., *The Economic Implications of Learning by Doing,* The Review of Economic Studies, Volume 28, Issue 3, 1962, 155-173.

10 Anderman, S. and Ezrachi, A., *Intellectual property and competition law: new frontiers*, Oxford, New York, Oxford University Press, 2011, 495 p.

A third, and related, justification for patents has been highlighted by Kitch in a seminal paper[11]. Patents are like *"prospects"* in mineral exploration: they signal research avenues to other innovators, like prospects signal territories of interest to mine developers. In particular, patent owners can channel research directions and *"coordinate the search for technological and market enhancement"*. Moreover, patents reduce *"the amount of duplicative efforts in innovation"* and save *"resources devoted to keeping the technology secret"*, including non-patentable information gathered at development stage. Put differently, patents act as *"development rights"*[12]. They are useful to society besides the incentives to innovate of, and the rewards granted to, inventors.

A fourth function of patents is to send signals to observers, and in particular to investors on capital markets[13]. This is because *"analysts often treat patents as a benchmark of a firm innovativeness"*, or *"to benchmark firms relative to others"*, etc. Patents help overcome information asymmetries, by entitling observers to more accurately and less costly measure the quality of a firm (and its research projects). Small firms seeking to leverage venture capital can for instance overcome investors' reluctance if they hold a strong patent portfolio and studies have shown that small firms that possess patents protecting their technologies will attract more venture capital and indeed grow faster than firms that do not[14]. Properly managed patent portfolios together with a well-constructed IPR strategy can serve as cost-effective and credible signals, which reduce investors' risk.

Fifthly, the *New Institutional Economics* school argues that patent ownership rules reduce the *"transactions costs"* incurred with other forms of knowledge protection such as trade secrecy and contract law[15]. The reasoning is simple: to appropriate an idea, an inventor must shield

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11 Kitch, Edmund W.,"The nature and function of the patent system", *The Journal of Law and Economics* (1977), No. 20, pp. 265-90.

12 Cheung, S., "Property Rights in Trade Secrets", 20 *Econ. Inquiry* 40, 49 (1982). Cheung, S. "Property rights and invention", *Research in Law and Economics*, 8, (1986) pp. 5-18.

13 Long, C., "Patent Signals", *University of Chicago Law Review,* Vol. 69, No. 2, 2002.

14 Holgersson, M., "Patent management in entrepreneurial SMEs: A literature review and an empirical study of innovation appropriation, patent propensity, and motives", *R&D Management*, Vol. 43, Issue 1, 2013, pp. 21-36.

15 Heald, P. J., "A Transaction Costs Theory of Patent Law", 66 Ohio St.L.J. 473, 2005, pp. 487-489.

it from a whole range of agents, including creditors, heirs of investors, subcontractors, employees, etc. To that end, he must conclude with them a myriad of costly confidentiality and non-compete agreements. Patents are less costly than the transactions costs of designing, drafting, negotiating and concluding such contracts.

Similarly, patents decrease transaction costs at the enforcement stage, by providing inventors with supportive institutions in case of dispute[16]. All in all, new institutional economics theories are linked with the second function of patents. They show that patents *"enable trading in information assets, stimulating a thicker market in technological information"*[17].

2.2. Discussion

Our survey of the literature brings the following thoughts. *Firstly,* the copious empirical literature on patents does not decisively point to one primary goal of the patent system and leading scholars concede that their theory remains an *"incomplete justification"* for the entire patent system[18]. In the same vein, many economists recognize that the patent system is a welfare enhancing, multi-purpose instrument serving a variety of goals, even though disagree they on the relative importance of those respective goals. In our view, the inability of scholars to reach a unifying agreement on a given function for the patent system is not a cause of concern. Similar divides exist in other branches of the law. In antitrust law, for instance, scholars have been fretting for decades over the goals of competition rules (consumer welfare v producer welfare; protection of consumer choice, safeguarding of small businesses; industrial policy; etc.)?[19]

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16 Merges, Robert P., A Transactional View of Property Right, 2005, 50 p. Available at SSRN: http://ssrn.com/abstract=707202 or http://dx.doi.org/10.2139/ssrn.707202.

17 Heald, P. J., "A Transaction Costs Theory of Patent Law", 66 Ohio St.L.J. 473, 2005, pp. 487-489.

18 Kitch, Edmund W., "The nature and function of the patent system", *The Journal of Law and Economics* (1977), No. 20, pp. 265-90.

19 Interestingly, the patent academics reflect on the function of the patent system, but this rarely results in policy change. Unlike in antitrust law, where the discussion over the functions of the legal system often give rise to critical changes in practices, as the antitrust thinkers are usually the agencies that enact their conclusions.

Secondly, both the incentivization to develop technology and the dissemination functions dominate the scholarship. Interestingly, the literature on technology dissemination describes the patent system as a sine qua non condition for technology dissemination. This is because patent protection commoditizes innovation. Troy and Werle[20] talk of a *"fictitious commodity"*. A patent transforms an idea into an asset that can be bought and sold on a commercial market[21]. Absent the patent system, there would be no technology dissemination other than marginal, benevolent distribution. Importantly, the literature suggests that the design of the patent system is critical to the efficiency of the patent market. For instance, some empirical studies show that the stronger the patent protection, the higher the probability of licensing.[22]

Thirdly, most studies in our sample focus on the firm, the patent system and innovation. But many studies also explore the role of government – or of other agents – in promoting innovation through other mechanisms, such as educational policy, labor policy, tax policy (eg, subsidies, rewards or fiscal incentives), etc. Those studies stress that patent protection is not the sole means to promote innovation, and that many government-related mechanisms play a key role in the generation of ideas, information and inventions. That said, one should not forget that if government policy clearly supports innovation, it is investors and companies that remain those that take the risks in testing new technologies, implementing them, and bringing them to the market. Moreover, publicly-funded R&D investments need patent protection too. And lastly, patent protection is, in itself, a form of public policy. Its purpose is to encourage, incentivise, nudge investors to publicise R&D results so as to foster social benefit and welfare.

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20 Troy, I. and Werle, R., Uncertainty and the Market for Patents, Köln: Max-Planck-Institut für Gesellschaftsforschung, Working Paper 08/2, 2008, 26 p.

21 McDonough, J. F., "The Myth of the Patent Troll: An Alternative View of the Function of Patent Dealers in an Idea Economy", Emory Law Journal, Vol. 56, 2006 p. 189; Emory Public Law Research Paper No. 07-6; Emory Law and Economics Research Paper No. 07-7. Available at SSRN: http://ssrn.com/abstract=959945.

22 Gambardella, A., Giuri, P. and A. Luzzi (2007) "The Market for Patents in Europe", Research Policy 36 (8), 2007, p. 1163-1183. Similarly, the higher the uncertainty, the lesser the liquidity of patents. Troy, I. and Werle, R., Uncertainty and the Market for Patents, Köln: Max-Planck-Institut für Gesellschaftsforschung, Working Paper 08/2, 2008, 26 p.

3. Definition of *"stealth licensing"*

This paper's submission is that the various social functions of the patent system are endangered by the rise of *"stealth licensing"* This novel concept means a progressive and subtle enlargement of the two exceptions of compulsory licensing provided respectively under Article 31 b) and k) of the TRIPS agreement, namely the *"national emergency or other circumstances of extreme urgency or in cases of public non-commercial use"* exception (hereafter, exception 1) and the *"anticompetitive practices"* exception (hereafter, exception 2).[23]

This enlargement takes place at two levels, which jointly dilute patent rights. First, some propose to make compulsory licensing more *"flexible"* in international law – and by the same token in national law – in response to global macro-economic imbalances. This may lead, for instance, to relax the strict exception 1 of the TRIPS agreement. Second, in antitrust law, legal interpretations which facilitate antitrust intervention on patent holders' market conduct are flourishing. This gives rise to an *"undercover"* expansion of exception 2 of the TRIPS agreement.

In our opinion, those top down – changes in IP regulatory frameworks at the international and national levels – and bottom up – intervention in the market place, to change patent holder conduct – interventions are not devoid of effects on patent owners. Much like compulsory licensing, they risk squeezing the patent rights, by placing them between hammer and anvil. Since these exceptions have differences, the following chapters discuss separately the rise of *"flexible"* compulsory licensing in international trade regulation (4) and of *"undercover"* licensing in antitrust law (5).

With this background, some lexical clarifications are in order. We deliberately use the adjective *"stealth"* licensing, because instrumentally those measures do not mandate outright compulsory licenses reviewable by courts (what one could refer to as *"hard licensing"*). Rather, they ease the formulation of such orders, by lowering the threshold for intervention under the TRIPS exceptions. This phenomenon can be observed in the international trade arena, where pressure is not exerted on patent owners

[23] See Article 31 b) and k) respectively.

directly, but through calls for a relaxation of the regulatory framework. It can be observed in antitrust law too. There, what is in question are incremental changes in legal tests, standards, interpretations and doctrines, which bring patent owners one step closer to antitrust licensing orders. For instance, the blanket and novel suggestion from the European Commission that companies that have developed successful platforms should be *"encouraged"* to license interoperability information, with no reference to market power, barriers to entry, or to the established theories of antitrust intervention is a clear symptom of stealth licensing[24].

But we also use the expression *"stealth"* licensing, because formally, many of those measures are not embedded (yet?) into clearly binding and judicially reviewable *"hard law"* instruments, and so exist in a variety of soft law instruments such as declarations, speeches, reports, etc. Much like *"hard law"* compulsory licensing, however, such measures may disincentivise patent holders' from creating and disseminating technology and one can argue that they are expressly intended to change the behaviour of patent owners. The ability of regulators to obtain remedies without formally enforcing the law is, after all, well documented in the legal and economic literature. For instance, papers on "*sunshine regulation*" recall that at the end of the XIXth century, in the US, the railway regulator devised a method of intervention based on naming and shaming.[25] This literature shows that regulators may rely on informal pronouncements (press releases) and soft law instruments to discipline market players without the need (or risk) of adopting a formal decision.

Our concept of stealth licensing could be criticized as overly broad. Many other policies that also weaken patents, incentives to innovate and technology dissemination could fall within our proposed definition. Take education policy. Cuts in university budgets or rise of tuition fees elevate barriers to education, and in turn may limit the production of innovative

[24] See the EU Digital Agenda Action 25 at http://ec.europa.eu/digital-agenda/en/pillar-ii-interoperability-standards/action-25-identify-and-assess-means-requesting-significant and the European Commission's Staff Working Document http://ec.europa.eu/digital-agenda/en/news/analysis-measures-could-lead-significant-market-players-ict-sector-license-interoperability.

[25] Petit N. and Rato M., "From Hard to Soft Enforcement of EC Competition Law – A Bestiary of 'Sunshine' Enforcement Instruments," in: Gheur, Ch. & Petit, N. (eds.): Alternative Enforcement Techniques in EC Competition Law: Settlements, commitments and other novel instruments, Brussels, Bruylant, 2009, 264.

idea in society. But this does not amount to stealth licensing, for such measures do not really seek to regulate patent rights and, through that, technology ownership.

4. "Flexible" Licensing in International Trade Regulation

4.1. Inception of "Flexible" Compulsory Licensing: The Pharmaceutical Sector

Stealth licensing is primarily observable in international trade regulation, where a *"flexible"* compulsory licensing doctrine ("FCL") is making way. In recent years, demands to the effect of relaxing the restrictive compulsory licensing derogations set forth in article 31 of the TRIPS agreement have escalated, in particular in relation to the derogation which entitles countries to order licenses in instances of *"national emergencies or other circumstances of extreme urgency or for public non-commercial purposes"*.[26]

Originally, those demands emanate from developing countries, seeking to secure cheap access to pharmaceutical products. In the end 1990s, those countries voiced increasing concern over the prohibitive cost of key patented drugs (and/or licenses) sold by Western firms.

In response to such demands, WTO members embraced in 2001 a doctrine of *"flexibility"*. In the Doha declaration, they affirmed that given *'the gravity of the public health problems afflicting many developing and least-developed countries"*, there should be *"a right of WTO members to use, to the full, the provisions in the TRIPS Agreement, which provide flexibility for this purpose"*.[27] This shift in legal policy entitled developing countries to issue compulsory licenses. The FCL doctrine was turned into practice in Africa, Asia and India, where compulsory licenses were issued over anti-retroviral drugs useful for the treatment of HIV/AIDS.

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[26] See Article 31b) TRIPS.

[27] Declaration on the TRIPS Agreement and Public Health, WT/MIN(01)/Dec/2, 14 November 2001, available at http://www.wto.org, (hereinafter "Doha Declaration"], paragraph 4 to 6.

4.2. Extension of "Flexible" Compulsory Licensing?: Green Technologies

In recent years, developing countries have sought to expand the FCL doctrine to *"green technologies"*. Green technologies (also known as *"clean technologies"*, *"environmentally sound technologies"*, or *"climate change mitigating technologies"*) are technical solutions that protect the environment without reducing economic activity: renewable energy,[28] clean fossil fuels, carbon capture and storage technologies, measures which reduce carbon emission,[29] etc. Like in pharmaceuticals, the argument goes that patents impede to the diffusion of green technology in developing countries.[30] This in turn would yield dramatic consequences, for developing countries lack sufficient resources to finance green-technology research, yet pollute more than others.[31]

Ahead of the 2009 Copenhagen Summit on Climate Change, the developing countries parties to the United Nations Framework Convention on Climate Change ("UNFCCC") put forward proposals to weaken (or even eliminate) IPRs in green technologies. China and India proposed to mandate compulsory licensing of patented technologies or to introduce explicit derogations for green technologies in the text of the TRIPS agreement.[32] Bolivia, the Philippines and Indonesia proposed to exclude patents for environmentally sound technologies.[33]

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28 Eg, wind, biomass, photovoltaic, tidal/wave, geothermal.

29 Eg, CO2 free and low-carbon technology.

30 Sovacool B.,Placing a Glove on the Invisible Hand : How Intellectual Property Rights May Impede Innovation in Energy Research and Development (R&D), Albany Law Journal of Science and Technology, Vol. 18, No. 2, 2008, pp. 381-440.

31 Fair R., "Does Climate Change justify Compulsory Licensing of Green Technology?", International Law and Management Review, Vol.6, Winter 2009, p. 21. Some also argue that compulsory licensing to developing countries like China and India would be efficient for the western world, given the huge comparative cost advantage of the former, where cheaper manufacturing capabilities are available, notably in wind and solar energy. Gupta, R. R., "Compulsory Licensing in TRIPS: Chinese and Indian Comparative Advantage in the Manufacture and Exportation of Green Technologies", Sustainable Development Law & Policy 12, no. 3, 2012, 21, pp. 54-55.

32 Maskus K., "Differentiated Intellectual Property Regimes for Environmental and Climate Technologies," OECD Environment Working Papers 17, OECD Publishing, 2010.

33 See FCCC/AWGLCA/2009/8 19 May 2009, Ad Hoc Working Group on Long-Term Cooperative Action under the Convention, Sixth session, Bonn, 1–12 June 2009.

Several high level politicians backed those proposals. Bolivian President Evo Morales ran riot against IPR in climate change technology requesting that *"all countries can access products already patented [...] free of cost"*.[34] Similarly, a number well established Western international institutions such as the World Bank or the European Parliament joined the cause.[35]

To date, those arguments have not garnered legal traction. The Copenhagen Conference and the 2012 Doha Climate talks resulted in no declaration or agreement on IPR and green technologies. But the issue remains live. At the Warsaw Climate Change conference in November 2013, the ministers stressed *"the urgent need to address the issue of [...] the appropriate treatment of intellectual property rights, including the removal of patents on climate-related technologies for non-Annex I Parties"*.[36] And in India, the "National Manufacturing Policy" plan has proposed to set up a Technology Acquisition and Development Fund which will be able to petition the Government for compulsory licenses in relation to "Green Technologies" (if the technology is not offered by the patent holder at reasonable rates or it is not being provided in India to satisfy the domestic demand).[37]

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34 See http://www.ip-watch.org/2009/04/01/cooling-the-world-by-misappropriating-patent-rights/ See also, Xie Zhenhua, President Hu Jintao's Special Representative on Climate Change and Vice Chairman of the National Development and Reform Commission of China: "Developed countries should also fulfill their obligations under the Convention to provide financial support and technology transfer to enable developing countries to effectively tackle climate change."; Shyam Saran, climate change envoy to Indian Prime Minister Manmohan Singh, India, saying that technology transfer to developing countries is "a burning issue" and that "intellectual property rights may need to be slacked for it." In the same vein, India wants "a global fund that could buy out IPRs of green technologies, and then distribute these technologies free, in a way that is similar to what is done for HIV/AIDS drugs."; And Minister Shri Ramesh, Indian Climate Change, who declared that access to intellectual property for low-carbon technology is a "global public good": http://online.wsj.com/news/articles/SB124760260278140953.

35 See World Bank (2012) "Inclusive green growth, the pathway to sustainable development" stating: "Making it easier for countries to issue compulsory licenses under appropriate circumstances can help ensure more affordable access to patented green innovations by poorer households in low-income countries"; See European Parliament, Resolution of 29 November 2007 on trade and climate change (2007/2003(INI)) Green position paper (2012) Climate change, Technology Transfer and Intellectual Property: http://www.greens-efa.eu/climate-change-technology-transfer-and-intellectual-property-5484.html which states that: "Equally important …is the right of developing countries to use the full TRIPS flexibilities, including compulsory licensing".

36 See http://www.twnside.org.sg/title2/climate/info.service/2013/climate131011.htm

37 See http://www.thehindubusinessline.com/industry-and-economy/us-eu-irked-by-indias-compulsory-licence-plan-for-green-technologies/article5193594.ece and http://www.financialexpress.com/news/us-uk-question-nmp-s-green-tech-protection/1177391/1. The US Chamber of Commerce indicates serious impact on jobs, in case compulsory licensing will be applied for "Green Technologies". See http://dev.theglobalipcenter.com/wp-content/uploads/GIPC_-_Green_Jobs_Leave_Behind.pdf

4.3. Discussion

The *"flexible"* compulsory licensing doctrine has a number of specific features which deserve to be discussed.

- **The "Patent=Barrier" Equation.** The rhetoric of FCL often relies on questionable lexical shortcuts. For instance, IPR are often equated with a *"barrier"* to trade. In the recent UNFCCC, the Like-Minded Developing Countries (ie 133 developing countries anchored in G77+China) noted that *"Annex I countries should put in place the enabling environment in their own countries that will remove the barriers (such as cost and IPRs) to technology development and transfer and enable them to effectively implement their technology development and transfer obligations to developing countries"*.[38] Both China and India's submissions on the same topic categorize IPRs as "*barriers*".[39]

- **The "Moral" Justification of FCL.** The pro-FCL movement also justifies extensions of the doctrine on grounds of higher societal, human or moral purposes. In this respect, FCL in green technology is often presented as a corollary of fundamental rights, as it was in the pharmaceutical sector with respect to the right to health, etc. On close examination however, the analogy with the pharmaceutical sector appears unjustified. No specific human rights legal basis is advanced in support of the application of the FCL to green technology, and one may question whether such a legal basis actually exists. Moreover, the sole possible legal basis that springs to mind is the right to a sustainable environment. However, to date, this right has only been recognized – and with many caveats – in some developed countries, and has never been in developing countries.

- **The Politicization of FCL.** The "*flexible*" compulsory licensing model advances in high level political forums. In such circles, there is no place for thorough empirical, *"evidenced-based"* discussion. Rather, debates are (i) dominated by intuitive,

[38] http://unfccc.int/bodies/awg/items/6656.php#workstreamone

[39] http://unfccc.int/bodies/awg/items/6656.php#workstreamone

qualitative and self-supporting arguments (unlike maybe, in antitrust law which follows a more robust, though necessarily imperfect, approach through adjudication);[40] and (ii) affected by negotiation and bargaining dynamics, intrinsic to any politicized process.

The debate surrounding green technologies perfectly illustrates this. First, the analogy drawn by policy makers between pharmaceutical and green technologies has little, if no empirical footing. In the pharmaceutical industry, many base technologies (*ie* drugs) must still be discovered; and when they are discovered, they cannot be substituted[41] This means that market players compete over *"drastic"* innovation. And drastic innovation is both very costly and risky. In contrast, in green technology, most base technologies derive from prior periods of R&D, for instance in the 1970s.[42] Those technologies are no longer protected by patents.[43] Innovation is thus essentially *"incremental"*. It takes place over specific improvements or features.[44]

This is important because this means that developing countries can avail themselves of a significant stack of unpatented drastic green technology[45]. Of course, developing countries may also need to practice incremental technologies. But those technologies are less costly to

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[40] Though the alleged superiority of antitrust is less true when it advances through general policy statements/discussions.

[41] Henry G., "Intellectual Property Rights and Green Technologies", *42nd World Congress of the International Association for the Protection of Intellectual Property,* October 2010, mimeo.

[42] See E.L. Lana, "Clean Tech Intellectual Property: Eco-marks, Green Patents, and Green Innovation", Oxford, Oxford University Press, 2011, 6 (hereinafter "Clean tech for IP is for real"): "Solar technology went through a period of innovation in the 1970s following the oil crisis of that era. The idea of using ocean waves to generate electricity has been around for a long time; the first patent application for an ocean power device was filed in the eighteenth century. Wind energy, too, is not new. Wind has been harnessed as a source of power for hundreds of years, and the modern wind power industry was born in the 1980s".

[43] See "Clean tech for IP is for real", 9 and 10.

[44] Barton notes that "the basic approaches to solving the specific technological problems have long been off-patent. What are usually patented are specific improvements or features", see J. H. Barton, (2007) "Intellectual Property and Access to Clean Energy Technologies in Developing Countries: An Analysis of Solar Photovoltaic, Biofuels and Wind Technologies", ICTSD Trade and Sustainable Energy Series Issue Paper No. 2, International Centre for Trade and Sustainable Development, Geneva, Switzerland. 5.

[45] Copenhagen Economics, 2009, *Are IPR a Barrier to Transfer of Climate Change Technology?*, Report to Directorate General of Trade, European Commission, January 19.

develop than drastic innovation. Moreover, there are more substitutes on incremental technologies than on drastic ones[46].

Second, the claim that the price of green technology would be anticompetitive is too contradicted by empirical analysis. Professor Barton has scrutinized the market structure in several green technology sectors, as a proxy for price competition in those industries. He finds that in the photovoltaic sector, the developing nations face a loose oligopoly structure, with many entrants. China, for instance, has developed and produced, successful solar panel technology. Similarly, developing nations have good access to the current generation of biofuel technology. Finally, the wind sector is competitive and developing nations can build wind farms with equipment from the global market without enormous IP costs.

In the same spirit, other studies empirically confirm that technology transfer in green technology happens between developed and developing countries. A WIPO meta-analysis of the empirical literature reports that in *"the existing evidence-based studies, most seem to suggest that IP rights are not a barrier to the transfer of ESTs and that, together with a range of other factors, they may play a positive role in facilitating the transfer of ESTs"*[47]. At a higher level of granularity.

Lane brings evidence of nine significant clean technology transfers towards developing countries in the year preceding the Copenhagen climate change conference.

In sum, patents are not a proven barrier to the dissemination of green technology. In the literature, other elements are described as possible impediments to the uptake of green technology in developing countries: insufficient technical knowledge to produce innovative technologies locally, insufficient market size to justify local production units, unfavorable market conditions and investment climate, ineffective government and institutions, etc.[48]

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[46] Fair R., "Does Climate Change justify Compulsory Licensing of Green Technology?", International Law and Management Review, Vol.6, Winter 2009, p. 21.

[47] Perez Pugatch, M., "When Policy meets Evidence: What's next in the discussion of intellectual property, technology transfer and the environment", Global Challenges Brief, WIPO, 2011.

[48] UNEP, EPO and ICTSD study, *Patents and Clean Energy: Bridging the Gap between Evidence and Policy,* 30 September 2010, available at http://documents.epo.org/projects/babylon/eponet.nsf/0/cc5da4b168363477c12577ad00547289/$FILE/patents_clean_energy_study_en.pdf

All in all, it is doubtful that the new licensing flexibility introduced in the pharmaceutical sector –which in itself, is disputable on its own merits– can or should be replicated in the green technology sector. Moreover, some authors rightly stress the adverse signals of FCL in green technology: compulsory licensing for a particular technology may decrease the incentive for other multinational companies to engage in joint ventures with local firms in that state[49].

5. "Undercover" Licensing in Antitrust Law

5.1. Compulsory Licensing in Antitrust Law

"Hard" compulsory licensing on the basis of competition rules remains epiphenomenal. In about 50 years of EU competition enforcement, there have only been 4 cases of compulsory licensing of IPRs in the EU ("European Union") legal system, i.e. *DSD, Magill, IMS Health and Microsoft.* And all those cases concerned respectively trademarks, copyright, database protection, software interfaces, IPRs that are less rigorous that patents.

This finding holds true at the global level. A 2011 WIPO survey on compulsory licenses reports that whilst antitrust-based compulsory licensing is theoretically available in most jurisdictions, it is *"seldom applicable in practice"*.[50] Concerns of *"hard"* competition-based compulsory licensing in the academic literature are thus off the wall.[51]

Several indications however suggest the rise of a more insidious *"stealth"* licensing paradigm in antitrust law. It takes shape through a collection of legal precedents and policy pronouncements which taken altogether impose on patent holders the prospect of being under an

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49 Fair R., "Does Climate Change justify Compulsory Licensing of Green Technology?", International Law and Management Review, Vol. 6, Winter 2009, p. 21.

50 See WIPO, CDIP/4/4 Rev./STU*DY/INF/5, p. 24.

51 See for an example of such concerns, F. Fine, "European Community Compulsory Licensing Policy: Heresy Versus Common Sense", 24 Nw. J. Int'L L. & Bus. 619, 619 (2004), arguing that what dilutes intellectual property rights is not the possibility of compulsory licensing, but the frequency by which the EC and the ECJ mandate a compulsory license. See also, Katarzyna A. Czapracka, "Where Antitrust Ends and IP Begins – on the Roots of the Transatlantic Clashes", 9 Yale J.L. & Tech. 44, 47–48, 72–77 (2007). However, we do not talk here of compulsory licensing in the context of merger proceedings, because such measures are submitted and approved by the parties.

antitrust duty to license their technology. The following paragraphs describe those symptoms in turn, though not all are of equal importance.

5.2. The Evidence

- **The "Patent=Monopoly" Equation.** The first symptom of stealth licensing is the inveterate tendency of competition agencies, judges and scholars to equate a patent with a monopoly. In turn, just by virtue of their IPR, patent holders would be allegedly dominant, and enjoy significant market power.[52]
  The Court of Justice of the European Union ("CJEU") itself has set the mark, affirming that: *"a medicine is protected by a patent which confers a temporary monopoly on its holder"*.[53] Likewise, antitrust agencies have voiced concern about *"the surge in the strategic use of patents that confer market power to their holders"*.[54] And a vast majority of respondents to a 2011 WIPO study consider that IP rights *"confer market power per se" or a "legal monopoly"*. Lastly, influential academics have claimed that *"the patent system is designed to create market power"*.[55]
  The patent=monopoly theorem is a clear symptom of stealth licensing. Pegging patent to monopolies eases the application of the competition rules on *"abuse of dominance"* (in the EU, Article 102 TFEU and in the US, Section II of the Sherman Act). To be sure, in most competition regimes, *"dominance"* is not alone a cause of remedial intervention. However, in Europe, a finding of dominance constitutes the first of the two components of an infringement of Article 102 TFEU. With the patent=monopoly equation, agencies and courts thus lift 50% of the burden of proof of an infringement, having solely to prove *"abuse"* to apply Article 102 TFEU.

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52 See S. Bostyn and N. Petit, "Patent=Monopoly: A Legal Fiction", SSRN: http://ssrn.com/abstract=2373471 or http://dx.doi.org/10.2139/ssrn.2373471 p. 19.

53 See CJEU, C-468/06 to C 478/06, Sot. Lélos kai Sia EE and Others v GlaxoSmithKline AEVE, [2008] ECR I-7139, § 64.

54 See J. Almunia, Speech at Industrial policy and Competition policy: Quo vadis Europa?, New Frontiers of Antitrust 2012 – Revue Concurrences Paris, 10 February 2012.

55 See Professor Tim Wu, Columbia University, Oversight of Innovation Catalysts, 2012 OECD Competition Committee Hearings on the Digital Economy.

- **The "IP atheism" Doctrine.** The world of competition agencies is flat: whilst most antitrust agencies profess market-specific approaches, they meanwhile consider that IPRs intensive sectors have nothing specific. In short, IPRs are just an asset like any other. And like tangible assets, they may be subject to heavy-handed remedial intervention. The EU Commission said just this in Microsoft: *"intellectual property rights are not in a different category to property rights as such"*.[56]
  In other cases, antitrust agencies explicitly skirt the issue. For instance, in Thomson Reuters, the EU Commission rebuffed the parties' argument to the effect that the impugned conduct involved IPRs by stating that: *"the Commission does not take a view on whether RICs [Reuters Instruments Codes – codes used by Thomson Reuters to identify financial instruments and indices] are protected by intellectual property rights"*.[57]
  Finally, antitrust agencies occasionally downplay the existence of IPRs by passing judgment on their invalidity. In *Standard and Poor's* for instance, the EU Commission held that *"the mere use of numbers for reference purpose is not capable of being subject to copyright"*.[58]

- **Anti IP Priority-Setting?** Antitrust agencies are resource-constrained. They must set enforcement priorities. Interestingly, in the past decade, antitrust agencies have placed a clear focus on patent intensive sectors. In the EU, for instance, Commissioner Kroes allocated vast resources to a wide ranging inquiry in the pharmaceutical sector, upon suspicion of abuses of the patent system, making light of the highly restrictive exceptions imposed by the European courts. And her successor, Commissioner Almunia, devoted large enforcement resources to high technology cases where patents (and copyrights) are numerous. In 2014, the European Commission was investigating at least 9 such cases, *Apple vs*

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56 See Commission Decision, Microsoft, Case No COMP/C-3/37.792 [2004] OJ C (2004) 900 final, §550.

57 See Commission Decision, Reuters Instrument Codes (RICs), Case No COMP/39.654 [2012] C (2012) 9635 final, §90.

58 See Commission Decision, Reuters Instrument Codes (RICs), Case No COMP/39.654 [2012] C (2012) 9635 final, §90.

Motorola; Microsoft vs Motorola; Huawei vs InterDigital; Google vs Microsoft/Nokia/Mosaid; Apple vs Samsung; Sierra Wireless vs Nokia; MathWorks; Icera v Qualcomm; Honeywell/Dupont JV. And a high level official, C. Madero, indicated that there were several other cases in the decisional pipeline.[59]

This, of course, does not suggest an anti-patent bias. Not all patent intensive sectors are subject to intense antitrust scrutiny. Sectors such as industrial machinery, the automotive industry or biotechnologies have for instance been under much lighter antitrust scrutiny. Yet, the selection of two highly visible patent intensive sectors as enforcement priorities may nurture the perception that antitrust enforcers are anti-patent. And there is no doubt that the evolution of antitrust law, in Europe and further afield, will draw on these precedents.

- **Antitrust Determinations of Weak Patents.** Patent validity assessments are outside antitrust agencies' jurisdiction. Those matters belong to patent offices and the judiciary. Despite this, however, antitrust agencies occasionally challenge the validity of patents, and use findings of invalidity as a basis for antitrust liability. The burgeoning case-law on pay-for-delay settlements in the pharmaceutical sector shows this. In the ordinary pay for delay case, a pharmaceutical patent holder *("originators")* makes a reverse payment to a generic entrant in order to end patent invalidity proceedings. With this financial transfer, the originator fences off his generic rival from the market, and can continue to exploit its patent until expiry.

  With this background, in *Servier*, the EU Commission held that such reverse payments constitute restrictions of competition *"by object" (ie* egregious and *de facto)* pursuant to Article 101 TFEU and unlawful abuse of a dominant position pursuant to Article 102 TFEU. The Commission's theory is interesting for it seems based on the view that the very existence of payment is suggestive that the patent is invalid, and that the patentee knows it. Therefore, a private settlement concerning a patent

[59] See M-Lex, EC to reveal position in tech-patents cases in 'near future,' Madero says, 7 December 12, Matthew Newman.

that may be invalid is, in itself, a restriction of competition. Why, after all, would a rational patent holder pay a generic manufacturer to withhold an invalidity application if its patent was valid?

This rule of inference is a coarse proxy. Amongst other rationales, the owner of a valid patent may settle a case because he is averse to the uncertainty of litigation; or simply because he is averse to litigation costs (financial and other); or because he is mistakenly convinced by the applicant's invalidity claim; or because he can, through a negotiated agreement, regain a level of control of the process.

At any rate, that antitrust agencies are suspicious of patents is clear, not only are they ready to assume invalidity pursuant to fragile inferential reasoning but they are also willing to look at the legitimate use of patents are a potential abuse.

- **Phasing out of IP-Protective Case Law.** In the EU, the upper courts have traditionally sought to protect patent rights in their case-law. To that end, they have fabricated three judicial doctrines that purport to *"exceptionalize"* antitrust enforcement against IP holders. First, the EU Courts consider that the application of competition rules cannot question the "existence" of IPRs, but simply their *"exercise"*. For what it is worth, this suggests that antitrust agencies cannot pass judgment on the validity of patent rights, on the adequacy of patent offices' assessments, of patentability requirements, etc.

  Second, the EU judicature has long held that there can be no infringement of competition law as long as the patent holder stays within the *"specific subject matter"* or seek to maintain the *"essential function"* of his right. In *Centrafarm v Sterling Drug*, the Court defined the essential function of patents as the *"exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time, either directly or by the grant of licences to third parties, as well as the right to oppose infringements"*.[60]

[60] CJEU C 15/74, Centrafarm BV and Adriaan De Peijper v Sterling Drug Inc., ECR [1974] 1147, § 9.

Third, in the area of abuse of dominance, where an antitrust duty to license permeates through the so-called *"essential facilities doctrine"* ("EFD"),[61] the Courts have been keen to restrict it to *"exceptional circumstances"*.[62] Furthermore, the Courts granted clarifications on the concept of *"exceptional circumstances"* which, though open ended –there can, and there should be no list of exceptional circumstances– must,[63] as it goes for all exceptions, be interpreted strictly and narrowly.

Interestingly, however, those protective case-law principles do not appear in the most recent EU Commission's soft law instruments related to patent rights, as if protective judicial precedent was being phased out from the law. This is very clear in the Article 101 Guidelines on horizontal cooperation agreements that cover joint R&D and standardization agreements or in the Guidelines on technology transfer agreements. Both instruments elide the abovementioned case-law of the Court of justice.[64] And this is remarkable because generally, Commission's soft law instruments are replete with case law citations.

- **The "Transactional Licensing" Practice.** To be sure, with four cases brought to completion in 50 years, the amount of compulsory licensing achieved on the basis of the EU competition rules has been statistically insignificant, if not trivial.[65] But a more significant degree of antitrust licensing has taken place through other, less visible, mechanism. For instance, in the

61 According to this doctrine, a dominant firm can be compelled to open access to its inputs, including intangible ones, to competitors, if this is necessary to remove a restriction of competition in a related, secondary market.

62 See CJEU, Case C-241/91 P and C-242/91 Radio Telefis Eireann (RTE) and Independent Television Publications Ltd (ITP) v Commission (Magill) [1995] 743 at §50; Case C-418/01 IMS Health, GmbH & Co. OHG v NDC Health GmbH & Co. KG [2004] I-5039 at § 35 to 37. This precedent is also the one affirmed by the General Court in Microsoft III (the so-called 'compliance' case). Case T-167/08 Microsoft Corp. v Commission, (also known as the compliance case) not yet published at §335.

63 See CJEU, Case C-241/91 P and C-242/91 Radio Telefis Eireann (RTE) and Independent Television Publications Ltd (ITP) v Commission (Magill) [1995] 743 at §50; Case C-418/01 IMS Health, GmbH & Co. OHG v NDC Health GmbH & Co. KG [2004] I-5039 at § 35 to 37. This precedent is also the one affirmed by the General Court in Microsoft III (the so-called 'compliance' case). Case T-167/08 Microsoft Corp. v Commission, (also known as the compliance case) not yet published at §335.

64 Our reading of GC T-201/04, Microsoft v Commission, ECR [2004] II-3620, §332.

65 See cases referenced above.

past 5 years, the EU Commission has settled 3 proceedings with dominant firms in exchange for a pledge to grant IPR licenses (in *Rambus, S&P and Thomson Reuters*).

Moreover, in the area of merger control, IPR licensing is the single most important remedy applied as an alternative to a corporate carve out.[66] For instance, in *Shell/BASF* (Project Nicole), the parties committed to openly license – and not to assert – patent rights over metallocene, a chemical compound.[67] In some transactions, the Commission has even nudged the merging parties to offer to sell IPRs in order to assist the emergence of a new industry player.[68]

Importantly, transactional antitrust licensing may even occur more informally. When Google sought to acquire the stockpile of patents detained by Motorola Mobility in 2011, the Commission observed that Google had issued a letter to Standard Setting Organisations ("SSOs") committing to FRAND licensing and good faith negotiations with licensees. But the Commission's concerns were only soothed when Google clarified the implications of this letter, and in particular that the letter had *"binding legal effects"* and was *"irrevocable"*.[69]

To sum up, beneath the tip of the compulsory licensing iceberg, looms a large amount of antitrust licensing activity.

- **The "Estoppel" Abuse Doctrine.** A possible interpretation of the controversial ruling of the CJEU in *Konkurrensverket v TeliaSonera Sverige AB* is that once a dominant firm has voluntarily chosen to supply a customer, it can no longer refuse to deal, and this notwithstanding the fact that the restrictive conditions of an antitrust duty to supply may not be fulfilled.[70] This

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66 See for instance, Commission Decision, Axalto/Gemplus, Case No COMP/M.3998 [2006] SG-Greffe (2006) D/202682; Intel/McAfee, Case No COMP/M.5984, C (2011) 529 final. See also D. Hoeg, European Merger Remedies, Law and Policy, Hart Publishing, 2013, pp. 87-88.

67 See Commission Decision, Case No COMP/M.1751, Shell / Basf / JV Project Nicole. See, for another example, Commission Decision, Case No COMP/M.1835, Monsanto (USA)/Pharmacia & Upjohn (USA).

68 See Commission Decision, Cisco/Tandberg, Case No COMP/M.4063, SG-Greffe (2006) D/200788.

69 See Commission Decision, Google/Motorola Mobility, Case No COMP/M.6381.

70 See CJEU, C-52/09 Konkurrensverket v TeliaSonera Sverige AB 2011 I-00527, §58.

interpretation, which remains subject to discussion,[71] is the one endorsed by certain officials of the EU Commission. Coates talks of an *"Estoppel"* abuse. In his view, this reading of the judgment is appropriate because customers make commercial decisions on the basis of the offer to supply, and it would be unfair to hold them *up ex* post with supply-disruption threats.[72]

In relation to IPRs, *Konkurrensverket v TeliaSonera Sverige AB* suggests that a dominant patentee who grants a license may be *"estopped"* from the ability to revoke it freely. This is because licensees make early *"make or buy"* business choices on the basis of patent holders' licensing policies.

- **The "Use it or lose it" doctrine.** In some policy circles, the view holds sway that antitrust agencies should impose compulsory licensing on patent owners who do not manufacture or license their IPRs. Sharon Bowles, a Member of the European Parliament and Chair of its IMCO Committee,[73] recently asserted at the European Commission's Competition Day:

  "I also think that you could use compulsory licensing more. You should also remove injunctory rights if the patents are not being actually worked. The whole point of having an injunction to stop somebody from infringing is to protect your market, your investment. If you are not working the patent, i.e. not yourself manufacturing or you don't have the licensee, you shouldn't have the right to stop somebody else. […] Indeed I would even go so far as to say that if you are not working it, there should be compulsory licensing. […] Everybody argues that it is complicated to negotiate a license, but if the will was there it could be done. And I think the will - could be imposed though competition policy."

  This *"use it or lose it"* doctrine has not (yet) been turned into administrative enforcement or judicial precedent. And it may never be given its far reaching encroachment upon century-old

[71] In terms of its scope, notably: does the self-imposed duty apply to existing customers only, or to prospective customers too?

[72] http://www.twentyfirstcenturycompetition.com/2013/10/the-estoppel-abuse/

[73] The IMCO Committee is the Internal Market and Consumer Protection committee of the European Parliament.

general principles of law, such as the law on trespass or the right to property protected by Article 17 of the Charter on the Fundamental Rights of the EU.[74] But the fact that Mrs Bowles felt confident enough to moot this idea as a credible one, and at such a gathering, is notable.

The potential effects of the *"use it or lose it"* doctrine on patent holders remain uncertain, but taken to its ultimate conclusion it dictates to inventors how to run their business, whether or not they are able or in a position to commercialise their invention. In addition, when read in conjunction with the estoppel abuse doctrine of *Konkurrensverket v TeliaSonera Sverige AB, the "use it or lose it"* doctrine risks yielding a *"catch 22"* situation for patent holders: if they license, they can no longer withdraw their license; And if they do not, they can be forced to license.

- **Innovation as a "free lunch"?** In the literature, scholars increasingly challenge the causal role of patents in incentivising innovation. Larouche and Schinkel cite to previous research to argue that "*ideas are often scarce, and will not necessarily be generated by investment. Ideas are unpredictable; they can, and often do, arise outside of well-planned efforts to produce them*".[75]
  Besides, the popular perception that innovation can arise accidentally –think of penicillin, microwave ovens, NutraSweet and vulcanized rubber– [76] or benevolently –think of the Steve Jobs and Steve Wozniak *"garage"* story– has gained immense traction.

  This lends credence to the view that policy efforts aimed at channelling, stimulating, organising or even controlling innovation are vain.

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74 See Article 17 of the Charter of Fundamental Rights of the European Union, 7 December 2000, Official Journal of the European Communities, 18 December 2000 (OJ C 364/01) which states that: "1. Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss. The use of property may be regulated by law insofar as is necessary for the general interest. 2. Intellectual property shall be protected".

75 See Larouche, Pierre and Schinkel, Maarten Pieter, Continental Drift in the Treatment of Dominant Firms: Article 102 TFEU in Contrast to § 2 Sherman Act (May 2013). TILEC Discussion Paper No. 2013-020. Available at SSRN: http://ssrn.com/abstract=2293141 or http://dx.doi.org/10.2139/ssrn.229314.

76 See http://www.innovationexcellence.com/blog/2012/09/09/innovation-is-no-accident/#sthash.vRDj6QzV. dpufor benevolently

But, this seems too much anecdotal and fragile ground to throw the baby with the bathwater, and significantly undermine patent protection. Many studies highlight that innovation thrives within an environment with some structure and organisation.[77] Patent law just provides this, just like technological clusters or tax incentives.

6. A Tale of a *"Black Swan"*

Despite the above, the actual award of compulsory licenses by domestic authorities pursuant to the FCL or by antitrust agencies on the basis of abuse of dominance rules should remain the exception rather than the rule (despite the inordinate amount of academic literature devoted to these issues). Antitrust enforcement is case focused. And even if international trade law was ever to request countries to *"flexibilise"* compulsory licensing on specified technologies, such provisions would only be exceptionally enforced. Therefore, it is tempting to dismiss concerns, for such compulsory licenses will arguably remain rare. Nicholas Banasevic, a senior official of the EU Commission in charge of the global smartphone war said just this: *"It's important to remember that antitrust intervention in IP is very rare". "Some of the cases [at the moment] are very high-profile, that's why they get more prominence. But [antitrust intervention] is over-stated".* [78]

But are rare events really devoid of effects on economic agents? In his best-selling book *"The Black Swan: The Impact of the Highly Improbable"* of 2007, Taleb shows that *"rare"* events – he calls them *"black swans"* – have profound consequences on day to day markets, which go beyond short term turbulences. A rare event is *"an event that comes as a surprise, has a major effect, and is often inappropriately rationalized after the fact with the benefit of hindsight"*.[79] Examples include the discovery of the black swan in Australia, World War I, the 2007 financial crisis, or the Fukushima meltdown. Taleb explains that following a rare event, economic

[77] See more at: http://www.innovationexcellence.com/blog/2012/09/09/innovation-is-no-accident/#sthash .vRDj6QzV.dpuf

[78] See Nicholas Banasevic, Global Competition Review, 8 October 2013.

[79] See http://en.wikipedia.org/wiki/Black_swan_theory

agents exhibit a *"retrospective predictability"* bias. Because of psychological quirks, economic agents tend to believe *ex post* that the event, despite its objective ex ante improbability, was just bound to happen.[80] In turn, market players make excessive, unnecessary adjustments. Since the Fukushima meltdown, many countries insulated from risks of seism have phased out civil nuclear power. Closer to the business community, since the 2007 crisis, traders on financial markets use mathematical risk models which overly anticipate bank defaults. Those models may have contributed to *"double dip"* recession spirals in recent years.

What does the black swan metaphor suggest in relation to patent law? After all, compulsory licensing is nothing comparable, even by a close call, to a nuclear meltdown in terms of human, environmental, and political consequences. That said, for millions of innovative firms whose whole and sole horizon is the marketplace, a patent –or a patent portfolio– is the lynchpin of their business model.

With this in mind, our opinion is that the mere prospect of sporadic trade or antitrust licenses risks affecting patentees' incentives to create and disseminate. Van Overwalle and Van Zimmeren –who cannot be categorized as IP activists– already find that existing compulsory licensing provisions, even though rarely enforced, have *"an indirect, preventive effect"*[81]. They add that those *"provisions are more than a paper tiger"*.[82] In reality, such cases, though at the fringes, risk being used by antitrust agencies *"pour encourager les autres"*[83] in order to corral markets.

In the real world, we may just be witnessing the early consequences of trade and antitrust black swans. For example, despite the absence of

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80 Everyone in his life, including the author of this paper, has once said "I knew it" when confronted with an unexpected event.

81 Van Overwalle and Van Zimmeren, "A Paper Tiger? Compulsory Licenses Regimes for Public Health in Europe" (December 1, 2010. International Review of Intellectual Property and Competition Law (IIC), January 2011, SSRN http://ssrn.com/abstract=1717974, p.37.

82 See Van Overwalle and Van Zimmeren, "A Paper Tiger? Compulsory Licenses Regimes for Public Health in Europe" (December 1, 2010. International Review of Intellectual Property and Competition Law (IIC), January 2011, SSRN http://ssrn.com/abstract=1717974, p.37.

83 In his novel Candide Voltaire alluded to the execution of British Admiral Byng in 1756, shot for 'failing to do his utmost' in preventing the loss of Minorca. Candide comments that "In that country, it is wise to kill an admiral from time to time in order to encourage the others."

any case-law precedent holding that the seeking of an injunction for patent infringement can be abusive (unless it comes within the ambit of the *"sham litigation"* judicial doctrine), Samsung withdrew in December 2012 all of its European injunction requests before national courts, wary of a finding of abuse, with a hefty antitrust fine…[84] Is this empirical proof that stealth licensing affects patent holders, and can lead natural and legal persons to forfeit their most fundamental right, that of access to court?. Similarly, in public statements, European companies keep expressing grave concern about the level of regulatory activism and erosion of patent rights, to the point that their R&D and commercial strategies are changing to address the threat that this activism may lead to a change in the law.

7. A Tale of a "Butterfly"

7.1. Presentation

In a seminal 1972 article, Edward N. Lorenz a climate specialist, asked *"Does the Flap of a Butterfly's Wings in Brazil Set Off a Tornado in Texas?"*. Or how, by virtue of global climatic interdependence, a negligible event in one region of the world can set off a cataclysm at the other end of the planet.

Lorenz's theory, also known as *"chaos theory"* has relevance for patent law. The symptoms of stealth licensing discussed under section 4 are often not enshrined in binding legal acts (such as infringement decisions with penalties and/or remedies), but rather come in the form of *"soft law"* instruments (such as Communications, Guidelines, Press Releases, Speeches, Reports, Discussion Papers, etc.). For instance, Joaquin Almunia, the EU Commissioner for competition has only rarely enforced the competition rules against patent owners. Yet, he has repeatedly sent words of warning to them. In a 2013 speech, he declared:

> *"Companies should spend their time innovating and competing on the merits of the products they offer – not misusing their intellectual*

[84] More fundamentally, many patent owners who anticipate plummeting licensing revenues, will recline on investing in R&D, seek other channels of protection not subject to publicity requirements (trade secrets, for instance) or vertically integrate by acquiring prospective licensors. This is a deadweight loss. And the problem is that it is difficult to measure, for investment that does not take place cannot be calculated…

property rights to hold up competitors to the detriment of innovation and consumer choice" [85]

This policy of using *"soft law"* instruments to address the potential harm to competition associated with patents cannot, in and of itself, be criticized.[86] However, like the flap of a butterfly, patent-adverse statements are not innocuous. In the global antitrust community, a soft law declaration by agency X may well be transformed into hard decisional initiatives by authority Y.[87] Or, less directly, a soft law declaration by agency X may well inspire a complainant in jurisdiction Y. Or, even less straightforwardly, a soft law declaration by agency X, may trigger decisional or regulatory intervention by non-antitrust organs in country Y. Judge Posner has distinctly referred to this as the *"cluster bomb"* effect of antitrust interventions.[88]

This twin dynamic of propagation and amplification should not be underestimated. There are approximately 128 antitrust agencies in the world,[89] and they increasingly operate as networks. Moreover, every year, new agencies are created. Those new agencies have a natural desire to build a reputation on the international scene. They may thus have a bias for big, headline grabbing cases, such as patent cases.[90]

Moreover, this may have dramatic impact, if antitrust action in country Y mistakenly interprets the content of the source on which it relies in country X. This concern is not merely academic. In a 2013 speech at George Washington University, Commissioner Ohlhausen from the Federal Trade Commission (FTC) expressed this fear directly. She observed:

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85 See Commissioner Almunia, "Antitrust: Commission sends Statement of Objections to Motorola Mobility on potential misuse of mobile phone standard-essential patents", European Commission, IP/13/406 06/05/2013.

86 After all, rather than addressing patent holders conduct through ex post punitive enforcement, it is probably a good thing that many agencies have preferred the humble approach of leaving the issue of infringement undecided, and to provide positive guidance ex ante.

87 See, on this, M-Lex, "US is model for developing countries on Antitrust, IP and should move cautiously, top patent judge says", 9 January 2004, Leah Nylen, alluding to public statements from US Judge Randall R. Rader.

88 See R. Posner, Antitrust Law, University of Chicago Press, Chicago, 2001, 2nd edition.

89 See http://www.internationalcompetitionnetwork.org/uploads/library/doc905.pdf

90 Not to talk of the developing world, where antitrust regimes may be used with protectionist purposes.

"our actions, if not properly explained, may send a message to our foreign counterparts that we do not place a very high value on intellectual property rights, which is clearly inconsistent with the appreciation for IP rights that we typically hold in the United States. Let me share with you an example of what I mean. Recently, I was in China attending a conference and meeting with Chinese competition officials. At the conference, I heard people claim that the United States has a well-established essential facilities doctrine, which is not exactly correct. In addition, it was suggested that when read in light of this doctrine, the FTC's Google decision implies that a SEP [Standard Essential Patent] is an essential facility and an unreasonable refusal to license that SEP constitutes monopolization. It was further suggested that the best remedy for monopolization with a SEP would be compulsory licensing because permitting more parties to use the SEP would facilitate competition. This is not a correct reading of relevant U.S. law or, in my opinion, of the FTC's decision in Google".[91]

7.2. Empirical Verification

On the facts, several antitrust cases support our *"butterfly effect"* theory. Importantly, those cases which mostly originate in the pharmaceutical industry, may serve as blueprints for enforcement in many other sectors of the economy. In the *Sanofi-Aventis* case of 2013, the French antitrust agency found that Sanofi-Aventis had actively pursued a strategy to discredit generic versions of Plavix® (one of the world's best-selling drugs) by seeking to convince doctors and pharmacists that there was no substitute for the drug, except for its own generic version. The French Authority considered this to be manifestly incorrect and that discrediting generic products therefore constituted a strategy to exclude competition. It meted out a €40.6 million fine on Sanofi-Aventis on grounds of unlawful abuse of dominance. Interestingly, discrediting or denigration of a rival product had to date never been deemed unlawful under Article 102 TFEU. The French agency however felt confident to

[91] See http://www.ftc.gov/sites/default/files/documents/public_statements/recent-developments-intellectual-property-and-antitrust-laws-united-states/130617intellectualpropertyantitrust.pdf

expand the boundaries of Article 102 TFEU, by reference to a largely controversial EU Commission report issued previously in the context of the Pharmaceutical sector inquiry. In this document, the Commission had surmised that disparagement may be deemed an abusive strategy. The French agency quoted the Commission's report as a basis for deciding that the conduct of Sanofi-Aventis was likely to inflict severe competition harm.[92] This was regardless of the fact that neither the EU Courts, nor the Commission had ever applied Article 102 TFEU to disparagement.

The *Pfizer Xalatan* case of 2012 even more clearly brings empirical evidence of the butterfly effect of soft law pronouncements. Here, the Italian Competition Authority found that Pfizer had abused a dominant position by attempting to unduly prolong the patent protection of its drug Xalatan, through the filing of divisional patent applications and the request for a Supplementary Protection Certificate ("SPC") on this basis.[93] This case broke new ground, because unlike previous cases where pharmaceutical firms had been sanctioned for misleading patent examiners, this decision sanctioned a legitimate, non-mischievous, patenting application strategy.[94] Unsurprisingly, the decision – later remanded on first instance review, and then reinstated on appeal – shocked the IP community.[95] But the *Pfizer Xalatan* case is an explicit offshoot of the EU pharmaceutical sector inquiry. Both the introductive and conclusive sections of its decision refer to the EU Commission report as the

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92 See Autorité de la concurrence, Décision n° 13-D-11 du 14 mai 2013 relative à des pratiques mises en oeuvre dans le secteur pharmaceutique at §659, foonote 267, quoting the Executive Summary of the Pharmaceutical Sector Inquiry Report at p. 14: "Originator companies devote a significant part of their budgets to marketing of their products with medical doctors and other health care professionals. The sector inquiry produced indications that some originator companies sought to put into question the quality of generic medicines, as part of a marketing strategy, and even after the generic product was authorised by the relevant authorities and was available on the market".

93 In essence, the ICA considered that the filing of the divisional patent, which did not cover a different invention to the parent patent, constituted double patenting. It also took objection with the fact that it had not told the Italian Patent Office that the patent was a divisional patent. Finally, it was concerned that this was a way, in Italy, to obtain protection where it had failed to obtain it on the basis of the original patent. "Italy: The Competition Authority fines anti-competitive Practices aimed at delaying Market Entry for generic Medicine", ECN Brief, 01/2012, p. 3. See http://ec.europa.eu/competition/ecn/brief/01_2012/it_medi.pdf

94 See T. Graf, "Italian Competition Authority Challenges Patent Measures", Kluwer Competition Law Blog, 23 January 2012, available at: http://kluwercompetitionlawblog.com/2012/01/23/italian-competition-authority-challenges-patent-measures/

95 See http://thespcblog.blogspot.co.uk/2014/02/italy-consiglio-di-stato-reinstates.html

basis for finding that filing divisional patents and SPCs may constitute an abusive strategy.[96]

Besides those clear-cut cases, several compulsory licensing judgments and decisions may have been facilitated by the climate of suspicion caused by patent-adverse soft law statements in other regions of the world, including the headline grabbing Indian decision in *Natco v Bayer* to grant a compulsory license over Nevaxar, an anti-cancer drug;[97] or the 2009 decision of the Taiwanese Fair Trade Commission that Sony, Royal Philips corporation, and Tayio Yuden Co Ltd jointly maintained a monopolistic position in the CDR market by virtue of a patent pool, and had abused this market position by charging excessive, non-negotiable royalties, prohibiting challenges to their patents, and failing to disclose important trading information.[98]

8. Conclusion

A pervasive and subtle form of stealth licensing is taking place in the realm of economic regulation, (i) top down through calls for a *"flexible"* interpretation of the TRIPS agreement, and (ii) bottom up through the facilitation of antitrust intervention against patent holders.

This paper has submitted that this novel stealth licensing paradigm risk squeezing the two main social functions of patent law, which is to protect patent holders incentives to create and disseminate.

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96 See §25 of the ICA Decision, for instance. Even more explicitly, the ICA states at §178: "*Ai fini della valutazione della natura anticoncorrenziale dei comportamenti di Pfizer, si osserva, in primo luogo, che essi devono essere ricondotti nell'ambito delle strategie escludenti, individuate della Commissione europea nella recente indagine sulla concorrenza nel settore farmaceutico, poste in essere dalle società originator al fine di ritardare o impedire l'accesso a mercato delle specialità generiche. Tra le strategie difensive delle imprese innovatrici figura, infatti, la presentazione di numerose domande divisionali sullo stesso brevetto, volte a bloccare lo sviluppo di un nuovo farmaco concorrente attraverso la costituzione di una fitta ragnatela brevettuale a protezione* di una medesima specialità medicinale".

97 See S. Vinod, "Guest post: Eye witness account of India's first compulsory licensing appeal before the IPAB", http://spicyip.com/tag/natco-vs-bayer; Bayer Corporation v. Natco Pharma Ltd., Order No. 45/2013 (Intellectual Property Appellate Board, Chennai), available at http://www.ipab.tn.nic.in/045-2013.htm

98 See Taiwan Fair Trade Commission Decision of October 28, 2009 (the 938th Commissioners' Meeting), Disposition Kung Chu Tzu No. 098156 For more, see http://apps.americanbar.org/antitrust/at-committees/at-s2/ebulletins/2009/December2009.pdf

Concretely, such stealth threats on the patent system are likely to affect firms' return prospects, and in turn their business strategies (in terms of dissemination, investment choices, etc.). The mere prospect of sporadic trade or antitrust licenses suffices to change patentees' incentives to create and disseminate as has been documented in the patent literature[99].

Moreover, compulsory licensing for a particular technology has a detrimental effect on technology transfer towards developing countries, as it decreases the incentive for other multinational companies to engage in joint ventures with local firms in that state[100].

Interestingly, the EU and its Member States have felt necessary to recently recall, in the context of a WIPO committee, the view that technology is developed in order to be deployed, and that the patent system is an enabler of technology transfer:

> *"Possible further activities of this [WIPO] committee in relation to the transfer of technology should be balanced, and objective, and considered in light of the great many examples of the benefits of the patent system to technology transfer, and the relatively fewer examples of the patent system as an impediment".*[101]

And they added:

> *"The mere existence of IPRs on a product is not a barrier to, nor its absence a guarantee of, access to that product".*[102]

Words of wisdom…

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[99] Van Overwalle and Van Zimmeren, "A Paper Tiger? Compulsory Licenses Regimes for Public Health in Europe" (December 1, 2010. International Review of Intellectual Property and Competition Law (IIC), January 2011, SSRN http://ssrn.com/abstract=1717974, p.37.

[100] Fair R., "Does Climate Change justify Compulsory Licensing of Green Technology?", *International Law and Management Review,* Vol.6, Winter 2009, p. 21.

[101] See 20th Session of WIPO Standing Committee on the Law of Patents (Geneva, 27 - 31 January 2014) - Final EU statements, http://www.parlament.gv.at/PAKT/EU/XXV/EU/01/09/EU_10910/imfname_10436323.pdf, 10

[102] *Idem.*

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Efficiency and technological progress in the internal market: Good reasons for exemption from prohibition on restrictive agreements?

ANITA PELLE*

ABSTRACT

The two substantial pillars of European regulation on restrictive agreements have from the beginning been prohibition and exemption. Ensuring competition has been one of the prior objectives of integration; however, there are further interests. Also, according to the "Schumpeterian" philosophy, research is most fruitful if carried out in a somewhat protected environment. Prohibition is general but not absolute. The improvement of the production or distribution of goods, and the promotion of technical and economic progress are crucial parts of the conjunctive set of criteria for exemption. Research and development agreements and technology transfer agreements are regulated by separate block exemption regulations but efficiency and technological progress are key factors in both. In fact, these exemption criteria are the most pro-competitive in nature. Efficiency can take various forms, e.g. cost-effectiveness, realising synergies, or integration of resources. Technological progress is also interpreted in a broad sense. Based on the block exemption regulations, agreements fulfilling the requirements are automatically exempt from prohibition but remain subject to continuous control. An exciting question is how the results of such agreements are expected to be exploited by the participating parties.

KEYWORDS: European integration, competition policy, restrictive agreements, efficiency, technological progress.

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1. Introduction

The Treaty establishing the European Coal and Steel Community[1] (ECSC) signed in 1951 by the six countries later founding the European Economic Community (EEC), with the aim to strengthen cooperation in the coal and steel industry, already stated[2] that restrictive practices leading to the segmentation or exploitation of the market were incompatible and were therefore prohibited. The ECSC Treaty then introduced the prohibition on restrictive agreements in the coal and steel industry.[3] When signing the Treaty establishing the EEC[4] in 1957, the contracting parties were driven by the experience that the ECSC Treaty fulfilled expectations already in a few years' time. The Benelux Memorandum and the Messina Declaration were also documents emphasising that the improvement of European productivity can only be achieved by the intensification of inner market competition.[5]

The 1955 Spaak Report[6] preparing the EEC Treaty already mentioned the significance of competition law. The report identified three basic types of behaviours restricting competition in the market: market segmentation by agreement; restrictions on production, development and investment by agreement; and the exploitation of dominant market position contrary to public interest. Despite the general consensus on the principles, it proved to be rather difficult to agree on the specific text of the Treaty. Paragraph (3) of current Article 101 (that is, the definition of categories of restrictive agreements exempt from prohibition) was especially highly debated. In fact, this is the part of European competition regulation where the different approaches are most evidently contradicted.

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1 Date of signature: 18/04/1951, entry into force: 23/07/1952, expired on: 23/.07/2002, was not published in the Official Journal.

2 Article 4, paragraph (d) of ECSC Treaty.

3 Article 65 of ECSC Treaty.

4 Date of signature: 25/03/1957, entry into force: 01/01/1958, was not published in the Official Journal.

5 János Zsúgyel, *Az európai integráció és intézményeinek története* (Miskolci Egyetem, Miskolc, 2000).

6 *Rapport des Chefs de Délégation aux Ministres des Affaires Etrangères (*Comité Intergouvermental Créé par la Conférence de Messine, Bruxelles, 1956).

We are convinced that a given competition regulation system is never independent of its direct socio-economic and theoretical environment but is always an answer to that.[7] The philosophy of the EEC has from the beginning relied mainly on the idea of the free market economy: real economic competition in the whole of the Community's territory.[8] However, besides stressing the importance of competition and freedom, the EEC has, from the beginning, distinguished itself from the American view of competition being the ultimate goal in itself.[9] In light of this distinction, the EEC Treaty considers competition as a tool, but not the sole one. The objectives of the creation of the Community are laid down in Article 2 of the Treaty:

> "The Community shall have as its task, by establishing a common market and by the constant convergence of the economic policies of its Member States, to promote throughout the Community a harmonious development of economic activities, a sustainable and balanced growth, a higher level of stability and the raising of the standard of living and quality of life, and stronger solidarity among Member States." Then, Article 3 lists the activities resulting in the achievement of these objectives in 11 points, of which the sixth in the row is the introduction of "a system ensuring that competition in the common market is not distorted".

The EEC Treaty is special also in legal terms as it unifies certain civil and public law systems in international law, which is then applied in a special administrative law. This way it tries to integrate laws with different cultural backgrounds, including the differences in the concepts of competition, in the cases of infringement of competition regulation, and the differences in competition law enforcement.[10]

When examining the environment of early European competition regulation, Europe's intention to find its own place between the US and the Soviet Union[11] should not be ignored. In the US, by this time, intensive

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7 Imre Vörös, *Az európai versenyjogok kézikönyve* (LOGOD, Budapest, 1996).

8 Walter Hallstein, 1961 'Wirtschaftliche Integration als Faktor politischer Einigung' in Franz Greiss and Fritz Walter Meyer (eds.), *Wirtschaft, Gesellschaft und Kultur. Festgabe für Alfred Müller-Armack* (Duncker & Humblot, Berlin, 1961) 267:278. Walter Hallstein was a West German politician, the first President of the European Commission (1958-1967), also known for the Hallstein doctrine.

9 Joanna Goyder and Albertina Albors-Llorens, *Goyder's EC Competition Law* (Clarendon Press, Oxford, 1992).

10 Philip Marsden, 'Checks and Balances – European Competition Law and the Rule of Law' (Lecture told at the Third Annual Antitrust Marathon, Boston, 17 April, 2009).

11 László J-Nagy, *Az európai integráció politikai története* (JATEPress, Szeged, 2005).

concentration had taken place. Western Europe also showed similar concentration tendencies but smaller in extent.[12] For the EEC, outside the exploitation of comparative advantages in the international arena, further factors like political independence or social security also played a role. With including the integration objective, the EEC goes beyond the traditional scope of competition, but also beyond basic economic policy objectives. So, European competition policy has implicitly presumed that, once the common market would be established, the development or sustainment of restrictive or discriminative institutions should be impeded.

All in all, the competition regulation of the EEC, at least in the early phase of integration, did not consider intensified competition as the single tool in the common market to reach its complex set of objectives.[13] This conviction is crucial in understanding the complex set of prohibition and exemptions that have characterised European competition policy all through the decades of European integration. The Commission's position paper on the concentration of undertakings published in 1966[14], for example, justified exemptions from the prohibition on restrictive agreements by declaring that these agreements serve the fight against concentration, the strengthening of the SME sector and entrepreneurial activity in general terms, and, as such, (indirectly) contribute to the fulfilment of the EEC's objectives. The Commission found it necessary at that time that European large companies of key industries would participate in the global market and would be ready to cope with global competition. The memorandum also pointed out that European concentration tendencies had been driven by American companies through joint ventures and the global market liberalisation processes.[15]

The combined application of tools in the field of regulation on restrictive agreements (that is, prohibition and exemptions) has from

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12 Alexis Pierre Jacquemin and Henk Wouter De Jong, *European Industrial Organisation* (Macmillan, London : Basingstoke, 1977).

13 Ulrich Immenga, 'Wettbewerbspolitik contra Industriepolitik nach Maastricht' in Lüder Gerken,(ed), *Europa 2000 – Perspektive wohin? Die europäische Integration nach Maastricht (*Rudolf Haufe Verlag, Freiburg, 1993).

14 Commission of the European Community, *Concentration of firms in the Common Market* (Information Memo, P-1/66, Brussels, January 1966).

15 Dennis Swann, 'Concentration and Competition in the European Community' [1968] 13 *Antitrust Bulletin* 1473:1491.

the beginning required the implementation of sophisticated practices. Inconsistencies have, however, occurred, partly as a result of the inner contradictions of the regulatory scheme. Moreover, the EEC (the EU) often gets into contradiction with its own policies applied in parallel.[16] The objectives of competition policy regularly conflict industrial, agricultural, regional or social policy objectives.[17] Still, it is important to clearly distinguish among the functions. For this reason, the objectives that competition policy should foster and those that it should not, have to be laid down explicitly. There is a general consensus that territorial development, full employment, or price stability are not the tasks of competition policy. However, Motta[18] for example thinks that competition regulation should operate exclusively in favour of competition and all other aims should be addressed by other tools (e.g. fiscal policy). As a matter of fact, the EEC's (EU's) regulation on restrictive agreements has never followed this latter approach.

Eventually, despite the institutionalisation of exemptions in the regulation on restrictive agreements, European integration has resulted in an intensification of competition in Europe not seen since the liberalisation movements of the 1860s and 1870s.[19] At the same time, intensifying competition has led to an increased economic uncertainty to which companies have, logically, reacted with efforts to regain control over market forces mainly by new (or even new types of) restrictive agreements and by strong waves of mergers. The former processes called for the improvement of regulation on restrictive agreements[20] while the latter tendencies were limited first in 1989, by the adoption of the merger control regulation. The greatest impetus to the adoption of the merger

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16 Roger van den Bergh, 'The 'More Economic Approach' and the Pluralist Tradition of European Competition Law' in Dieter Schmidtchen, Max Albert and Stefan Voigt (eds), *The More Economic Approach to European Competition Law* (Mohr Siebeck, Tübingen, 2007) 7:26.

17 Willem Molle, *The Economics of European Integration – Theory, Practice, Policy (*Ashgate, Aldershot : Burlington USA : Singapore : Sidney, 2001).

18 Massimo Motta, *Competition Policy – Theory and Practice* (Cambridge University Press, New York, NY, USA, 2004).

19 Jorgo Chatzimarkakis, 'Vier-Ebenen-Modell als ordnungspolitischer Ansatz für Europa' in Lüder Gerken and Otto Graf Lambsdorff, (eds), *Ordnungspolitik in der Weltwirtschaft (*Nomos Verlagsgesellschaft, Baden-Baden, 2001) 192:208.

20 Maarten Pieter Schinkel, 'Effective Cartel Enforcement in Europe' in Dieter Schmidtchen, Max Albert and Stefan Voigt (eds), *The More Economic Approach to European Competition Law* (Mohr Siebeck, Tübingen, 2007) 131:170.

regulation was, paradoxically, provided by the deadline set in the Single European Act: 1992 was the date for the completion of the single European market. This deadline was believed to have started a wave of mergers that would not have served inner market competition any more.[21]

2. The general prohibition

Paragraph (1) of Article 101 of the Treaty per se prohibits restrictive agreements:

> "The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:
> (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
> (b) limit or control production, markets, technical development, or investment;
> (c) share markets or sources of supply;
> (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
> (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts."

The most relevant element of the article is the general prohibition (general clause). The article specifies a number of prohibited behaviours ((a) to (e)) which can be regarded as an exemplificative list in the sense that everything listed is definitely prohibited but other behaviours may also be found as subjects to the general prohibition.[22] Regulation addresses three types of agreements: restrictive agreements; decisions of associations of companies that have a restrictive aim or impact; and concerted practices of a similar nature.[23] The concept of 'agreement' should be interpreted functionally and broadly: it involves the classical contract covering a mutual and unanimous declaration of will, just as an implicit unity of will. The agreement may take any form and the way it is

[21] Theo Hitiris, *European Community Economics* (St. Martin's Press, New York, NY, 1991).

[22] Marc van der Woude, Christopher Jones and Xavier Lewis, *E. C. Competition Law Handbook* (Sweet&Maxwell, London, 1994).

[23] Tihamér Tóth, *Az Európai Közösség versenyjoga* (CompLex, Budapest, 2007).

expressed is also irrelevant (e.g. invoice, cover letter, bill of freight etc.). At the same time, unity of will has to be proved.[24]

Concerted practices are the most typical manifestations of restrictive agreements. Concerted practices are, inter alia, so 'popular' because they are the most difficult to disclose and prove legally. It may even occur that, due to legal difficulties, the companies in question consciously substitute agreement by concerted practice. Moreover, some types of market behaviours appearing as concerted practices are natural: they derive from the fact that actors of the market pay attention to one another.[25] The legal category of concerted practice presumes some 'section of wills' that is primarily manifested in market behaviour. Any cooperation that, effectively or potentially, endangers competition, can be regarded as concerted practice.[26] In light of EU competition case law, two substantive criteria should be met: firstly, a mental consensus embodied in practical cooperation should occur. Secondly, the consensus realised in direct or indirect contact has to be proved.[27]

Restricting competition is in fact restricting the freedom of market actions. On the whole, the Treaty protects all forms of competition, even potential competition. Article 101 lacks expressions like 'excessive' or 'unreasonable', which is an obvious distinction from the rule-of-reason approach of US regulation.[28]

3. The institution of exemptions

The most debatable (and in fact debated) part of Article 101 of the Treaty is paragraph (3) which introduced the institution of exemption from the general prohibition laid down in paragraph (1), already in 1957:

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24 Ern Várnay and Mónika Papp, *Az Európai Unió joga* (KJK-Kerszöv, Budapest, 2005).

25 Piet Jan Slot and Angus Johnston, *An Introduction to Competition Law* (Hart Publishing, Oxford: Portland, OR, 2006).

26 Christopher Decker, *Economics and the Enforcement of European Competition Law* (Edward Elgar, Cheltenham, UK : Northampton, MA, USA, 2009).

27 Valentine Korah, *An Introductory Guide to EC Competition Law and Practice* (Sweet&Maxwell, London, 1994).

28 András Osztovits (ed), *Az Európai Unió alapító szerzõdéseinek magyarázata 1. Szerzõdés az Európai Közösség létrehozásáról* (CompLex, Budapest, 2008).

"The provisions of paragraph (1) may, however, be declared inapplicable in the case of:

– any agreement or category of agreements between undertakings,
– any decision or category of decisions by associations of undertakings,
– any concerted practice or category of concerted practices,
– which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question".

So, prohibition is general but not absolute. Paragraph (3) of Article 101 is based on the theoretical conviction that some economic objectives (obviously other than competition itself) cannot be reached without restricting competition. The conviction relies on a complex economic philosophy, mainly rooted in German economic thinking.[29] So, the Treaty does not deny that any cooperation among companies may include restrictive features but rather implies that, besides competition, there are other favourable economic objectives, to which competition appears subordinated, with certain conditions, of course. The reasoning is the same as that of German competition regulation distinguishing between cooperation agreements and cartels.[30] From this viewpoint, exemption is not only justified but also necessary.

As we can see, exemption is bound to four conjunctive conditions[31]:

– improvement of conditions, technical-economic development (effectiveness);
– fair share to consumers (the concept of consumer is not restricted to natural persons);
– the extent of restriction is minimal (indispensable) in light of the objective to be reached;
– competition is not eliminated in a substantial part of the market..

[29] Anita Pelle, The German Roots of the European Community's Cartel Regulation – From a Historical and Theoretical Perspective (Lambert Academic Publishing, Saarbrücken, 2011).

[30] Kai-Uwe Kühn, 'Germany' in Edward Montgomery Graham and David J. Richardson, (eds), *Global Competition Policy* (Institute for International Economics, Washington, DC, 1997) 115:150.

[31] Judit Dán, *Bevezetés az Európai Közösség versenyjogába* (SZTE ÁJTK, Szeged, 2005).

Two of the conjunctive conditions contain a positive statement while two of them imply a negative approach. At the same time, conditions are equal (if either of them is not met, no further investigation is needed) and exhaustive (if all four conditions are met, the agreement is exempt). Let us examine them in detail[32]:

– Effectiveness includes the improvement of the production or distribution of goods and the fostering of technological and/or economic development. Impact has to be connectible to the given agreement, it has to be justifiable and has to, at least partly, serve the benefit of consumers. To this end, investigation addresses the nature of effectiveness, its relation to the agreement, its probability and size, and when and how it will be realised. The improvement in effectiveness has to be objective. It can be cost-effectiveness but may be manifested in the economies of scale, in the richness of varieties, in an improved processing or a more effective use of capacities. It can also be of a quality nature: cooperation which leads to the development of a better or a new product. The burden of proof of effectiveness is on the parties.

– Behind the condition of a fair share to consumers lies the conviction that consumers have to be at least compensated for restrictions, and the overall impact has to be at least neutral. 'Fair' implies that the greater the extent of restriction or the more distant the realisation of effectiveness, the greater the consumers' benefit should be.

– Inevitability refers to the extent of restriction of competition; it should be minimal. The extent of restriction should be proportionate to the advantages. The inevitability criterion has to be interpreted in light of the improvement in effectiveness; these two conditions are interrelated. In the course of investigation, the core question is always whether the same effectiveness can be reached by an alternative scenario where restriction is

[32] Based on: Ádám Remetei-Filep, 'Versenypolitika' in Attila Marján (ed), *Az Európai Unió gazdasága – minden, amit az EU gazdasági és pénzügyi politikáiról tudni kell* (HVG-ORAC, Budapest, 2005) 284:308.

smaller (or none). The moment it is proved, the agreement is not inevitable.

– In respect of elimination of competition, investigation addresses the remaining sources of competition after the agreement. At this point, potential competition also plays a part. When assessing expected future competition, barriers to entry also have to be examined.

The need for a unified regulation on exemptions was articulated already in the 1960s, due to the large number of requests and the limits to the Commission's capacities, and also because there are certain types of behaviours carrying similar characteristics. The Commission was entitled to draft a regulation allowing block exemption[33], and the adoption of the first such regulation occurred in 1967.[34] Block exemption regulation on horizontal agreements exists only in the EU.[35] The legal policy basis for block exemption is the following: if the parties agree in a way which is compatible with the regulation in its contents, they may regard their contract as valid. This logic has induced a long process of willingness to comply on behalf of undertakings, thus shaping market behaviours in a pro-competitive manner. In our view, this is the major impact of the institution of exemptions on European markets.

Block exemption regulations have shown certain similarities all through their development:

– they bind exemption to certain proportions of market share;
– they contain a so-called black list (excluding conditions and behaviours already restrictive in their objectives);
– they regulate the withdrawal of allowances.

Block exemption regulations currently in force can be categorised into three groups: there are the horizontal type regulations (research and development agreements, specialisation agreements); regulations on

[33] Based on Regulation No 19/65/EEC of the Council of 2 March 1965 on application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices (OJ P 36, 6.3.1965, p. 533).

[34] Pál Béla Szilágyi, 'A közösségi versenypolitika (antitröszt jog) 50 éve – Mekkától Medináig, és tovább Párizsba?' [2007] Iustum Aequum Salutare, III, 4, 145:164.

[35] Einer Elhauge and Damien Geradin, *Global Competition Law and Economics* (Hart Publishing, Portland, OR, 2007).

vertical agreements; and the ones applying a sectoral approach (especially branches of the service sector[36]).

4. Application of the rules on research and development agreements

As for the primary law, the Single European Act[37], signed in 1986 and enforced in 1987, was the first legal source referring to the necessity to harmonise research and development objectives with competition policy, in Article 130f(1):

> "The Community's aim shall be to strengthen the scientific and technological basis of European industry and to encourage it to become more competitive at international level. (...) In the achievement of these aims, special account shall be taken of the connection between the common research and technological development effort, the establishment of the internal market and the implementation of common policies, particularly as regards competition and trade".

The declaration of intent is relevant but, as we saw above, competition policy had already provided the possibility to apply development policy objectives. Research and development agreements between companies, with an effect on trade between the member states and above a certain threshold in size and market share, are subject to Community regulation on restrictive agreements. In this regard, the relevant Commission Guidelines on horizontal cooperation agreements[38] should be used as the main compass in interpreting primary law. According to the Guidelines,

> "co-operation is of a 'horizontal nature' if an agreement is entered into between actual or potential competitors. (...) Horizontal co-operation agreements can lead to substantial economic benefits. (...) On the other hand, horizontal co-operation agreements may lead to competition problems. (...) The Commission, while recognising the benefits that can be generated by horizontal co-operation agreements, has to ensure that effective competition is maintained".

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36 Anita Pelle, 'Az Európai Unió versenyszabályozása a kutatás-fejlesztés és az innováció szolgálatában a csoportmentességi rendszereken keresztül' in Buzás Norbert (ed), *Tudásmenedzsment és tudásalapú gazdaságfejlesztés* (JATEPress, Szeged, 2005) 63:73.

37 http://ec.europa.eu/economy_finance/emu_history/documents/treaties/singleuropeanact.pdf

38 Communication from the Commission, *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements* (Text with EEA relevance) (2011/C 11/01).

These introductory sentences highlight the complex approach of the Commission: certain horizontal cooperation agreements can be justified based on the economic benefits they yield. However, such agreements and especially their anti-competitive dimension need to be kept under cautious scrutiny.

Regarding the types of agreements that may enjoy exemption, the Commission acknowledges that:

> "Given the potentially large number of types and combinations of horizontal co-operation and market circumstances in which they operate, it is difficult to provide specific answers for every possible scenario. These guidelines will nevertheless assist businesses in assessing the compatibility of an individual co-operation agreement with Article 101. Those criteria do not, however, constitute a 'checklist' which can be applied mechanically. Each case must be assessed on the basis of its own facts, which may require a flexible application of these guidelines".

So, when applying Article 101 paragraph (3), the case-by-case approach is encouraged. This suggests that the basically per se type of European competition policy in fact contains clearly rule-of-reason elements.[39] Nevertheless, the Commission continues to face the difficulty of finding the borderline between the two approaches.[40]

Regarding the basic principles for the assessment under Article 101, the Guidelines again defines a clear setting:

> "The assessment under Article 101 consists of two steps. The first step, under Article 101(1), is to assess whether an agreement between undertakings, which is capable of affecting trade between Member States, has an anti-competitive object or actual or potential restrictive effects on competition. The second step, under Article 101(3), which only becomes relevant when an agreement is found to be restrictive of competition within the meaning of Article 101(1), is to determine the pro-competitive benefits produced by that agreement and to assess whether those pro-competitive effects outweigh the restrictive effects on competition. The balancing of restrictive and pro-competitive effects is conducted exclusively within the framework laid down by Article 101(3). If the pro-competitive effects do not outweigh a restriction of competition, Article 101(2) stipulates that the agreement shall be automatically void".

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39 Christian Kirchner, 'Goals of Antitrust and Competition Law Revisited' in Dieter Schmidtchen, Max Albert and Stefan Voigt (eds), *The More Economic Approach to European Competition Law* (Mohr Siebeck, Tübingen, 2007) 27:36..

40 Ernest Gellhorn, William Evan Kovacic and Stephen Calkins, *Antitrust Law and Economics.* (Thomson West, St. Paul, MN, 2004).

The text of the Guidelines is rather suggestive by literally speaking about putting the pro-competitive and anti-competitive elements of an agreement into the two pans of the scale and looking at which pan weighs more. However, it is not at all easy to define those 'elements' that should be put in the pans, especially in a measurable and comparable way. Even if so, very rarely does it happen that an exempt agreement is ex-post found to be subject to prohibition.

All in all, the Guidelines strives for indicating the borderlines of restriction as clearly as possible:

> "For an agreement to have restrictive effects on competition within the meaning of Article 101(1) it must have, or be likely to have, an appreciable adverse impact on at least one of the parameters of competition on the market, such as price, output, product quality, product variety or innovation. (...) Restrictive effects on competition within the relevant market are likely to occur where it can be expected with a reasonable degree of probability that, due to the agreement, the parties would be able to profitably raise prices or reduce output, product quality, product variety or innovation. (...) Horizontal co-operation agreements between competitors that, on the basis of objective factors, would not be able to independently carry out the project or activity covered by the co- operation, for instance, due to the limited technical capabilities of the parties, will normally not give rise to restrictive effects on competition within the meaning of Article 101(1). (...) Horizontal co-operation agreements may limit competition in several ways. The agreement may be exclusive (...), require the parties to contribute such assets that their decision-making independence is appreciably reduced; or affect the parties' financial interests in such a way that their decision-making independence is appreciably reduced".

The Guidelines also describes the possible restrictions on competition, both from the objective and impact points of view. The conclusion is drawn that a major factor to be investigated is how the agreement influences (potentially: reduces) the independence of the actors.

Regarding exemptions, efficiency gains enjoy special attention:

> "Information exchange may lead to efficiency gains. Information about competitors' costs can enable companies to become more efficient if they benchmark their performance against the best practices in the industry and design internal incentive schemes accordingly. Moreover, in certain situations information exchange can help companies allocate production towards high-demand markets (for example, demand information) or low cost companies (for example, cost information). The likelihood of those types of efficiencies depends on market characteristics such as whether companies compete on prices or quantities and the nature of uncertainties on the market. (...) Exchange of consumer data between companies in markets with asymmetric information about consumers can also give rise to efficiencies".

What we see in this passage of the Guidelines is the very reasoning for exemptions based on potential pro-competitive effects.

Turning our attention to the research and development agreements potentially exempt from prohibition, the Guidelines states that:

> "A research and development agreement may bring together different research capabilities that allow the parties to produce better products more cheaply and shorten the time for those products to reach the market".

A separate chapter (Chapter 3) is dedicated to research and development agreements. It starts with the definition of the concept:

> "R&D agreements vary in form and scope. They range from outsourcing certain R&D activities to the joint improvement of existing technologies and co-operation concerning the research, development and marketing of completely new products. They may take the form of a co-operation agreement or of a jointly controlled company. This chapter applies to all forms of R&D agreements, including related agreements concerning the production or commercialisation of the R&D results".

The definition is rather clear. However, it calls for cautiousness about the relations of such agreements to intellectual property rights as these may appear as barriers to entry to markets.[41] Accordingly, impact on competition in innovation is crucial. In this respect, the Guidelines states that:

> "R&D co-operation may not only affect competition in existing markets, but also competition in innovation and new product markets. This is the case where R&D co-operation concerns the development of new products or technology which either may –if emerging– one day replace existing ones or which are being developed for a new intended use and will therefore not replace existing products but create a completely new demand. The effects on competition in innovation are important in these situations, but can in some cases not be sufficiently assessed by analysing actual or potential competition in existing product/technology markets. In this respect, two scenarios can be distinguished, depending on the nature of the innovative process in a given industry".

The Commission seems to be aware of the potential restrictive effects of research and development agreements, including foreclosure problems:

> "R&D co-operation can restrict competition in various ways. First, it may reduce or slow down innovation, leading to fewer or worse products coming to the market later than they otherwise would. Secondly, on product or technology markets the R&D co-operation may reduce significantly competition between the parties outside

[41] Steven Anderman, *The interface between intellectual property rights and competition policy* (Cambridge University Press, Cambridge – New York, NY, 2007).

> the scope of the agreement or it may make anti-competitive coordination on those markets likely, thereby leading to higher prices. A foreclosure problem may only arise in the context of co-operation involving at least one player with a significant degree of market power (which does not necessarily amount to dominance) for a key technology and the exclusive exploitation of the results".

On the other hand, the potential pro-competitive effects are also revealed:

> "Many R&D agreements –with or without joint exploitation of possible results– bring about efficiency gains by combining complementary skills and assets, thus resulting in improved or new products and technologies being developed and marketed more rapidly than would otherwise be the case. R&D agreements may also lead to a wider dissemination of knowledge, which may trigger further innovation. R&D agreements may also give rise to cost reductions. (...) In general, it is more likely that an R&D agreement will bring about efficiency gains that benefit consumers if the R&D agreement results in the combination of complementary skills and assets. The parties to an agreement may, for instance, have different research capabilities. If, on the other hand, the parties' skills and assets are very similar, the most important effect of the R&D agreement may be the elimination of part or all of the R&D of one or more of the parties".

Research and development agreements are regulated in a block exemption regulation.[42] The regulation replaced its predecessor[43] in 2010, without changing its philosophy, basic approach or general framework. The (original) block exemption regulation was called forth by the double requirement of protecting competition and ensuring the legal security for R&D. The regulation (both the old and the new one) manifests this dichotomy as the conditions of exemptions aim at ensuring that

- the agreement is in fact a research and development agreement;
- that it strives for reaching and harvesting the joint R&D objectives;
- and that it does not perform any of the characteristics of hard-core restrictions.

Conditions for exemption can be summarised as follows:

- agreements should not restrict any other activities of the parties (including other R&D activities);

[42] Commission Regulation (EU) No 1217/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to certain categories of research and development agreements (Text with EEA relevance) (L 335/36).

[43] Commission Regulation (EC) No 2659/2000 on the application of Articles 81(3) of the Treaty to categories of research and development agreements (L 304/7).

- parties may utilise results of the agreement freely and independently of the other party;
- no restriction may be prescribed for the time period after the expiration of the agreement;
- agreement should not prescribe conditions for output or distribution;
- agreement should not aim at fixing prices;
- consumer choice should not be violated due to the agreement;
- agreement should not aim at division of markets;
- agreement should have as an objective the fulfilling of market needs.

Although not a case on restrictive agreements, the importance of consumers' access to and choice of innovative products and services is one of the Commission's major arguments in the ongoing investigation against Google.[44]

In relation to research and development agreements, the relevant block exemption regulation provides a rather clear scheme which companies are incited to comply to but some of the borderlines between encouraged and discouraged practices and, even more so, the answer to the question how the imagined beam of that imagined scale for measuring pro- and anticompetitive elements would eventually tilt, continue to be ambiguous.

5. Application of the rules on technology transfer agreements

The regulation on technology transfer agreements currently in force[45] was adopted in the course of the latest major competition policy reform in 2014. The regulation's starting point is rather different as that of the regulation on research and development agreements by declaring that technology transfer agreements in general foster economic efficiency

[44] Case No. Antitrust 39740, Google.

[45] Commission Regulation (EU) No 316/2014 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of technology transfer agreements (L 93/17).

and competition by reducing parallelism in R&D activities while, at the same time, foster corporate R&D activities, promote innovation, and encourage the dissemination of innovation and know-how, thus resulting in an enhanced competition in product markets.[46] Together with the regulation, the Commission also published a Guidelines on technology transfer agreements[47]. Just like the Guidelines on horizontal cooperation agreements, it states that

> "Each case must be assessed on its own facts and these guidelines must be applied reasonably and flexibly".

So, there is again room for case-by-case investigation and rule-of-reason policy application.

The Guidelines defines the relevant factors to be investigated:

> "In the application of Article 101 of the Treaty to individual cases it is necessary to take due account of the way in which competition operates on the market in question. The following factors are particularly relevant in this respect:
>
> (a) the nature of the agreement;
>
> (b) the market position of the parties;
>
> (c) the market position of competitors;
>
> (d) the market position of buyers on the relevant markets;
>
> (e) entry barriers and;
>
> (f) maturity of the market;"

Technology transfer is grabbed in a broad sense:

> "The concept of 'technology rights' covers know-how as well as patents, utility models, design rights, topographies of semiconductor products, supplementary protection certificates for medicinal products or other products for which such supplementary protection certificates may be obtained, plant breeder's certificates and software copyrights or a combination thereof as well as applications for these rights and for registration of these rights. (...)The concept of 'transfer' implies that technology must flow from one undertaking to another".

Similarly to the approach to horizontal cooperation agreements, hard core restrictions are in any circumstances prohibited. Regarding other possible negative effects, these include the following:

> "1. reduction of inter-technology competition;

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46 Steven D. Anderman and John Kallaugher, *Technology transfer and the new EU competition rules – Intellectual property licencing after modernisation* (Oxford University Press, Oxford 2006).

47 Commission Notice, Guidelines on the application of Article 81 of the EC Treaty to technology transfer agreements (Text with EEA relevance) (2004/C 101/02).

2. foreclosure of competitors by raising their costs, restricting their access to essential inputs otherwise raising barriers to entry; and
3. reduction of intra-technology competition."

The Guidelines implies that a thorough knowledge on the relevant market(s) and the relevant technology/technologies is essential when assessing technology transfer agreements.

As regards the potential positive effects, there are many of these mentioned and described in the Guidelines. Related to the efficiency criterion, the Commission's approach is as follows:

> "It is thus presumed that the agreements give rise to economic efficiencies, that the restrictions contained in the agreements are indispensable to the attainment ofthese efficiencies, that consumers within the affected markets receive a fair shareof the efficiency gains and that the agreements do not afford the undertakings concerned the possibility of eliminating competition. (...) Even restrictive licence agreements often also produce pro-competitive effects in the form of efficiencies, which may outweigh their anti-competitive effects. (...) Licence agreements have the potential of bringing together complementary technologies and other assets allowing new or improved products to be put on the market or existing products to be produced at lower cost. (...) Another example of potentially efficiency enhancing licensing is where the licensee already has a technology and where the combination of this technology and the licensor's technology gives rise to synergies. (...) Such efficiencies can take the form of cost savings or the provision of valuable services to consumers. (...) A further example of possible efficiency gains is to be found in agreements whereby technology owners assemble a technology package for licensing to third parties. Such pooling arrangements may in particular reduce transaction costs".

As the previous block exemption regulation on technology transfer agreements expired on 30 April 2014, the Commission carried out a public consultation on the topic between 6 December 2011 and 3 February 2012.[48] The results of the consultation were assessed and a proposal for a new regulation was drafted and consulted.[49] The newly drafted proposed block exemption regulation and guidelines appear to be substantially similar to the current ones. However, there are a few notable changes[50]:

– Passive sales exhausting certain conditions are to be subject to a case-by-case investigation.

48 http://ec.europa.eu/competition/consultations/2012_technology_transfer/index_en.html

49 http://ec.europa.eu/competition/consultations/2013_technology_transfer/index_en.htm

50 http://www.sjberwin.com/insights/2013/07/26/changes-to-the-technology-transfer-block-exemption

- Exclusive grant-backs would also require individual assessment in the future.
- Amendment has been made to the provisions on no-challenge clauses.
- The revised block exemption regulation clarifies that it will only apply if other potentially applicable block exemptions, being those covering R&D and specialisation agreements, do not apply.
- Certain settlement agreements may contravene Article 101.

As we can see, the proposed changes are of a technical nature and target minor issues compared to the objective and scope this part (starting with paragraph As the) should be put before the quotes from the Guidelines. An exciting new issue brought into the assessment of technology transfer cases is the encouragement of application of the FRAND (fair, reasonable, and non-discriminatory terms) approach on behalf of the Commission, connected to the "patent ambush" challenge. As Commissioner Almunia phrased it:[51]

> "Both competition authorities and the courts should intervene to ensure that standard-essential patents are not used to block competition."

The most plausible example for the application of the approach is the currently ongoing case of the US-based software company MathWorks.[52] Under EU antitrust legislation, the Commission is investigating whether the company has restricted competition through end-user licences and interoperability information. In the investigation, the Microsoft case[53] serves as an important benchmark.

6. Conclusion

If we examine the development of European economic integration, we can see that it has always been put forth by a constant political will. Where are we today in this respect? There are clear signs that the common political will is highly challenged these times. Whatever the

[51] Joaquín Almunia, *Higher Duty for Competition Enforcers*, speech told at the International Bar Association Antitrust Conference in Madrid on 15 June 2012, European Commission SPEECH/12/453.

[52] Case No. Antitrust 39840, MathWorks.

[53] Case COMP/C-3/37.792.

stance, competition can still be enhanced further. At the same time, the exploitation of competitive advantages deriving from integration and the common market varies by Member States.[54] Nevertheless, it is undisputable that European integration has been based on competition and has fostered its intensification.[55]

If competition authority does not condemn restrictive agreements categorically but encourages them instead (e.g. by exemptions), there is the threat that the authority itself fosters cartelisation.[56] Comparing American and European competition regulation schemes in a historical perspective, Europe has shown, compared to the US, a vast and persistent confidence towards governments and great tolerance towards economic dominance, explaining why legal possibilities for exemption could endure for such a long time.[57]

When examining the broader economic policy context, we see that, after 2000, the economic policy strategies of the EU (Lisbon Strategy and its restart in 2005 or, most recently, the Europe 2020 strategy) handle competition policy as of strategic importance: by now, inner competition has evidently become a tool for international competitiveness. The renewed strategy explicitly emphasises the importance of competition in respect of growth and the creation of workplaces.[58] The Commission is striving for shaping European regulatory environment so that it provide answers to the challenges imposed by today's economy that is more and more knowledge- and technology-based. How do we use this tool? At present, the member states are showing a rather large dispersion in their one word![59] Such dispersion is a challenge in itself that should be

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54 Giuliano Amato, *Antitrust and the Bounds of Power – The Dilemma of Liberal Democracy in the History of the Market* (Hart Publishing, Oxford, 1997).

55 Roland Vaubel, 'Ordnungspolitische Konsequenzen der europäischen Integration' in Lüder Gerken and Otto Graf Lambsdorff (eds), *Ordnungspolitik in der Weltwirtschaft* (Nomos Verlagsgesellschaft, Baden-Baden, 2001) 188:191.

56 Eleanor Morgan, 'Controlling Cartels – Implications of the EU Policy Reforms' [2009] European Management Journal, 27, 1, February, 1:12.

57 Clifford Jones, 'Foundations of Competition Policy in the EU and USA – Conflict, Convergence and Beyond' in Hans Ullrich (ed.): *The Evolution of European Competition Law (*Edward Elgar, Cheltenham, UK – Northampton, MA, USA, 2006) 17:37.

58 European Commission, *Working together for growth and jobs – A new start for the Lisbon Strategy*. COM(2005) 24, Brussels.

59 For more information, see: http://ec.europa.eu/europe2020/making-it-happen/key-areas/index_en.htm

addressed, and in a complex approach, in which competition policy has a part.[60]

European regulation on restrictive agreements has still not turned away from the original objectives stemming from an attitude based on permissiveness. As a matter of fact, this has been the very acknowledgement of diversity and complexity. Nevertheless, we continue to face a delicate issue in this respect as cooperation among competitors has been substantially problematic, as acknowledged by the EEC Treaty already. Still, European competition regulation does not exclude the possibility that such cooperation may result in efficiency. Efficiency may derive from the joint development of standards, from the harmonisation of procedures (which thus become more transparent), and from economies of scale. The history of European competition regulation shows that these convictions have enjoyed wide acceptance and support. Even the 2011 Guidelines on horizontal cooperation agreements[61] highlights the positive impacts. The philosophy is spectacularly manifested in the Commission's latest decision on 4 December 2014 by clearing the acquisition of Nokia's mobile device business by Microsoft.[62]

It is rather clear that the European Commission has repeatedly strengthened the legitimacy of exemptions from the prohibition on restrictive agreements. The Commission Communication of 2001[63] preceding the current one and basically stating the same served as a significant ground for leaving the respective article of the Treaty unchanged during the adoption of the Lisbon Treaty[64].

On the other hand, Article 101, and especially paragraph (3), has constantly been scrutinised. Critiques have usually pointed out that the European regulation on horizontal restrictive behaviours is in fact

60 WEF, *The Europe 2020 Competitiveness Report: Building a More Competitive Europe* (World Economic Forum, Geneva, 2012).

61 Communication from the Commission, *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements* (Text with EEA relevance) (2011/C 11/01), analysed in Chapter 4 detail.

62 Case No. M.7047 Microsoft/Nokia.

63 Commission Notice, *Guidelines on the applicability of Article 81 of the EC Treaty to horizontal cooperation agreements* (Text with EEA relevance) (2001/C 3/02).

64 *Consolidated Version of the Treaty on the Functioning of the European Union* (C 115/49).

an active industrial policy instrument which serves the strengthening of the SME sector and outward competitiveness.[65] Therefore, the substantial question behind the logic of Article 101 paragraph (3) is whether positive outcomes outweigh the negative effects of restriction, and whether they really contribute to competitiveness. In this respect it is somewhat calming that hard-core restrictions will most probably never enjoy exemption as paragraph (1) specifies these as prohibited practices. Still, cooperation agreements enjoying exemption may raise doubts in cases when the objective is not to fix the price, the output, or the segmentation of the market but such impacts occur while companies successfully argue in favour of their agreement. Another case is when, 'thanks to' automatic exemption, companies pretend pro-competitive cooperation to hide restriction and thus escape sanctions.[66]

The next dilemma is that of Schumpeter: what serves innovation better, competition or protection? The question gains a new interpretation with the development of intellectual property rights. The problem has been appreciated especially in the most recent times as technology plays an ever greater role in the global economic performance.[67] The competition regulation issue connected to property rights, still waiting to be fully answered, is whether patents create barriers to entry and, if yes, how regulation should handle these. The justification of the protection of know-how dates back to 1986 with the Pronuptia judgment of the European Court.[68] At the level of policy objectives, competition and innovation policies are in fact closely related as both of them aim at promoting economic welfare. Regulation should be rooted in these close relations.[69]

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65 Wulf-Henning Roth, 'Strategic Competition Policy – A Comment on EU Competition Policy' in Hans Ullrich (ed), *The Evolution of European Competition Law* (Edward Elgar, Cheltenham, UK – Northampton, MA, USA, 2006) 38:52.

66 Einer Elhauge and Damien Geradin, *Global Competition Law and Economics* (Hart Publishing, Portland, OR, 2007).

67 Phillip Beutel, 'The Intersection of Antitrust and Intellectual Property Economics – A Schumpeterian View' in Lawrence Wu (ed), *Economics of Antitrust – New Issues, Questions, and Insights* (NERA Economic Consulting, White Plains, NY, 2004) 131:140.

68 Judgment of the Court of 28 January 1986, Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis, Case No. 161(84.

69 François Lévêque and Howard Shelanski (eds), *Antitrust, Patents and Copyright. EU and US Perspectives* (Edward Elgar, Cheltenham, UK – Northampton, MA, USA, 2005).

Eventually, we come back to the principal question[70]: should competition policy serve industrial policy objectives (as well)? We could see that European competition policy has never been 'clean' competition policy but has encompassed industrial, economic, or even integration policy elements. Buigues, Jacquemin and Sapir grasped the core of this dilemma back in 1995[71] when they claimed that, as all the EU policies refer to the same economy, the emphasis should be put on policy harmonisation. Their conclusion is perhaps more adequate in our post-crisis times than ever before as lack of successful harmonisation results in loss of efficiency, credibility is questioned, and uncertainty arises for private and public actors as well. Petit reframes the issue by asking whether competition policy supports or undermines other policies that seek to foster innovation, e.g. IPR policy.[72] Anyhow, the optimum is realised through a policy mix – not an easy task to commingle the right elements in the right proportions and to maintain the combination ever-optimal. This definitely gives legitimacy for an active competition policy on the European policy palette.

The EU has lately been on the position that competition regulation should exclusively aim at maximising consumer welfare[73], to which the Treaty in fact gives the basis, and that industrial policy objectives and competitiveness should be served this way.[74] Only such a decisive distinction makes it possible that competition regulation encourages companies to maintain or strengthen their positions by improving their own effectiveness. For this reason, the prevalence of economic aspects has been introduced in recent years' competition law investigations, under the scope of the 'more economic approach', a methodology under dynamic development.[75]

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70 Ádám Török, *Ipar- és versenypolitika az Európai Unióban és Magyarországon – Helyzetértékelés.* (Integrációs Stratégiai Munkacsoport, Budapest, 1997).

71 Pierre Buigues, Alexis Jacquemin and André Sapir (eds), *European Policies on Competition, Trade and Industry – Conflicts and Complementarities* (Edward Elgar, Aldershot, 1995).

72 Nicolas Petit, *Does EU competition policy sufficiently promote companies' investment & innovation? R&D and technology transfer cooperation, abuse of dominant positions and merger control policy*, Speech told at the conference Fostering growth: reinforcing the EU internal market, held at CEU San Pablo University on 28-29 October 2013.

73 Katalin Judit Cseres, *Competition Law and Consumer Protection* (European Monographs, 49, Kluwer Law International, The Hague, 2005).

74 Jürgen Basedow, 'Konsumentenwohlfahrt und Effizienz – Neue Leitbilder der Wettbewerbspolitik?' [2007] *Wirtschaft und Wettbewerb,* 7, 8, 712:715.

75 Roger van den Bergh and Peter Camesasca, *European Competition Law And Economics – A Comparative Perspective* (Sweet&Maxwell, London, 2006).

As we could see, case-by-case investigations continue to enjoy certain freedom which requires great wisdom on behalf of competition authorities, be they national or Community level bodies. The Freiburg scholars knew as early as in the 1930s that such collective wisdom should be embodied in an economic constitution.[76] Based on the Freiburgian theoretic framework of Ordoliberalismus, the principles constructing the economic constitution should be applied in an active way, which they called Ordnungspolitik.[77] In some respect, the European competition regulation can be regarded as an economic constitution for the European internal market of the 21st century. On the other hand, impreciseness in the rules and in their application gives room for discretion, which is not necessarily favourable in the case of a constitutional framework.

[76] Nicola Giocoli, 'Competition versus property rights: American antitrust law, the Freiburg School, and the early years of European competition policy' [2009] Journal of Competition Law & Economics, 5(4), 747:786.

[77] Otto Schlecht, *Ordnungspolitik für eine zukunftsfähige Marktwirtschaft – Erfahrungen, Orientierungen und Handlungsemfehlungen* (Ludwig-Erhard-Stiftung, Bonn, 2001).

11

EU state aid policy reform to support growth: An assessment[1]

PIET JAN SLOT

ABSTRACT

This chapter briefly introduces the relationship between EU state aid policies and economic growth. Although it might not be always noticeable, this section suggests that economic growth is always present in the basic rationale underpinning EU state aid policies; and most interestingly, it acts as a constraint on Member States policy choices to ensure that public resources are allocated to maximise economic and social gains. In this new light, art. 107 TFEU and the General Block Exemption Regulation 800/2008 are analysed to conclude with a reference to some of the most recent proposals contained in the Commission's State Aid Modernisation plan, such as the broadband and environmental protection guidelines. Here, sustainable growth, transparency and efficient allocation of subsidies have become major concerns and the main driving forces for the future EU state aid policy review.

KEYWORDS: State aid, growth, State Aid Modernisation Plan, transparency, broadband guidelines, environmental protection guidelines.

1. Introduction

This paper explores the fundamentals of EU State Aid Policy as far as they may affect economic growth. Because the very essence of the EU state aid policy is to make sure that state resources will be spent in a way to ensure economic efficiency, there are many aspects of it that have a bearing on economic growth. It is impossible to deal with these in any detailed manner let alone provide a detailed analysis of their effect on growth. For the purpose of this paper it is enough to give a brief introduction and to restrict ourselves to a limited discussion of these elements. In the second part of this paper I will also discuss the actual policy

[1] This paper is an elaboration of a presentation given at a seminar organized by the Instituto Universitario de Estudios Europeos at the Universidad San Pablo Madrid on the 29th of October 2013.

instruments with a view of their relevance for economic growth. Finally, I will discuss some initiatives already presented as part of the State Aid Modernisation Plan currently ongoing.

2. Some questions

2.1. What kind of growth?

Before embarking upon our main topic it is useful to ask ourselves what we mean by growth. Is this an increase of the Gross Domestic Product? I assume it is. Nevertheless there are other objectives that can and probably should be taken into account. Among those are the growth of welfare and sustainable growth. In the context of EU State Aid policy the concept of sustainable growth is important since this policy also takes the protection of the environment into account. Environmental objectives are taken into account when individual decisions are taken by the Commission. Similarly the Commission has developed guidelines on state aid for environmental protection to be discussed further below. Environmental objectives are also included in the General Block Exemption (GBER) addressed below.

2.2. Whose growth?

A next question is whose growth are we trying to stimulate? Here several options present themselves. Is it the EU? The individual Member States? The regions? Or the world at large? For the purpose of this paper we may omit the latter, not because such effects would not be important but because the objectives of the EU are focused on the EU. World-wide effects of aid are the subject of the World Trade Organisation(WTO).[2]

[2] The WTO URUGUAY round Agreement on Subsidies and Countervailing Measures (The SCM Agreement) addresses the prohibition of subsidies Part II: Prohibited Subsidies
Article 3 provides as follows:

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact(4), whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I(5);

(b) Subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1.

See on these rules: Marco Bronckers, Gary Horlick and Ravi Soopramanien: "WTO Regulation of Susidies" in Leigh Hancher, Tom Ottervanger and Piet Jan Slot; "EU State Aids" Sweet & Maxwell/

We will therefore focus our attention on the growth of the EU, its constituent Member States and where relevant the regions of the Member States.

3. Economic rationale for state aid

Before addressing the question of state aid control and its contribution to growth, it is important to ask ourselves what the reasons are for which governments grant state aid. This will help us to better understand the rationale of EU Sate aid policy. Although it can be generally assumed that state aid is distorting competition and therefore harmful, there are a number of situations in which state aid may be acceptable. In such situations state aid policy will condone state aid albeit often subject to conditions so as to limit their harmful effect on other economic activities. The main reasons why state aid may be accepted are market failures. Such failures exist[3] because of:

– Externalities (plus public goods)

– Economies of scale

– Asymmetric information

Externalities is a concept used to denote the existence of a cost or benefit that cannot directly be attributed to a specific producer and will therefore not be paid for by the individual producer. For example, manufacturing activities that cause air pollution impose health and clean-up costs on the whole society, whereas the neighbors of an individual who chooses to fire-proof his home may benefit from a reduced risk of a fire spreading to their own houses. If external costs exist, such as pollution, the producer may choose to produce more of the product than would be produced if the producer were required to pay all associated environmental costs. If there are external benefits, such as in public safety, less of the good may be produced than would be the case if the producer were to receive payment for the external benefits to others. For the

Thomson Reuters, 4th ed. London 2012 Chapter 6. See also: M.C.E.J. Bronckers: "Better rules for a new millennium: a warning against undemocratic developments in the WTO," Journal of International Economic Law (1999) 2 (4): 547-566.

3 See Phedon Nicolaides: Nicolaides P, 'The Economics of State Aid and the Balancing Test', *EU State Aids* (4th edn, Sweet & Maxwell 2012).

purpose of these statements, overall cost and benefit to society is defined as the sum of the imputed monetary value of benefits and costs to all parties involved. Thus, it is said that, for goods with externalities, unregulated market prices do not reflect the full social costs or benefit of the transaction.[4]

Economies of scale occur when the costs of production will be lower for additional products. Hence it may not be possible for an individual undertaking to reach a satisfactory level of production allowing him to compete with other firms producing at a level with significant economies of scale. In such a situation governments may have reason to enable producers operating at a sub-optimal level of production to meet the competition. This will especially be the case when the product concerned is considered to be of vital national interest. An example would be the production of state of the art jet fighters such as the Joint Strike Force (JSF).

Asymmetric information: In contract theory and economics, information asymmetry deals with the study of decisions in transactions where one party has more or better information than the other. In contrast to neo-classical economics which assumes perfect information, this is about "What We Don't Know". This creates an imbalance of power in transactions which can sometimes cause the transactions to go awry, a kind of market failure in the worst case. Examples of this problem are adverse selection, moral hazard, and information monopoly. Most commonly, information asymmetries are studied in the context of principal–agent problems. Information asymmetry causes misinforming and addressing it is essential in every communication process.[5] The granting of state aid may help the less informed market party to compete on the same level.

When market failures exist the granting of aid may contribute to a better functioning of the market and hence to support economic growth. It will also contribute to an increase in sustainable growth.

4 http://en.wikipedia.org/wiki/Externality

5 http://en.wikipedia.org/wiki/asymatric information

4. Why eu rules on state aid control?

4.1. Secure a Level playing field because state aid may prevent or delay the market forces to reward the most competitive firms

This is the most often given reason for the control of state aid. The political economies of the original EEC member states differed greatly. Some member states notably France and Italy had a very high level participation in the economy of state owned enterprises and state involvement in the economy. The objective of the common market (later called the internal market) imposed the creation of equal competitive conditions. It was telling that in some sectors where markets were strictly regulated the state aid rules were not applied until the liberalization.

4.2. Aid may result in welfare losses if allocated to inefficient sectors

If aid is granted to inefficient sectors public funds are put to use without resulting in economic growth. Such funds could have produced innovation and thus stimulated growth.

4.3. To avoid "beggar thy neighbour" policies

The term "beggar thy neighbour" policies was coined in the 1930's at the heyday of the Great Depression.[6] States tried to help their industries at the expense of other states often by raising tariffs.

4.4. To avoid tit-for-tat strategies

For instance, if you subsidize your car industry I will subsidize mine regardless of its cost level.

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[6] The term was originally devised to characterise policies of trying to cure domestic depression and unemployment by shifting effective demand away from imports onto domestically produced goods, either through tariffs and quotas on imports, or by competitive devaluation. The policy can be associated with mercantilism and neomercantilism and the resultant barriers to pan-national single markets. http://en.wikipedia.org/wiki/Beggar_thy_neighbour.

4.5. To help solve the prisoners dilemma:

Since country A grants aid country B feel obliged to the same whereas the better solution would be cooperation resulting in welfare gain for all.

The ECSC policy to phase out the European steel industry is a good example of a successful operation. To constrain national pressures to grant aid, decision makers can shift the blame to EU.

The reasons enumerated above under 4.3, 4.4 and 4.5 are closely related.EU State aid control must perform some kind of balancing of positive and negative effects across the member states

Some EU rules (e.g. for regional aid) allow different aid intensity according to economic circumstances. Normally the state aid rules do not allow such a differentiation. Nevertheless, we see that in complex rescue and restructuring cases the specific circumstances may be taken into account which can de facto lead to differentiation.

5. Features of eu law reflecting the objectives

It is important to recall that I will assume that policies promoting efficiency will contribute to economic growth. There are several elements of EU state aid policy that are specifically designed to prevent member states from engaging in harmfuly subsidizing their national industries and thus promote the efficient use of national resources and hence foster economic growth.

The structure of EU state aid law consists basically of two layers. The first layer is found in Article 107, paragraph 1, of the Treaty on the Functioning of the EU (TFEU). This provision lays down the basic prohibition to grant state aid. The prohibition applies once four criteria are satisfied. First there must be a State aid. Second, the aid must operate in a selective manner. Third, there must be an effect on competition. And fourth, there must be an effect on trade between the member states.

The second layer is constituted by Article 107, paragraph 2 and 3, TFEU. These two provisions provide for exemptions from the basic

prohibition of granting state aid. The most important categories of exemptions are enumerated in Article 107, paragraph 3 (a), (b) and (c):

> 3. The following may be considered to be compatible with the internal market:
>
> (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation;
>
> (b) Aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
>
> (c) Aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

5.1. The definition of state aid

It is important to understand that EU state aid policy is found at these two levels. At the first level it is developed in the definition of state aid. A very important element of this definition is the concept of the market economy investor principle (M.e.i.p.)

This notion was developed by EU policy makers to address the situation when a contribution of state resources to government enterprises and enterprises in which governments have controlling influence constitutes aid and when not. This concept allows a differentiation between governments funding that is in conformity with market conditions and that which is not. Providing government resources under conditions to enterprises that would not have been able to attract private funding is considered state aid. On the other hand by allowing government contributions to undertakings under conditions similar to those of the private sector state aid policy contributes to promote competition and hence economic growth.

5.2. Differentiation of criteria

The major part of EU state aid policy is found in the application of the different exemptions. The essential elements for each of these exemptions are formulated in the provisions of the Treaty itself. Thus Article 107, paragraph 3 under a) is drafted in such a way that it will only be applicable in cases of a standard of living that is abnormally low or

of serious unemployment. On the other hand the Article 107, paragraph 3 under c) allows aid to facilitate the development of certain economic activities or of certain economic areas. However, such aid may not adversely affect trading conditions to an extent contrary to the common interest. In the case of the exemptions under letter a) there is no such conditionality. That means that this category of exemptions will be more favourably reviewed than the category under letter c). Moreover, in the case of letter a) exemptions higher percentages of aid will be allowed. This is reflected in the regulations and guidelines which the Commission has drafted to define its policy. This is further discussed in section 6 below.

5.3. Laying down conditions for approval

When the Commission approves the granting of state aid in individual cases it will usually do so under certain conditions. The setting of conditions is designed to limit the harm to competition. Thus when the Commission approved a major aid package for Air France, one of the conditions was that Air France could not open new scheduled services, nor increase its capacity on specified routes (although a growth rate of 2.7 per cent per annum was allowed).[7] The decision stated that the productivity of Air France was considerably lower than that of major private airlines in the Community.

In case the Commission intends to subject the approval to conditions it will test these conditions in the market. To that end it will publish a draft of its intended decision and invite comments from the industry and governments of the member states.

One specific condition when approving new aid is the so-called Deggendorf condition. In the case of a second aid package to the Deggendorf enterprise the Commission required that a previous aid that was identified as being incompatible with the internal market, i.e. was prohibited, and for which recovery had been ordered, had to be paid back before new aid could be granted.[8]

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7 Commission Decision 94/653/EC [1994] OJ L 254/73.

8 See the Recovery Notice of the Commission, [2007] OJ C 272/4 para. 71. Case C-355/95P Textilwerke Deggendorf v. Commission [1997 E.C.R. I-2549.

Sometimes it has been suggested that aid should only be granted according to the "One time last time" principle. Thus excluding any further aid in case of a request for an exemption. This principle was suggested by a Committee of experts on aid in the air transport sector.[9] As the Commission itself has pointed out there is no such a principle since the Treaty rules do not allow for it.[10]

In its guidelines[11] and decisional practice on rescue aid the Commission will only allow the granting of aid under very strict circumstances and for a very short timeframe. As the same guidelines and decisional practice show restructuring aid is only allowed when there is a restructuring plan.

6. Specific instruments

As the Commission's policy on state aid was shaped through individual decisions the Commission gradually gathered sufficient experience to allow it provide some guidance in the form of guidelines or frameworks and of late regulations. Presently, a major part of the Commission's policy is found in the General Block exemption regulation and several guidelines and communications.

6.1. The General Block Exemption Regulation (GBER)

The Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Article 87 and 88 of the Treaty[12] is a very important step in the development of the Commission's state aid policy.[13] It codifies the

9 This recommendation is cited in the Commission's sector specific guidelines for the aviation sector. [1994] OJ C 350/5.

10 "The Commission wrote: "It is not possible for the Commission to change or disregard the rules of the EC Treaty." Para 5 of the guidelines.

11 Community guidelines on state aid for rescuing and restructuring, [2009] OJ C 156/3; further prolonged [2012] OJ C 296/3.

12 [2008] OJ L 214.

13 See Koen Van de Casteele: "General Block Exemption Regulation" in: Leigh Hancher, Tom Ottervanger and Piet Jan Slot; "EU State Aids" Sweet & Maxwell/Thomson Reuters, 4th ed. London 2012 Chapter 11.

considerable experience of the Commission in granting individual aid as well several Commission guidelines. Enacted as a regulation it has direct effect. The basic principle of the regulation is that no notification is required as long as the conditions of the regulation are met. Notwithstanding its objective to simplify the rules, it is a rather complex piece of legislation and it does not make an easy read. I will therefore limit myself to the parts of it that are important for our topic. There are several categories of exemptions that have a direct bearing on the promotion of growth. Several parts relate directly to the question of growth. Article 4 of the regulation provides rules for aid intensity and eligible costs.

Article 5 gives the following rules for transparency of the aid:

1. This Regulation shall apply only to transparent aid.

In particular, the following categories of aid shall be considered to be transparent:

(a) aid comprised in grants and interest rate subsidies;

(b) Aid comprised in loans, where the gross grant equivalent has been calculated on the basis of the reference rate prevailing at the time of the grant;

(c) Aid comprised in guarantee schemes:

(i) where the methodology to calculate the gross grant equivalent has been accepted following notification of this methodology to the Commission in the context of the application of this Regulation or Regulation (EC) No 1628/2006 and the approved methodology explicitly addresses the type of guarantees and the type of underlying transactions at stake; or

(ii) where the beneficiary is a small or medium-sized enterprise and the gross grant equivalent has been calculated on the basis of the safe-harbour premiums laid down in the Commission Notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees;

(d) aid comprised in fiscal measures, where the measure provides for a cap ensuring that the applicable threshold is not exceeded.

The requirement of transparency is very important to secure a level playing field.

Chapter II of the regulation gives specific provisions for the different categories of aid. Section 1 contains rules for Regional aid. Section 2 provides the exemptions for SME investment and employment aid. Section 4 deals with Aid for environmental protection. Section 6 gives rules for aid in the form of Risk Capital. Section 7 gives rules for

Aid for research and development and innovation. The latter have to be read together with the Community guidelines on state aid to promote risk capital investments in small and medium-sized enterprises 2006.[14]

Presently the regulation is under review as part of the Commission's State Aid Modernisation (SAM) plan. The goals of the SAM are to contribute to sustainable growth, focus on cases with the biggest impact and provide fast tracks for small and good aids; simplify and streamline rules; provide for faster, better informed and more robust decisions; increase transparency.[15]

6.2. Broadband Guidelines adopted on 18 December 2012[16]

These guidelines constitute the latest example of the Commission's policy to stimulate technical development, innovation and growth. In the introduction the Commission writes:

> "(1) Broadband connectivity is of strategic importance for European growth and innovation in all sectors of the economy and for social and for territorial cohesion. The Europe 2020 Strategy (EU2020) underlines the importance of broadband deployment as part of the EU's growth strategy for the coming decade and sets ambitious targets for broadband development. One of its flagship initiatives, the

[14] See on the interaction between these different sets of rules Kleiner T, 'Research, Development and Innovation Aid', *EU State Aids* (4th edn, Sweet & Maxwell 2012) p. 898 and 899.

[15] The proposals are summarized as follows in the speech of Commissioner Almunia given at the IBA 17th annual competition conference Florence, 13 September 2013. "The GBER II extending the scope of the present GBER: Broadband infrastructures Builds on new BB GL and new draft GBER I, Regional aid section: extended to all EU regions; sufficient experience to block exempt based on 120 decisions (90 %without objections) Form of aid: investment aid'. Main conditions: -limitation to 'white' and 'white NGA' areas:-Open, transparent and non-discriminatory selection process respecting the principle of technology neutrality, e.g. tender;-fair and non-discriminatory wholesale access together with the full and effective unbundling requirement in case of NGA networks; -Notification threshold: EUR [70]mill of total project costs.
4. Aid for innovation clusters. Existing category in the RDI Framework: sufficient experience to block exempt. Form of aid: investment aid and operating aid. Main conditions: entity operating the cluster may be a LE or an SME, access on an open and non-discriminatory basis,operating aid for the operation of innovation clusters limited to 5 years. Notification threshold: EUR 5 mio per cluster. Maximum aid intensity:-investment aid: 15% for LEs + 10-20% bonus for SMEs, 5-10% regional bonus operating aid: 50% of total eligible costs during five years period.
5. Process and organisational innovation: Existing category in the RDI Framework: sufficient experience to block-exempt. Form of aid: operating aid. Main condition: granted to LEs only if they collaborate with SME which incurs at least 30% of the total eligible costs. Notification threshold: EUR 5 mio per project per undertaking. Maximum aid intensity: for LEs: 15% of eligible costs; for SMEs: 50% of eligible costs." The new regulation 651/2014 was adopted 17 June 2014.

[16] {2013] OJ C 25/1.

> Digital Agenda for Europe (DAE) acknowledges the socio-economic benefits of broadband, highlighting its importance for competitiveness, social inclusion and employment. The achievement of Europe 2020 objective of a smart, sustainable and inclusive growth depends also on the provision of widespread and affordable access to high-speed Internet infrastructure and services. Meeting the challenge of financing a good-quality and affordable broadband infrastructure is a crucial factor for Europe to increase its competitiveness and innovation, provide job opportunities for young people, prevent relocation of economic activity and attract inward investments. The DAE restates the objective of the EU2020 to bring basic broadband to all Europeans by 2013 and seeks to ensure that, by 2020,(i) all Europeans have access to much higher Internet speeds of above 30 Mbps and (ii) 50 % or more of European households subscribe to Internet connections above 100 Mbps."

6.3. Guidelines on state aid for environmental protection[17]

These guidelines set out the conditions for support of economic activities that aim to enhance the protection of the environment. The objective is explained in the preamble of the guidelines:

> "(6) The primary objective of State aid control in the field of environmental protection is to ensure that State aid measures will result in a higher level of environmental protection than would occur without the aid and to ensure that the positive effects of the aid outweigh its negative effects in terms of distortions of competition, taking account of the polluter pays principle (hereafter "PPP") established by Article 174 of the EC Treaty.
>
> (7) Economic activities can harm the environment not least through pollution. In certain cases, in the absence of government intervention, undertakings can avoid bearing the full cost of the environmental harm arising from their activities. As a result, the market fails to allocate resources in an efficient manner, since the (negative) external effects of production are not taken into account by the producer, but are borne by society as a whole."

The key concept of the guidelines is the balancing test. The test is explained as follows:

> "16) In assessing whether an aid measure can be deemed compatible with the common market, the Commission balances the positive impact of the aid measure in reaching an objective of common interest against its potentially negative side effects, such as distortion of trade and competition. The State Aid Action Plan, building on existing practice, has formalised this balancing exercise in what has been termed a "balancing test" [7]. It operates in three steps; the first

[17] OJ C 82 ,01.04.2008, p.1-33. The guidelines are presently under review see the website of the Directorate General for Competition: ec.europa.eu/competition/sectors/energy/legislation_en.html

two steps address the positive effects of the State aid and the third addresses the negative effects and resulting balancing of the positive and negative effects. The balancing test is structured as follows:

1) Is the aid measure aimed at a well-defined objective of common interest? (For example: growth, employment, cohesion, environment, energy security). In the context of these Guidelines, the relevant common interest objective is the protection of the environment.

2) Is the aid well designed to deliver the objective of common interest that is to say; does the proposed aid address the market failure or other objective?

a) Is State aid an appropriate policy instrument?

b) Is there an incentive effect, namely does the aid change the behaviour of undertakings?

c) Is the aid measure proportional, namely could the same change in behaviour be obtained with less aid?

3) Are the distortions of competition and effect on trade limited, so that the overall balance is positive?

(17) This balancing test is applicable to the design of State aid rules as well as to the assessment of cases."

7. Examples of individual cases

The Amsterdam municipality participates in the project on the same terms as would a market investor; the Appingendam municipality does not. These two cases show how the Commission applies the state aid rules and in particular the market economy investor principle in order to make sure that the use of public money contributes to growth and not to pet projects of local politicians. The Commission discusses the participation of the Amsterdam Municipality in the following terms:

"In its Amsterdam decision[18], the Commission has examined the application of the principle of the market economy private investor in the broadband field. As underlined in this decision, the conformity of a public investment with market terms has to be demonstrated thoroughly and comprehensively, either by means of a significant participation of private investors or the existence of a sound business plan showing an adequate return on investment. Where private investors take part in the project, it is a sine qua non condition that they would have to assume the commercial risk

[18] Broadband guidelines paragraph 17. Commission Decision of 11 December 2007 in Case C 53/06 — *The Netherlands, Citynet Amsterdam* — Investment by the city of Amsterdam in a fibre-to-the home (FttH) network (OJ L 247, 16.9.2008, p. 27.

> linked to the investment under the same terms and conditions as the public investor. This also applies to other forms of State supports such as soft loans or guarantees."

By contrast in the Appingendam case the Commission found that there was no market failure and thus no reason for the municipality to engage in economic activities.[19]

8. Future developments of eu state policy

A good illustration of the objectives of EU state aid policy can be found in the speech of the Spanish EU Commissioner for Competition Almunia.[20] It is therefore worth quoting in extenso.

> "As you know, State aid policy is going through a sweeping reform thanks to the State aid modernisation strategy I launched in May last year. Its main goal is to align State aid control to the objectives of our growth strategy –Europe 2020 – and its main policy areas. At the same time, as this period is marked by the need to consolidate public finances, the reform will also help Europe's governments do more with less money; including more efficient ways to support economic activities and create incentives for research and innovation. Promoting research, development and innovation is a key driver to achieve the objective of smart, sustainable and inclusive growth. The level of research and development in Europe remains too constrained by market failures. State aid, if well-targeted, can be a positive factor and take these activities to higher levels."
>
> Since 2007, the Commission has approved over 200 national schemes in Research, Development and Innovation, and the guidelines that we use to assess and control these subsidies are being reviewed as part of the State aid modernization process.
>
> The main objective of the new guidelines is to increase the level of R&D&I activities in the EU, while limiting distortions to competition. The new guidelines will cover different aspects, which I can anticipate to you. The new guidelines will include simpler and clearer rules to build a regulatory environment that will encourage the collaboration of public and private actors. The scope will be widened by including new categories of aid, such as aid for research infrastructures and enlarged scope for aid for pilot projects and prototypes. The notification thresholds will be increased to exempt small aid measures from notification. This will provide a solid basis for Member States to continue granting aid in this domain with sufficient legal certainty and a lighter administrative burden.
>
> All these measures should foster the incentive effect for both public and private actors in R&D&I. We want to provide guidance and steer Member States towards designing "good aid" measures ensuring the engagement of private actors."

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19 Commission Decision of July 19, 2006, C 35/02005, {2005} OJ L 86/2007.

20 Given at the IBA 17th annual competition conference Florence, 13 September 2013.

8. Conclusion

As can be seen from the above summary, the EU state aid policy is designed with a view to promoting economic growth. This objective may not always be explicitly formulated but it is nevertheless implicit in all its instruments and individual decisions.

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Recent trends concerning SGEI: *Know them by their fruits*

JOSÉ LUIS BUENDÍA SIERRA* **& MARÍA MUÑOZ DE JUAN****

ABSTRACT

The TFEU establishes a general prohibition on State aid measures but allows certain exceptions. One of these relates to the public provision and financing through public funds of SGEIs. In order to regulate this issue, in 2012 the Commission adopted a new legal framework for SIEGs, known as the Almunia package, which is based on four pillars: a Commission Communication on the notion of aid, a Commission Decision, a Framework, and a *de minimis* Regulation.

This paper analyzes the Almunia package, paying special attention to the objectives and the main changes introduced by the Communication and the Framework. It also examines the application of the new rules by the Commission in its recent decision-making practice.

In particular, this paper reviews how the Almunia package has been applied in three recent cases: Decision of 19.6.2013 -Aid for the deployment of digital terrestrial television (Spain), Decision of 2.5.2013 -State compensation to Bpost (Belgium) and Decision of 20.2.2.2013 -Health Insurance Risk Equalization Scheme 2013 (Ireland).

These decisions show that the Commission has not been entirely consistent with the declared intentions of the package. In particular, it has clearly avoided applying some of the key new rules introduced in the package, such as the obligation to use a competitive tender to choose the operator of the SGEI or the obligation to introduce efficiency incentives. This is not unduly surprising and may even be considered reasonable if the Commission has now finally realized that these rules were simply too ambitious.

However, if this is the case, it is essential that in the future this reasonable interpretation of the rules is applied across the board, in a consistent manner and not just in certain cases. The Commission must always strive to be

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reasonable and consistent, and this is particularly true of an area as sensitive as that of SGEIs, in which it is relying on its powers under Article 106 TFEU.

KEYWORDS: State aid, Services of general economic interest, public services, notion of state aid. public funds, Almunia package, SGEI Communication, SGEI decision, SGEI Framework, SGEI de minimis Regulation

1. Introduction

It is widely accepted that competition policy contributes to economic growth. This is not only true as regards the application of antitrust rules to the anticompetitive behavior of undertakings. It is also widely accepted that many distortions are the result of State intervention in the market. For this reason State aid must also be controlled, to ensure a level playing field for all undertakings in the European Union. Thus, competition among Member States must also be supervised by an independent supra-national authority.

The Treaty on the Functioning of the European Union (the "TFEU") declares that State aid measures are, in principle, forbidden unless they come within one of the exceptions laid down in the Treaty. These exceptions are based on the balancing of interests between the need to avoid distortions of competition due to State intervention and the need to achieve certain public interest goals (environmental protection, regional development etc.).

One of the main exceptions to the State aid prohibition relates to the provision of public services or services of general economic interest (hereinafter "SGEIs").[1]

Pursuant to the TFEU, the Commission is entrusted with ensuring that while promoting and financing public services, Member States do not alter free competition conditions beyond what would be strictly necessary to attain the public goal in question.

[1] Legal commentators, the Commission in its decision-making practice and the EU courts all agree that 'SGEI' is an EU law concept which has no direct equivalent in national legal systems, even if it roughly equates to the concept of 'public service' used in certain Member States. See Buendía Sierra JL and Muñoz de Juan M, 'Some Legal Reflections on the Almunia Package' European State Aid Law Quarterly 2/2012, pp. 63-81.

The main issue is, therefore, how to ensure the protection of public services without disrupting free competition, or at least minimizing the effects on free competition.

This question was already dealt with in the Treaty of Rome in 1957, since former Article 90(2) of the European Economic Community Treaty –currently Article 106(2) TFEU– stated that:

> "In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 7 and Articles 85 to 94.
>
> Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.
>
> The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States."

The EU understood from the outset that it was of paramount importance to find the right balance between the application of the competition rules –including the State aid rules– and the protection of public services, this need is no less important in times of crisis.[2]

The objective of this paper is to briefly review the current legal framework for SGEIs and its effective implementation by the European Commission.

In 2012, the Commission adopted a new package on SGEIs –the so-called Almunia package– which sets out very clear predetermined

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[2] The EU reiterated its commitment to the protection of SGEIs in the EU Constitution and the Treaty of Lisbon, by amending Article 16 EC. The current version of Article 14 TFEU was introduced into the Treaty by the Treaty of Lisbon, with the objective of granting further flexibility regarding the rules on SGEIs. Article 14 provides as follows: *"Without prejudice to Article 4 of the Treaty on the European Union or to Articles 93, 106 and 107 of this Treaty and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, The Union and the Member States, each within their respective powers on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfill their missions. The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall establish these principles and set these conditions without prejudice to the competence of Member States, in compliance with the Treaties, to provide, to commission and to fund such services*."

objectives: simplification of the rules, stricter control of compensation paid to SGEIs and a more in-depth competitive analysis for large commercial SGEIs.[3]

While reading the Almunia package, one has the impression that it is an attempt to tighten the rules applicable to the financing of SGEIs. This point was made in the post "*A turn of the screw*"[4] published in March 2012 on the well-known blog dealing with competition matters, "*Chillin' Competition*".[5]

When that post was written, the Almunia package was in the final phase of being adopted but it was not in force. At that time, then, one could only imagine what the future rules would be and hazard a guess as to their effects. It was already clear that the rules applicable to large commercial SIEGs and big operators were going to be different and stricter than those applicable to smaller SIEGs. However, there were concerns about the consistent application of the new rules since the package was, perhaps, too ambitious on certain points. For instance, in order to reinforce the link between State aid control and public procurement rules, the package made it necessary to have a competitive tender for the award of large SGEIs as a compatibility condition. This was without any doubt a far-reaching condition.[6] Would the Commission be able to apply

3 More precisely, the objectives of the Almunia package were defined as follows: (i) clarifying the rules, (ii) reducing the administrative burden on local and small SGEIs (concentrating EU scrutiny on large-scale commercial services with a clear impact on the internal market) and (iii) taking account of the range of ways of organizing European public services throughout the EU. Joaquín Almunia, Vice President of the European Commission responsible for Competition Policy: "Reform of the State aid rules for Services of General Economic Interest (SGEI)". SPEECH/11/901; "Reforming EU State aid rules on public services: The way forward EPC policy Dialogue", Brussels, 2 May 2011 SPEECH/11/300.

4 Buendía Sierra JL, 'A Turn of the Screw' <http://chillingcompetition.com/?s=a+turn+of+the>

5 http://chillingcompetition.com/

6 Since the Package was adopted, several authors have commented on this point. See for instance Sinnaeve A, 'What's New in SGEI in 2012? An Overview of the Commission's SGEI Package' European State Aid Law Quarterly 347. According to this author "*While the 2005 Framework applied without prejudice to the Transparency Directive and the public procurement rules, compliance with those rules now becomes a compatibility condition. More far-reaching is the condition that the public procurement rules, including the principle of transparency, equal treatment and non-discrimination must be complied with. So far the Commission systematically treated public procurement as a separate issue, which is not indissolubly linked to the object of the aid and can thus be assessed independently from the state aid analysis, in accordance with the Matra doctrine. (…) Although one might consider that state aid control should not be used as a tool to enforce public procurement rules, there does not seem to be a legal obstacle to the inclusion of compliance with those rules into the compatibility conditions*". (underline added).

the new (stricter) rules on SGEIs? Would it do so in a consistent way? Would the Member States obey the new regime? One may hope so, but it would certainly be prudent not to take this for granted. The package is now in force and it has already produced its first 'fruits', thus, the first Commission decisions adopted under it. It is therefore time to take stock and measure the effects of the package according to the dictum of Matthew in the bible, who proclaimed "*you will know them by their fruits*". Thus, according to Matthew, you can know a tree by its fruits and people by their actions.[7] In the same way, we may examine the fruits of the Almunia package, by the quality and consistency of the decisions applying it.

Before doing so, the 'tree' in our comparison –the Commission's current approach towards SGEIs– will be described.

2. The Almunia package: the tree

Following a long public consultation, in 2012 the Commission adopted a new legal framework for SGEIs (replacing the previous Monti-Kroes package[8]) with a different legal structure and certain new substantive rules in some key areas.

The Almunia Package is composed of:

A new Commission communication[9] ('the Communication') that discusses the elements related to the notion of State aid. This text essentially provides that: (i) an extensive overview of key concepts (including the notion of aid or the notion of SGEI); and (ii) a detailed explanation

7 Matthew, 7, 15-20.

8 In July 2003, the Court of Justice issued its landmark *Altmark* judgment (Case C-280/00, *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, and Oberbundesanwalt beim Bundesverwaltungsgericht* [2003] ECR I-7747). In this judgment, the Court considered that State support for the provision of an SGEI by an undertaking could not be classified as State aid if four well-defined conditions were fulfilled. Post *Altmark*, legal certainty was necessary for the large number of cases ineligible for a non-aid outcome. In this context, the Commission decided to issue elements for assessing the compatibility of these cases with the Treaties, hence the Monti-Kroes package. For further detail, see Buendía Sierra JL and Muñoz de Juan M, 'Some Legal Reflections on the Almunia Package' European State Aid Law Quarterly 2/2012, pp. 63-81.

9 Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest. OJ 11.1.2012 C 8/12.

of the Commission's approach to how the *Altmark* criteria should be fulfilled in order for a measure not to be classified as State aid.

A 'horizontal' Commission decision[10] ('the Decision'), adopted by the Commission on the basis of Article 106(3) TFEU, which allows certain types of State aid to SGEI providers that are considered *ex ante* compatible, and for which there is no need to notify the Commission.

The objective of the Decision is to exclude the need for notification of small SGEIs with a lower impact on the internal market.

A framework[11] ('the Framework') for the assessment of the compatibility of State aid granted in the form of public service compensation. The Framework establishes the conditions to be applied by the Commission when examining the compatibility of the cases that remain subject to the notification requirement because they are not covered by the Decision. In other words, the Framework is applicable to large commercial SGEIs not covered by the block exemption (see para. 11). As a consequence, the Framework lays down the rules applicable for the assessment of SGEIs with a higher risk of distorting free competition and greater effects on the internal market. This makes the Framework a key policy-making instrument in State aid control regarding SGEIs.

A *de minimis* Commission Regulation[12] as regards State support to undertakings providing SGEIs establishing a general threshold of support of €500,000 over three years.

Of the above-mentioned acts, this paper mainly focuses on the Communication on the notion of aid and the Framework, since both introduce important rules and considerations related to the application of State aid rules to large SGEIs, i.e. those cases which remain subject to the notification obligation and normally lead to Commission Decisions.

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10 Commission Decision of 20 December on the application of Article 106 (2) of the Treaty on the Functioning of the European Union to state aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest. OJ 11.1.2012 L 7/13.

11 Communication from the Commission, European Union Framework for State aid in the form of public service compensation. OJ 11.1.2012 C 8/15.

12 Commission Regulation on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to *de minimis* aid granted to undertakings providing services of general economic interest. OJ L 114 of 26.4.2012, p. 8.

The main objectives of the **Framework** were: (i) to ensure that provision of SGEIs do not include any overcompensation: financing of SGEIs should not exceed what is necessary to cover the net cost of discharging the public service obligation, including a reasonable profit; (ii) to promote or even to impose the introduction of efficiency incentives; and (iii) to impose public tenders even for compatibility purposes.[13]

In order to achieve these goals, several requirements were introduced in the compatibility test. In our opinion, the most significant and bold requirements are as follows:

- The Framework requests a consistent application of State aid and public procurement rules. Thus, paragraph 19 of the Framework states that a public tender to select the SGEI provider will be required for compatibility purposes.[14]

- The compensation for the provision of SGEIs must be limited to the net cost of the SGEI plus a reasonable profit (paragraph 21). In order to reinforce this objective, claw-back mechanisms are required[15] and the revenues that result from exclusive/special rights must be taken into account.[16]

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13 The *Altmark* judgment provided an incentive to use the mechanism of public tenders by stating that a competitive tender may exclude the presence of aid.

14 Para. 19: "Aid will be considered compatible with the internal market on the basis of Article 106(2) of the Treaty only where the responsible authority, when entrusting the provision of the service to the undertaking in question, has complied or commits to comply with the applicable Union rules in the area of public procurement. This includes any requirements of transparency, equal treatment and non-discrimination resulting directly from the Treaty and, where applicable, secondary Union law. Aid that does not comply with such rules and requirements is considered to affect the development of trade to an extent that would be contrary to the interests of the Union within the meaning of Article 106(2) of the Treaty."

15 Para. 49: "Member States must ensure that the compensation granted for operating the SGEI meets the requirements set out in this Communication and in particular that undertakings are not receiving compensation in excess of the amount determined in accordance with this the requirements set out in this section. They must provide evidence upon request from the Commission. They must carry out regular checks, or ensure that such checks are carried out, at the end of the period of entrustment and, in any event, at intervals of not more than three years. For aid granted by means other than a public procurement procedure with publication [24], checks should normally be made at least every two years."

16 Para. 32: "The revenue to be taken into account must include at least the entire revenue earned from the SGEI, as specified in the entrustment act, and the excessive profits generated from special or exclusive rights even if linked to other activities as provided in paragraph 45, regardless of whether those excessive profits are classified as State aid within the meaning of Article 107(1) of the Treaty."

• The Framework tries to ensure that SGEI operators would be remunerated in a way that encourages efficiency. It therefore defined "efficiency incentives" as mandatory, unless duly justified, so that efficiency incentives will be required for compatibility purposes.[17] Member States will have some discretion to define them[18] but efficiency incentives cannot be adopted at the expense of the quality of the service.[19]

• In certain cases, Member States might also proposed "commitments" to render the measure compatible.[20] According to the Commission, in cases that particularly distort competition, additional requirements might be requested "to ensure that trade and competition in the internal market are not affected to an extent contrary to the interests of the EU (Article 106(2) of the TFEU)".[21]

The **Communication on the notion of aid** also introduced some interesting considerations. It suggested, firstly, that the mere entrustment

17 Para. 39: "In devising the method of compensation, Member States must introduce incentives for the efficient provision of SGEI of a high standard, unless they can duly justify that it is not feasible or appropriate to do so".

18 Para. 40: "Efficiency incentives can be designed in different ways to best suit the specificity of each case or sector. For instance, Member States can define upfront a fixed compensation level which anticipates and incorporates the efficiency gains that the undertaking can be expected to make over the lifetime of the entrustment act".
Para. 41: "Alternatively, Member States can define productive efficiency targets in the entrustment act whereby the level of compensation is made dependent upon the extent to which the targets have been met".

19 Para. 43. "Efficiency gains should be achieved without prejudice to the quality of the service provided and should meet the standards laid down in Union legislation".

20 "2.9. Additional requirements which may be necessary to ensure that the development of trade is not affected to an extent contrary to the interests of the Union.
51. The requirements set out in sections 2.1 to 2.8 are usually sufficient to ensure that aid does not distort competition in a way that is contrary to the interests of the Union.
52. It is conceivable, however, that in some exceptional circumstances, serious competition distortions in the internal market could remain unaddressed and the aid could affect trade to such an extent as would be contrary to the interest of the Union.
53. In such a case, the Commission will examine whether such distortions can be mitigated by requiring conditions or requesting commitments from the Member State".

21 Commission staff working document. Guide to the application of the European Union rules on state aid, public procurement and the internal market to services of general economic interest, and in particular to social services of general interest. Brussels, 29.4.2013.SWD(2013) 53 final/2.

of an exclusive right might be considered as State aid.[22] This is a far-reaching conclusion which is not easily reconciled with the case law and one that might be difficult to implement in practice. Secondly, the Commission underlined –once more– that Member States have a wide degree of discretion as to what should be defined as an SGEI. Therefore, the Commission acknowledged that it only had to check for any manifest error of appreciation.[23] Finally the Communication also refers to public procurement rules in the context of the application of the fourth *Altmark* condition. In order to benefit from the non-aid treatment under *Altmark,* the Commission finds it necessary to launch an open, transparent and non-discriminatory public procurement procedure even in cases where there it is no legal obligation under the public procurement rules.[24] With respect to the characteristics of the tender, the Communication clarifies that an open or restricted procedure is considered to be acceptable under the *Altmark* test. However, a competitive dialogue or a negotiated procedure with prior publication would only be accepted in very exceptional circumstances.[25]

As can be seen, the new rules are far reaching and the requirements for compatibility are in principle quite strict. However, both the Framework and the Communication allow for the possible deviation from the general rules in certain undefined 'exceptional circumstances'.

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22 Para. 32: "This transfer of State resources may take many forms such as direct grants, tax credits and benefits in kind. In particular, the fact that the State does not charge market prices for certain services constitute a waiver of State resources. In its judgment in Case C-482/99 France v Commission [56], the Court of Justice also confirmed that the resources of a public undertaking constitute State resources within the meaning of Article 107 of the Treaty because the public authorities are capable of controlling these resources. In cases where an undertaking entrusted with the operation of an SGEI is financed by resources provided by a public undertaking and this financing is imputable to the State, such financing is thus capable of constituting State aid."

23 Para. 46. This was already settled case law. See Case T-17/02 *Fred Olsen v. Commission.* ECR [2005] II-2031.

24 Para 64. "Also in cases where it is not a legal requirement, an open, transparent and non-discriminatory public procurement procedure is an appropriate method to compare different potential offers and set the compensation so as to exclude the presence of aid".

25 Para. 66. "Concerning the characteristics of the tender, an open procedure in line with the requirement of the public procurement rules is certainly acceptable, but also a restricted procedure can satisfy the fourth Altmark criterion, unless interested operators are prevented to tender without valid reasons. On the other hand, a competitive dialogue or a negotiated procedure with prior publication confer a wide discretion upon the adjudicating authority and may restrict the participation of interested operators. Therefore, they can only be deemed sufficient to satisfy the fourth Altmark criterion in exceptional cases. The negotiated procedure without publication of a contract notice cannot ensure that the procedure leads to the selection of the tenderer capable of providing those services at the least cost to the community."

This is somewhat worrying. First, a rule is not effective if applied with too many exceptions and the target objectives might not be reached if too many cases are considered exceptional. Therefore, the question remains - how to assess what could be considered as an exceptional circumstance? On the other hand, the current lack of definition may lead to the risk of the rules being applied differently in different cases, without any obvious consistency.

Taking into account these basic premises, in order to assess the real value and effect of the Almunia package it is necessary to review the Commission decisions, that is, its fruits.

3. The Commission's decisions: the fruits

Although Almunia's package was published in January 2012,[26] there are still only a handful of Decisions in which its rules have been applied.

This may be due to the fact that, after the reform, various types of State aid to SGEIs are now covered either by the Decision or by the *de minimis* Regulation. Furthermore, while assessing unlawful State aid, it must also be taken into account that the Commission will decide "in accordance with the substantive criteria set out in any instrument in force at the time when the aid was granted." [27]

As a result, in the last two years the number of cases in which the Commission has applied the Almunia package can almost be counted on

[26] The Communication, the SGEI Decision and the SGEI Framework were published in January 2012. The SGEI *de minimis* Regulation was published in April 2013.

[27] Commission notice on the determination of the applicable rules for the assessment of unlawful State aid. OJ C 119, 22.5.2002, p. 22–22.
The Notice states that "[a] number of instruments approved by the Commission over the years contain a provision to the effect that unlawful State aid, i.e. aid put into effect in contravention of Article 88(3) of the EC Treaty, shall be assessed in accordance with the texts in force at the time when the aid was granted. This is for example the case for the Community guidelines on State aid for environmental protection(1) and the multisectoral framework on regional aid for large investment projects(2).
For the purpose of transparency and legal certainty, the Commission informs Member States and third parties that it has decided to apply the same rule in respect of all instruments indicating how the Commission will exercise its discretion in order to assess the compatibility of State aid with the common market (frameworks, guidelines, communications, notices). Therefore, the Commission shall always assess the compatibility of unlawful State aid with the common market in accordance with the substantive criteria set out in any instrument in force at the time when the aid was granted".

the fingers of one hand. However, while not numerous, these decisions are very interesting and already provide an initial idea of how the Commission will apply the package.

The main conclusion that can be extracted from these cases is that the application of the new stricter rules is actually being avoided. In fact, the "exceptions" to the new rules are being applied quite systematically, as if they were the norm.

To illustrate this point, this paper will now review three different cases:

- The first relates to the deployment of digital terrestrial television (DTT) in remote and less urban areas of Spain. The case concerns an alleged error in defining the services as an SGEI. (Decision of 19.06.2013. **SA.28599 Aid for the deployment of digital terrestrial television (DTT)).**[28]

- The second relates to State aid granted to Bpost, the Belgium postal incumbent. (Decision of 2.5.2013, **N1/2013 State compensation to Bpost for the delivery of public services over the 2013-2015 period)**.[29]

- The third concerns the Irish risk equalization system. (Decision of 20.2.2013, **SA.34515 Health Insurance Risk Equalisation Scheme 2013).**[30]

3.1. Decision of 19.06.2013, SA.28599. Aid for the deployment of digital terrestrial television (DTT) – Spain

This Decision concerns the financing by the Spanish authorities of the deployment of digital terrestrial television (DTT) in remote and less urban areas in Spain, known as Zone II. These are areas where a market

[28] Pending publication in the OJ. http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_2859

[29] OJ 27.9.2013 C 279 http://eur-lex.europa.eu/JOHtml.do?uri=OJ:C:2013:279:SOM:EN:HTML

[30] OJ 18.7.2013. C 204 http://eur-lex.europa.eu/JOHtml.do?uri=OJ:C:2013:204:SOM:EN:HTML; http://europa.eu/rapid/press-release_IP-13-132_en.htm

failure had been identified since no private operator provided or planned to provide the service due to the lack of profitability.

Under the Spanish Telecommunications Law then in force, public broadcasting is a public service and the transmission of broadcasting signals is an SGEI. Despite this, the Commission Decision concluded that the deployment of the DTT in Zone II constituted State aid as it did not amount to a genuine SGEI and therefore did not comply with the *Altmark* requirement.

The Commission based its decision mainly on a purely formalistic argument, stating that "public service" and "SGEI" are in practice two different concepts and that the *Altmark* rules are only applicable to public services. It seems that the manifest error of the Spanish authorities was to define the transmission of broadcasting signals as an SGEI, reserving the concept of public service to the service of broadcasting retransmission.

The Commission also links the error in assessing the existence of an SGEI in this case with the alleged infringement of the principle of technological neutrality. In its Decision, the Commission claims that the deployment of the DTD breached the principle of technological neutrality, i.e. DTD (terrestrial television) was promoted to the detriment of other possible technical solutions, such as satellites. According to the Commission, since there are several platforms that can be used for the transmission of broadcasting signals, it would be a manifest error of assessment to highlight only one of these as having the status of a public service.[31] Since the principle of technological neutrality was not respected in this case, "it is therefore concluded that under Spanish law the operation of terrestrial networks does not have the status of a public service", and a manifest error of appreciation was found to exist.

However, one could argue that the manifest error of appreciation was not clear cut in this case. It should be noted at this juncture that the degree of discretion of Member States to define and organize SGEIs in the broadcasting sector is specially reinforced in the Protocol on the

[31] Para. 120-122 of the Decision.

system of public broadcasting of the Treaty of Amsterdam.[32] Moreover, in this case both the administrative and judiciary national authorities had defined the transmission of broadcasting signals as an SGEI.

It is also difficult to understand that the signal transmission service –a service which is needed to ensure the broadcasting public service– does not deserve the same protection as the final service. If the signal transmission service under SGEI rules is not protected, broadcasting in Zone II will not be ensured. It is therefore difficult to see the manifest error of appreciation of the Spanish Authorities.

In spite of the above, the Commission imposed its own interpretation of what should be considered an SGEI and it almost seems to conclude that when a Member State uses EU terminology it is, in reality, committing a manifest error of appreciation.

The Decision of the Commission in this case is particularly striking when we analyze previous decisions regarding public intervention in the provision of broadband services. In particular, it is hard to understand how the Commission can consider that the establishment and operation of a very high-speed broadband electronic communications network in the Hauts-de-Seine - a *département* bordering Paris, a fully developed and inhabited area - is a genuine SGEI[33] while the digitalization of the terrestrial television in Zone II areas (where a market failure has been established) is not.

There would appear to be a lack of consistency among the Commission's decisions. In the DTT case, the Commission corrects not only the Spanish authorities but also the opinion of national courts.

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[32] Protocol on the system of public broadcasting in the Member States of the Treaty of Amsterdam: *"The provisions of the Treaty establishing the European Community shall be without prejudice to the competence of Member States to provide for the funding of public service broadcasting insofar as such funding is granted to broadcasting organizations for the fulfillment of the public service remit as conferred, defined and organized by each Member State, and insofar as such funding does not affect trading conditions and competition in the Community to an extent which would be contrary to the common interest, while the realization of the remit of that public service shall be taken into account."*

[33] Commission Decision of 30.09.2009 in N 331/2008 – *France Compensation de charges pour une Délégation de Service Public (DSP) pour l'établissement et l'exploitation d'un réseau de communications électroniques à très haut débit dans le Département des Hauts-de-Seine.* This decision was upheld by the judgment of the Court of 16.09.2013 in Case T-79/10.

Given this fact and the nature of the service at stake (signal broadcasting transmission), at the very least it is not entirely clear that the Spanish authorities have committed a manifest error of appreciation.

Finally, it is worth underlining that the reference to the principle of technological neutrality –as a condition for the acceptance of the existence of an SGEI– is not present in either the EU case law or the Commission's practice. It is not one of the *Altmark* criteria, and certainly not mentioned in any of the other cases reviewed in this paper.

The case is pending before the EU General Court. Accordingly, these doubts will soon be resolved.[34]

3.2. Decision of 2.5.2013, N1/2013 State compensation to Bpost for the delivery of public services over the 2013-2015 period

The Decision concerns the Belgian plan to finance SGEIs entrusted to the incumbent Bpost through the 5th Management Contract over the 2013-2015 period. The contract covers services such as press distribution, early delivery of newspapers, postal services, and special services during elections.

Unlike the previous case, the Commission did not contest the SGEI nature of any of the above missions, despite the total absence of any analysis of "technological neutrality". The decision is for that reason consistent with normal EU practice of not looking at the neutrality of the means in SGEI cases (yet it totally conflicts with the DTT Decision referred to above).

The Commission concluded that the measure in question constituted State aid for failure to comply with the fourth *Altmark* criterion, since the public service obligations had been entrusted to Bpost without an open tender procedure.

To analyze its compatibility, the Commission applied the 2012 SGEI Framework and concluded, unsurprisingly, that the public service obligations entrusted to Bpost were genuine SGEIs. The surprise came

[34] See Cases T-461/13, T-462/13, T-463/13, T-464/13, T-465/13 and T-541/13.

as regards compliance with EU public procurement rules, which are supposedly now a necessary condition for the compatibility of the compensation to the 'large' SGEI. Despite this, the Commission accepts that Bpost is the only operator with the appropriate infrastructure to efficiently provide certain services.

In particular, it states that:

> "At the same time, the Commission does recognize that bpost holds a unique logistic and retail network in terms of density and size which makes it the sole possible provider for the Network SGEI and for other SGEIs […]"

Consequently, the Commission concludes that all compensated SGEIs delivered though the postal distribution and retail networks can be entrusted though a negotiated procedure without prior publication. This is a clear example of how the application of the stricter new rules can actually be avoided through the application of exceptions. Indeed, it is far from clear that a situation in which the incumbent is actually the best placed to provide the SGEI can be considered as 'exceptional'. Quite on the contrary, it looks like the normal scenario. Moreover, it could be argued that by taking this position the Commission is clearly making the entry of potential competitors impossible. In any case, if this is the way in which the new requirement will actually be applied, one may wonder why the rule was changed at all.

As regards the press distribution SGEI, the Commission accepted the Belgian authorities' commitment to organize a competitive, transparent and non-discriminatory procedure as from 2016. The Commission accepted such a long period until the organization of the public tender because of the following explanations offered by the Belgian authorities:

> "As regards the overall duration of the concession award procedure, the Commission considers important to take into account the fact that it will be organized for the first time by the Belgian authorities after a long period where the Press distribution SGEI was delivered by post. In such circumstances, sufficient time would be necessary for effective competition to be possible. Effective competition to materialise would indeed necessitate some existing competitors to team up or allow the emergence of new competitors. Therefore, it is required for potentially interested bidders to be given a sufficient period of time to prepare for this bidding scenario. In the hypothesis that a concession award procedure would be immediately organized, it is unlikely that bidders will be capable of submitting a sufficiently competitive bid. The required period for the amendment of the regulatory framework can therefore

additionally serve the purpose of allowing competitors to properly prepare a competitive bid"

Again, accepting such a long transitional period seems to be somehow contradictory with the predetermined objective of the Framework of promoting and ensuring the organization of public tenders. At the very least, it is a very loose interpretation of this goal.

It goes without saying that there is no reference whatsoever in the decision to the announcement made by the Communication according to which *"[t]he mere entrustment of an exclusive right might be considered as State aid*".

Finally, in line with para. 43 of the SGEI Framework, the Commission was supposed to verify that 'efficiency incentives' are set out in a transparent manner in the contract. Nevertheless, in this Decision, the Commission seems to mix the calculation of the compensation with the need to ensure efficiency incentives in paragraph 188, in which efficiency gains are taken into account in the mechanism to avoid over-compensation. It is not clear therefore, at least for these authors, whether the announced efficiency incentives are not in fact mere conditions to avoid over-compensation.

Again, if this is the way in which the new rule on 'efficiency incentives' will actually be applied, one may wonder why the rules were changed at all.

3.3. Decision of 20.2.2013, SA.34515 Health Insurance Risk Equalization Scheme 2013

This Decision concerns the Irish risk equalization scheme ("RES"). The RES relates to the private medical insurance (PMI) market, which is subject to special regulation in Ireland. Almost half of the Irish population has voluntary health insurance in the form of PMI cover, as a supplement to the public health system. The objective of the scheme was to promote intergenerational solidarity by ensuring better risk sharing between health insurers in the Irish PMI market. In particular, "*the purpose of the RES is to allow better risk sharing between insurers, by compensating insurers with a worse-than-average risk profile in their*

portfolio of insured persons. It is designed to partially compensate for the higher costs of insuring an older and less healthy person".[35]

According to the European Commission as stated in the previous BUPA case, the RES was a genuine SGEI. However, contrary to the DTT Decision, this Decision did not examine whether the means selected to provide the SGEI was the best possible option.

The Commission adopted a positive decision once it verified –through the application of the 2012 Framework– that there were clear rules on the parameters for calculating, monitoring and reviewing the service compensation, and that the method of calculation adopted depended on simple and objective criteria; thus, the compensation takes into account the net cost to discharge the SGEI (i.e. the difference between the net cost for the provider of operating with the public service obligation in question and the net cost or profit for the same provider of operating without that obligation).

However, the Commission approved the scheme even if the rules on public procurement were not at all applied, which were supposed to be a necessary condition for the compatibility of the aid. The reason, according to the Commission, was simply that the system was 'not suitable' for a public procurement process (para 72). It is on that sole basis that one of the main requirements of the new rules for compatibility was neither imposed nor required.

It was not however the only 'exception' in this case. The Commission also stated that the 'efficiency requirements' were not needed in this case because that would have a negative impact on the health policy of the Irish State (para. 159). On this point, the Commission states that:

> "In the specific circumstances of the present case, the Commission does not consider appropriate to intervene, by imposing efficiency requirements, in this policy matter of the Irish State"

Furthermore, in footnote number 60 the Commission notes as follows:

> "Indeed, the framework leaves the option of introducing such incentives where "feasible or appropriate to do so".

[35] http://europa.eu/rapid/press-release_IP-13-132_en.htm

This statement seems a poor justification for the fact that the Decision departed from one of the main new compatibility requirements imposed in the Framework. In fact, the efficiency incentives were, in principle, mandatory, not just an option.[36] Therefore, the justification provided in the decision is not sufficient. The Commission seems reluctant to intervene in a "*policy matter of the Irish State*", which can be understood, but it should not declare that efficiency incentives depend on the policy of the Member State. If this were the case, few efficiency incentives can be expected in the coming years. Once more, if this is the way in which the rule will be applied, one may wonder why it was introduced at all.

4. Conclusions

It is widely accepted that, while allowing State aid for the provision of SGEIs might often jeopardize competition within the internal market, the protection of public services must nevertheless be ensured. The issue continues to be the need to achieve a balance, i.e. to ensure an adequate provision of SGEIs without distorting free competition – or at least to minimize the negative effects.

The application of State aid rules to SGEIs is a difficult and very political task as it touches areas of public services which are politically very sensitive. In this sense, the adoption of the new SGEI rules, the Almunia package, is in principle a laudable initiative to the extent that it establishes stricter compatibility rules for large commercial SGEIs.

As we have seen, two of the main declared goals of the new package are to ensure the high quality of SGEIs in the EU and to avoid any distortion of competition due to possible overcompensation for providing the SGEI (in line with the political trends in time of crisis). Moreover, the new provisions are especially rigorous as regards the application of the public procurement rules, which are considered to be a condition of compatibility.

[36] See, for instance, Righini E, 'The Reform of the State Aid Rules on Financing of Public Ser' 2/2012 EStAL 3. According to this author, "the main change in the new framework relates to the introduction of a compulsory compensation mechanism in order to incentivize efficiency gains, as it is already the case for land transport services. Member state will be free to design how these efficiency incentives work."

As a result, the new package appears at first sight to have substantially limited the Member's State discretion to organize larger SGEIs, therefore affecting areas which are politically very sensitive.

The Commission's efforts to adopt a new package in order to guarantee high-level SGEIs at a reasonable price with the least possible distortion of competition should be applauded. However, although the package is an important step forward, it is not the end of the story.

Generally speaking, it is important that any rule which is in force is actually applied. This is even more the case if the new rule has just been adopted. Viewed from another perspective, this suggests that the Commission should only enact rules that can actually be applied – otherwise its credibility may suffer. The lack of actual enforcement of certain key new provisions of the package seems to suggest that the Commission was perhaps too ambitious and is now having second thoughts about these points.

If so, this would not be the end of the world. After all, *errare humanum est*. The Commission would be right in such a situation to adopt a reasonable interpretation of the package and apply it to all new cases. What the Commission should avoid at all cost is to add a new error: that of inconsistency. Thus, it would be very dangerous if the Commission started to apply the strict rules to some cases while avoiding their application in others.

Indeed, for the new rules to attain the objectives of the Almunia package, the Commission needs to apply the rules reasonably, predictably and consistently across the board in all cases.

This challenge is even more important in view of the current situation of economic crisis and the delicate political context in which the package has been adopted. It is worth remembering that the Commission refused – contrary to the demands of various Member States - to use the new legal basis of Article 14 TFEU and chose instead to rely on its own powers under Article 106(3) TFEU. This makes it absolutely crucial for the Commission to show that the rules contained in the new package and its actual application is both legally sound and reasonable. It is to be hoped, then, that the future application of the package is more consistent and predictable than has been the case so far in the first few Decisions adopted.

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13

Squaring EU competition law and industrial policy: the case of broadband

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ABSTRACT

Industrial and competition policy are often seen as logical opposites: inherently conflicting. In my earlier research (1997) I have found that at EU level these two policies are in principle compatible if industrial policy is defined as promoting structural reform. This was illustrated by the telecommunications liberalization which was then ongoing. An update of this research based on the example of broadband roll-out shows that the finding of consistency remains the same or at least similar. However the impact of competition policy has broadened. It has moved from antitrust and mergers to include more active policies on state aid and sectoral competition policy. At the same time in the context of broadband these policies favour (i) more public intervention (aid) and (ii) perpetuate sectoral regulation where originally a rapid transition to general antitrust had been envisaged. This example suggests that to balance industrial policy and competition policy as a whole consistency and predictability – including between the different branches of competition policy – is essential.

KEYWORDS: EU competition law; industrial policy; state aid law; broadband; infrastructure; telecommunications liberalization

1. Introduction

For this paper I have originally been asked to address the question whether competition law constitutes a barrier that needs to be adjusted in order to promote industrial policy. However I will slightly modify this task and instead examine the thesis that the EU competition and

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industrial policy are fundamentally compatible given the characteristics of both policies at EU level. This means that I will test and update industrial policy are fundamentally compatible given the characteritics my earlier work in this area which was in part based on a case study of telecommunications liberalisation. The new test case will be that of the application of the state aid rules to the roll-out of broadband networks, which is ongoing throughout the EU (and indeed worldwide) and therefore currently topical in all Member States and at EU level. In conclusion I will revisit the thesis and specify the lessons to be learned from the broadband case study regarding the relationship between EU competition law and industrial policy.

2. Back to the future

In the past (1997) I have argued that in the constitutional context of the Treaty competition and industrial policy are in principle of equal rank, although competition policy is generally given precedence in practice. I have also argued that the competition and industrial polices of the EU are essentially compatible, categorizing competition policy as constituting both a precondition for a successful industrial policy and as a constraint on those national industrial policies that could threaten the internal market.[1] This view was in line with the EU doctrine of the time. In that context I had taken the telecommunications sector as an example that illustrated this fundamental compatibility. This network sector, previously dominated by stagnant national monopolies, was then being liberalized in a process that saw a gradual introduction of competition first into satellite services, Cable TV and mobile telephony, then non-reserved services (ultimately all services except voice telephony), and eventually by 1998 full liberalisation covered all public communications networks and services.

In line with the Commission's key 1990 Communication on Industrial Policy (that will be discussed in more detail below) the contribution of competition policy in removing monopoly rights from this

[1] W. Sauter, *Competition law and Industrial policy in the EU* (Oxford University Press, Oxford 1997). For a more recent view see e.g. J. Galloway, "The pursuit of national champions: the intersection of competition law and industrial policy", (2007) *European Competition Law Review* 172.

sector has been highly significant.[2] The Commission has successfully pursued several high profile individual dominance abuse cases against former incumbents.[3] However since the introduction of full liberalisation in 1998 the contribution made by managed competition based on the introduction and continued application of ex ante sectoral rules administered by independent national regulatory authorities (NRAs) coordinated by the Commission has been even greater. The results have been mixed – by and large national markets persist, but prices have decreased whereas the range and quality of the services provided (especially mobile and internet based) has increased spectacularly. Hence the sector functions as a multiplier of economic growth across the economies of the Member States. As an industrial policy measure, telecommunications liberalization has been a success.

Today the EU level political context regarding the balance between competition and industrial policy is shaped by the ambitious Europe 2020 goals for smart sustainable and inclusive growth adopted in 2010 to update the Lisbon Agenda that had been set in 2000 – with innovation as the engine of economic change.[4] Within the Europe 2020 framework we find seven different flagship policies, one of which concerns industrial policy in general[5] and another which regards the digital agenda, which can be seen as a sectoral industrial policy.[6] At the same time the economic crisis that followed on the global financial crisis continues to jeopardize attainment of the goals set.

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2 Commission Directive 88/301/EEC of 16 May 1988, on competition in the markets in telecommunications terminal equipment, OJ 1988, L131/73; Commission Directive 90/388/EEC of 28 June 1990 on competition in the markets for telecommunications services, OJ 1990, L192/10, both successively amended.

3 Such as Case C-202/07 P *France Télécom SA v Commission* [2009] ECR I-2369; Case C-280/08 P *Deutsche Telekom AG v Commission* [2010] ECR I-9555; Case T-336/07, *Telefónica, SA and Telefónica de España, SA v Commission*, judgment of 29 March 2012, nyr. Earlier, guidance had been provided in Notice on the application of the competition rules to access agreements in the telecommunications sector - framework, relevant markets and principles, OJ 1998 C265/2.

4 Communication from the Commission, Europe 2020, A strategy for smart, sustainable and inclusive growth, COM(2010) 2020; Council conclusions on Europe 2020, 16 March 2010.

5 Communication from the Commission, An integrated industrial policy for the globalisation era putting competitiveness and sustainability at centre stage COM(2010) 614; Communication from the Commission, A stronger European industry for growth and economic recovery, COM(2012) 582.

6 Communication from the Commission, A digital agenda for Europe, COM(2010) 245; Communication from the Commission, The digital agenda for Europe – Driving European growth digitally, COM(2012) 784.

3. Industrial policy viewed from the lens of competition

Remarkably in the abovementioned industrial policy documents competition policy is rarely mentioned if at all. The reverse is not true. For instance at the 2006 annual Fordham University competition policy conference then competition Commissioner Kroes stated:

> "I think it makes no sense to speak of industrial policy and competition policy as distinct one from the other, let alone as antagonistic policies. I would rather define industrial policy as one which frames the structural conditions necessary to ensure economic success in a globalising economy. And I therefore have no qualms in saying that competition policy forms –or should form– a central plank in any industrial policy."[7]

In the same speech Commissioner Kroes singled out electronic communications as an example:

> "In the telecoms sector, liberalisation has led to the emergence of a multitude of competitors for fixed-line and mobile voice services as well as Internet connections. (…) So competition not only gives more customers access to mobile services, faster and at lower prices. But it also grows existing markets and creates new ones, provides market entry opportunities for new firms, and lowers the input cost of telecommunication services, as well as widening the choice of available services. So, *I think it is evident from the EU's experience that a carefully planned and executed liberalisation policy is a central piece of a comprehensive modern industrial policy* (emphasis added)."[8]

Electronic communications liberalization thus seems to have become a favourite example for those of us who are intent on illustrating the compatibility of industrial and competition policy. In the conclusions I will get back to the issue of whether communications is a special case or whether drawing broader conclusions based on this case is justified. The central point that I have made so far however is that according to the Commission industrial and competition policy are compatible in a context of structural adjustment and liberalization.

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7 Neelie Kroes, "Industrial policy and competition law & policy", Fordham University School of Law, New York City, 14th September 2006, SPEECH/06/499.

8 Ibid.

4. Compatibility: the next generation

I want to test this view of essential compatibility between industrial and competition policy that I shared with then Commissioner Kroes, at least when I first wrote about this topic ten years before her speech that I have just cited. I also want to see if this compatibility, if it exists, is limited to structural adjustment and liberalization. Hence, I propose to focus on state aid and broadband. The focus on broadband has three reasons:

> – High speed broadband is generally seen as a driver for economic development, so it fits in with the focus of the Lisbon agenda and the Europe 2020 communication in the context of which explicit targets have been set for its delivery;
>
> – It goes a step beyond the services across legacy (pre-existing) networks that were the focus of the Commission's abovementioned liberalization drive – that is to say the context is not one of liberalization and services but of technological change;
>
> – Finally the Commission has not only adopted a broadband communication but has also taken over 120 formal state aid decisions regarding broadband in numerous Member States, which means that an ample dataset is available.[9]

At the same time state aid is subject to modernization which aims to make it more economic and internal market oriented.

> "The objectives of modernisation of State aid control are (…) threefold: (i) to foster sustainable, smart and inclusive growth in a competitive internal market; (ii) to focus Commission ex ante scrutiny on cases with the biggest impact on internal market whilst strengthening the Member States cooperation in State aid enforcement; (iii) to streamline the rules and provide for faster decisions."[10]

Hence I believe the application of state aid policy to broadband provides a good case study for our purposes.[11] A sectoral alternative

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9 http://ec.europa.eu/competition/sectors/telecommunications/broadband_decisions.pdf

10 Communication from the Commission on EU State aid modernization (SAM), COM(2012) 209, para 8.

11 Cf. K.-H. Neumann, Study on the implementation of the existing Broadband guidelines COMP/2011/006, WIK-Consult final report, Bad Honnef 7 December 2011.

with a significant number of cases, but with a less clear industrial policy relevance, might have been public broadcasting; a non-sectoral alternative with evidently a much larger number of cases, but probably too broad for my purposes, would have been merger control.[12] The three questions I will address are: is competition policy in the broadband case compatible with industrial policy? Are competition and industrial policy in the broadband case aimed at promoting structural adjustment? And is competition policy affected or compromised by industrial policy objectives here?

The general background is examined as follows. First we will look at what constitutes industrial policy, and what is specific about the industrial policy of the EU. Next we will look at competition policy and state aid in this context, before moving on the specific example of broadband.

5. What is industrial policy?

Traditionally industrial policy is understood as public authorities backing and/or financing particular undertakings, or "picking winners". Also strategic industries or sectors are often defined, sometimes even by law – famously caricaturized as the French yogurt sector when a take-over threatened the Danone food-products conglomerate in 2005 (which today features a perhaps more obviously strategic medical devices division). If applied simultaneously by different Member States in the EU such policies can lead to an "arms race" in subsidies and preference that is both self-defeating and frustrates the working of the internal market.[13]

This type of industrial policy is clearly not appropriate for the EU itself since it does not dispose of comparable budgets to promote winners (after all the EU budget is only 1% of GDP and the budgets of the respective Member States are generally over 40%) and it could not pick

[12] See however D. Geradin and I. Girgenson, Industrial policy and European merger control – a reassessment, TILEC discussion paper 2011/53, where they conclude that in the practice of EU merger control competition concerns prevail, not industrial policy motives.

[13] See J. Pelkmans, "European industrial policy", in P. Bianchi and S. Labory (eds), *International Handbook of Industrial Policy* (Edward Elgar publishers, Cheltenham 2006).

them without resistance from the other Member States. Hence it should not be surprising that the industrial policy of the EU, dating back to a landmark Commission communication from 1990 on industrial policy in an open and competitive environment, promotes a policy based on structural adjustment towards competitiveness in open markets.[14] An effective competition policy is presented as one of the key elements of such a strategy: in fact competition policy is seen as one of its prerequisites.[15] In particular the legal certainty and opportunities for growth offered by the new merger policy (the first merger control regulation had just been adopted in 1989)[16] and protection against anti-competitive state aid measures are mentioned in the 1990 industrial policy document.[17] This is logical because structural adjustment is fundamentally consistent with the market orientation of the EU as a whole.

Figure I. Source: COM(90) 556 final, Industrial policy in an open and competitive environment

Structural adjustment

I Prerequisites	II Catalysts	III Accelerators
Competition		R&D, Technology, Innovation
Economic context	Internal market	Training
Educational attainment		
Economic & social cohesion	Commercial Policy	Small and Medium Size Enterprises
Environmental protection		Business services

[14] Communication from the Commission, Industrial policy in an open and competitive environment: Guidelines for a Community approach, COM(90) 556. This seminal text was preceded by a Memorandum from Industry Commissioner Martin Bangemann of 14 September 1990 that was likewise titled "Industrial policy in an open and competitive environment".

[15] The other prerequisites listed are the economic context; educational attainment; economic and social cohesion; and environmental protection.

[16] Council Regulation (EEC) No 4064/89 of 21 December 1989 on the control of concentrations between undertakings, OJ 1989, L395/1.

[17] COM(90) 556, above n. 14, pp. 7-8.

Industrial policy in the EU today remains based largely on the notions set out in this 1990 policy paper. The approach it promoted was explicitly incorporated into the EU constitutional framework itself by the Maastricht Treaty in 1993. This was the first time that an industrial policy platform was included in the Treaty.[18] Article 130 EC (now 173 TFEU) in a new title on "industry" set out that "the EU and the Member States shall ensure the conditions necessary for the competiveness of the Union's industry exist" with an emphasis on structural adjustment ("speeding up the adjustment of industry to structural changes"). It also stated that the industrial policy provisions shall be "in accordance with a system of open and competitive markets and "shall not provide a basis for the introduction by the Community of any measure which could lead to a distortion of competition". Hence compatibility with the competition rules was emphasized from the outset.

Since then the fundamentally market-oriented industrial policy at EU level has been adapted to the circumstances of the time,[19] such as enlargement in 2002 and 2004;[20] globalization in 2010;[21] and the global financial crisis in 2012.[22] EU industrial policy thus moves with the times but remains grounded in the same principles. The fundamental compatibility between industrial and competition policy at least is thus a thesis that is supported by the Treaty itself and (consistently) by the explicit policy aspirations at EU level as well.

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18 This led to indignant responses from economic liberals notably in Germany. Cf. M.E. Streit and W. Mussler, "The Economic constitution of the European Community: From 'Rome' to 'Maastricht'" (1995) *European Law Journal* 5.

19 For reasons of space and scope I will not go into the developments in the meantime as documented, sometimes repetitively, in key Communications such as White paper on Growth, competitiveness, employment: The challenges and ways forward into the 21st century, COM(93) 700, *Bull EC* Supplement 6/93; Communication from the Commission on an industrial competitiveness policy for the European Union, COM(94) 319; Communication from the Commission, Some key issues in Europe's competitiveness – towards and integrated approach, COM(2003) 704.

20 Communication from the Commission, Industrial policy in an enlarged Europe, COM(2002) 714 final; Communication from the Commission, Fostering structural change: an industrial policy for an enlarged Europe, COM(2004) 274.

21 COM(2010) 614, above n. 5.

22 COM(2012) 582, above n. 5.

As set out in the Europe 2020 communication (adopted in 2010) the Flagship policy of an industrial policy for the globalization era the Commission will work.

> "To develop a horizontal approach to industrial policy combining different policy instruments (e.g. "smart" regulation, modernized public procurement, competition rules and standard setting)."[23]

This horizontal approach looking at the conditions for industrial success that can be shaped by EU measures for all sectors of industry alike can be contrasted with a "vertical" approach addressing particular sectors (such as shipbuilding or the manufacture of semiconductors) that is not mentioned in the 2010 communication on Europe 2020. Other horizontal policies that are mentioned include promoting small and medium-sized enterprises (SMEs), the transition to more resource efficiency and the use of transport and logistics networks (although incidentally a specific sector is mentioned, such as the tourism industry).

The 2010 Industrial policy communication itself states that competition policy, by way of enhanced competition, contributes to the innovation and efficiency gains that are necessary to become and remain competitive. In addition the Commission emphasizes in this document that competition policy provides frameworks to support the competitiveness of EU industry, listing state aid, antitrust and merger control.[24] As regards state aid the emphasis is on directing the Member States toward addressing market failures. For antitrust and merger controlling prices and in the latter case enabling restructuring are mentioned as contributions. Surprisingly, promoting market access or reducing entry barriers are not. These are themes that justify a sector-specific framework as well as intervention based on the general competition rules in in the electronic communications sector and that will surface in the broadband context.

How does the relationship between competition and industrial policy play out in practice? Below I will first introduce the concepts of competition policy in general and state aid in particular. The next section will then look specifically at the example of broadband.

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[23] COM(2010) 2020, above n. 4, p. 16.

[24] COM(2010) 614, above n. 5, p. 10.

6. What is competition policy?

6.1. Antitrust and mergers

The EU competition rules serve to ensure that restrictions between private undertakings do not replace those by the Member States that are removed by the application of the internal market freedoms. They aim to protect both the structure of the market and in doing so the process of competition as such, and consumer welfare.[25] Competition policy in the strict sense covers antitrust (the prohibitions on anticompetitive agreements and dominance abuse) and mergers. Somewhat more broadly it also includes the policy concerning state aid – on which we will focus below. Still more broadly we see sector specific competition rules concerning the various utility sectors, in our case electronic communications.

Since 1997, when I last took a closer look at the relationship between competition law and industrial policy, there have been significant changes in the application of competition policy. In the first place since 2004 the application of the antitrust rules in the EU has been decentralized, removing the original monopoly over clearance of anticompetitive (but pro-efficiency) agreements from the Commission. This decentralization is based on a new reading of Article 101(3) TFEU as a directly applicable legal exception, with a greater role for self-assessment by undertakings and a new competence (and obligation) to apply Articles 101 and 102 TFEU to issues with an EU dimension for national competition authorities (NCAs).[26] In parallel, starting out from a more lenient approach to vertical agreements a more economic approach has gradually become prevalent not only in mergers and antitrust but regarding state aid as

[25] *GlaxoSmithKline Services Unlimited v Commission (C-501/06 P) and Commission v GlaxoSmithKline Services Unlimited (C-513/06 P) and European Association of Euro Pharmaceutical Companies (EAEPC) v Commission (C-515/06 P) and Asociación de exportadores españoles de productos farmacéuticos (Aseprofar) v Commission (C-519/06 P) (C-501/06 P, C-513/06 P, C-515/06 P and C-519/06 P)* [2009] E.C.R. I-9291, at [63]. Cf *T-Mobile Netherlands BV, KPN Mobile NV, Orange Nederland NV and Vodafone Libertel NV v Raad van bestuur van de Nederlandse Mededingingsautoriteit* (C-8/08) [2009] E.C.R. I-4529, at [38].

[26] Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty OJ 2003 L1/1.

well.[27] One aspect of this more economic approach is that an efficiency defense now exists for anticompetitive agreements, dominance abuse and mergers alike.[28]

Another change is that in order to make the Lisbon Treaty acceptable after the failure of the EU Constitutional project competition policy has (at the insistence of the French government as a way of addressing the concerns behind negative outcome of the referendum) been removed from the activities of the Union listed in body of the Treaty (formerly Part 1, Principles, Article 3g EC: "a system ensuring that competition in the internal market is not distorted"). Instead competition policy is now mentioned in Article 3(1) b TFEU in relation to its necessity to the functioning of the internal market as well as in Protocol 27 –that by force of Article 51 TEU is in principle of equal legal value as the Treaty[29]– which Protocol includes a statement that "the internal market as set out in Article 3 of the Treaty on European Union includes a system ensuring that competition is not distorted". This apparent shift in emphasis has variously been regarded as a major reorientation of the Treaties, as an affront to competition policy and as a sop to French politics that is legally meaningless (the later two sometimes simultaneously).[30]

The view from the EU institutions is that it makes no difference: competition policy was never an objective in its own right (although the draft Constitutional Treaty that was ultimately not adopted would have made it one) but an instrument to achieve the internal market, which it remains. Hence, in 2007 the then Competition Commissioner Kroes reacted as follows:

> "An Internal Market without competition rules would be an empty shell - nice words, but no concrete results. The Protocol on Internal Market and Competition agreed

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27 For example: Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices , OJ 1999, L336/21; Commission notice - Guidelines on Vertical Restraints, OJ 2000, C 291/1. Now updated: Commission notice - Guidelines on Vertical Restraints, OJ 2010, C130/1.

28 A separate debate is whether there is also increased scope for non-economic goals. Cf. H. Vedder, "Of jurisdiction and justification. Why competition is good for 'non-economic' goals, but may need to be restricted", (2009) *The Competition Law Review* 51.

29 Article 51 TEU: "The Protocols and Annexes to the Treaties shall form an integral part thereof".

30 See eg A. Riley, The EU Reform Treaty & the Competition Protocol: Undermining EC Competition Law, CEPS policy brief 142, September 2007, and the sources cited there; A. Scordamaglia Tousis, The Lisbon Treaty and competition: much ado about nothing? (2009) SSRN: 1889141.

> at the European Council clearly repeats that competition policy is fundamental to the Internal Market. It retains the existing competition rules which have served us so well for 50 years. It re-confirms the European Commission's duties as the independent competition enforcement authority for Europe. Now I would like to get back to the job."[31]

More recently this view was essentially confirmed by the Court in *Commission v Italy* (2011):

> As to the seriousness of the infringement, the vital nature of the Treaty rules on competition must be recalled, in particular those on State aid, which are the expression of one of the essential tasks with which the European Union is entrusted. At the time of the Court's assessment of the appropriateness and the amount of the present penalty payment, that vital nature is apparent from Article 3(3) TEU, namely the establishment of an internal market, and from Protocol No 27 on the internal market and competition, which forms an integral part of the Treaties in accordance with Article 51 TEU, and states that the internal market includes a system ensuring that competition is not distorted.[32]

To me at least the symbolism is clear: no more centre stage, or in any event rather less of it, for competition in political terms. In actual practice however the impact of the decentralization process discussed above is likely to be much more significant. It will contribute to the effectiveness and impact of the EU competition rules at national level more than any perceived demotion to a Protocol can undo. Eventually it will be the Commission's success at coordinating the efforts of the NCAs that will in large measure determine the direction and the impact of EU competition policy.

I will now move on to discuss the state aid rules, which are something of a specific case, because here de NCAs do not play a role.[33]

6.2. What is state aid?

As I have stated above apart from antitrust and mergers competition policy in the broad sense also comprises state aids. State aid regards measures that: (i) at a cost to the public purse (ii) confer an

[31] Statement by European Commissioner for Competition Neelie Kroes on results of June 21-22 European Council - Protocol on Internal Market and Competition, MEMO/07/250.

[32] Case C-496/09 *Commission v Italy*, judgment of 17 November 2011, nyr (para 60). I am indebted to Ben van Rompuy's blog for both of these references. http://kluwercompetitionlawblog.com/2011/11/25/.

[33] Such a role is sometimes proposed: cf. N. Fiedziuk, "Towards decentralization of State Aid control: The case of services of general economic interest" (2013) *World Competition* 387.

advantage selectively on particular undertakings, which (iii) negatively affects competition and (iv) has an effect on trade between the Member States. Unlike antitrust, state aid policy remains highly centralized. Although national courts are competent to make a finding that aid exists, (apart from a limited group of exceptions in Article 107(2) TFEU) only the European Commission can declare aid that is in the public interest (either on efficiency or equity grounds) to be compatible with the internal market based on Article 107(3) TFEU.

As regards compensation for public services the CJEU in the 2003 *Altmark* Case formulated a boundary test that, if met, means there is no aid for there is no advantage (but a quid pro quo).[34] This test requires (i) that there is a public service obligation set by a public authority; (ii) there must be compensation parameters set out in advance; (iii) compensation is at the level of cost plus a reasonable rate of return; (iv) and unless the service is tendered costs are set at those of an efficient undertaking. Another boundary issue in state aid law is the market investor principle (MEIP), which means that if a private investor would have (or in fact has) accepted the same conditions there is likewise no advantage and therefore no aid.

In addition to the general compatibility exception and the *Altmark* test there is also a particular exception with regard to services of general economic interest (SGEI), set out in Article 106(2) TFEU. Here the rule is that proportionate infringements of the state aid rules (or the competition rules for that matter) in pursuit of legitimate public policy objectives may be justified. Specific frameworks (and guidance) concerning the application of the SGEI test in the state aid context were adopted by the Commission in 2005 and 2011.[35]

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[34] Case C-280/00, *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, and Oberbundesanwalt beim Bundesverwaltungsgericht* [2003] ECR I-7747.

[35] (Here I provide references only for the currently applicable rules.) Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest [2012] OJ L7/3; Communication from the Commission on a European Union framework for State aid in the form of public service compensation [2012] OJ C8/15; Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest [2012] C8/4; Commission Regulation on de minimis aid to undertakings providing SGEI [2012] OJ L114/8. Cf E. Szyszczak, "Modernising state aid and the financing of SGEI", (2012) 3 *Journal of Competition Law and Practice* 332; W. Sauter, "The Altmark package Mark II: New rules for state aid and the compensation of services of general economic interest" (2012) 33 *European Competition Law Review* 307.

The state aid policy of the EU is currently undergoing modernization,[36] and has in fact been doing so since the state aid action plan of 2005.[37] As cited above the three main objectives of modernization are fostering growth, focusing on the areas with the greatest impact on the internal market and streamlining procedures. It is in this context that the Broadband guidelines were published in 2009 –and again in 2013– that will be discussed in greater detail in a specific section below.[38] The reason to discuss broadband, as will become clear, is that the promotion of its roll-out is an industrial policy objective of the EU. Its treatment under the state aid rules therefore provides an illustration of the present relationship between competition law and industrial policy in the EU.

7. Broadband: A case study

This section starts out by setting the scene with some general background on electronic communications liberalization and regulation. Next I will look at broadband in particular, first on the basis of the state aid Broadband Guidelines and second based on examples of the relevant decisional practice of the European Commission. The case of broadband is peculiar in the context of electronic communications regulation as it is a service that did not exist prior to liberalization and that is increasingly offered across wholly new (non-legacy) fibre-optic networks. At the same time these are expected to be the networks of the future. This raises specific questions on how in this context of dynamic technological change sector specific regulation can be justified in the first place.

7.1. Infrastructure liberalization

The liberalization of electronic communications infrastructure was accompanied by the introduction of a harmonized system of regulation that set out a relatively mild general regime as well as a stricter regime for operators who enjoyed significant market power (SMP). SMP was originally based on a fixed 25% market share threshold. However it

36 COM(2012) 209, above n. 10.

37 Communication from the Commission, State aid action plan - Less and better targeted state aid : a roadmap for state aid reform 2005–2009, COM(2005) 107.

38 See notes 55 and 60 below.

was subsequently reviewed to mimic the dominance standard from the general competition rules with a more flexible market share threshold closer to 40 or 50% and a requirement of demonstrating an ability to behave independently from competitors, suppliers and/or consumers.[39] It was hoped that transplanting the dominance norm would help avoid a needless proliferation of competition standards –a goal which was arguably achieved– and would facilitate the eventual transition from sector specific rules to sole application of the general competition rules as it was then intended. The latter goal remains largely elusive with the migration of sectoral rules across new technologies, as we will see below.

Initially the justification for imposing SMP regulation was based on the premise that the networks involved had been constructed on the back of special and exclusive rights, often as public monopolies: this gave them an unfair advantage over newcomers.[40] Local loop unbundling was introduced in order to promote facilities based competition across copper based access networks, alongside the introduction of various other types of third party access. Especially the access networks were difficult to replicate in economic terms to the extent that they were considered to form natural monopolies, hinting at the need for long term regulation of these network elements.

Mobile and (TV) cable were new networks and initially not (or very lightly) regulated. Eventually however in mobile markets the regulation of specific elements such as termination (delivering calls to end users) and roaming (the use of other mobile networks than that which a user subscribes to) were introduced. Here the regulation of new services emerged, at least initially where the existence of significant externalities and technical monopolies (specific forms of market failure) played an important role.

Next wholly or largely new (fibre optical) networks were submitted to SMP regulation – a break with the original logic of regulating

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39 Cf. e.g. P. Nihoul and P. Rodford, *EU Electronic Communications Law: Competition & Regulation in the European Telecommunications Market*, 2nd ed (Oxford University Press, Oxford 2011); P. Larouche, *Competition law and regulation in European telecommunications* (Hart Publishing, Oxford 2000).

40 L. Hancher and P. Larouche, "The coming of age of EU regulation of network industries and services of general economic interest", in P. Craig and G. de Búrca (eds), *The evolution of EU law*, 2nd ed (Oxford University Press, Oxford 2011).

incumbency based on special and exclusive rights in the interest of promoting competition. It also formed a break with the original intention of a speedy transition to the general competition rules as the main (or even only) applicable framework. Regulation thus appears to become self-perpetuating.

As a consequence of the introduction of these various layers of regulation, today we find parallel regimes of sector-specific and general competition policy in the electronic communications sector,[41] with parallel networks of NRAs and of NCAs to apply them, in both cases coordinated by the Commission – although the Commission in the case of the competition rules retains both more important independent powers and stronger coordination powers because it can pre-empt and claim cases with a Community dimension.[42]

7.2. The next generation

Standard broadband is the transmission of communications with a high bandwidth capacity that enables the rapid and simultaneous transmission of different signals at higher speeds than traditional copper-based telephone and co-axial cable networks, but that is to a significant extent based on upgrading such networks. High speed broadband networks consist largely of completely new fibre optic networks that are capable of delivering high definition services and bandwidth intensive applications as well as symmetrical (uploading as well as downloading) broadband connections. "Triple play" services of media, information technology and communications are often mentioned as forms of expected use although in relatively low capacity form these services

41 Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive), OJ 2002, L108/33; Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users' rights relating to electronic communications networks and services (Universal Service Directive), OJ 2002, L108/51; Directive 2009/136/EC of the European Parliament and of the Council of 25 November 2009 amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services, Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector and Regulation (EC) No 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws, OJ 2009, L337/11.

42 S.A.C.M. Lavrijssen and L. Hancher "Networks of Regulatory Agencies in Europe", in P. Larouche and P. Cserne (eds), *National Legal Systems and Globalization: New Role, Continuing Relevance* (TMC Asser Press/Springer, The Hague 2013), 183.

are already available across basic broadband networks. High speed broadband networks are also called next generation access networks (NGA).[43] Finally, ultra high speed broadband networks are based on delivering still higher capacity across fibre connections all the way down to the end user.

Because such networks are by definition the result of technical change and therefore new the question arises whether regulating non-legacy infrastructure with third party access regimes (such as various forms of unbundling, wholesale access) is justified.[44] It appears that they are tainted with the original sin of incumbency: where access obligations exist on the historic copper network operators cannot be required to operate a parallel copper network but the obligations must be transposed to their new fibre network. Regulation thus migrates, following the technology. It should be noted here that mandatory access may be designed to promote the emergence of competitive (parallel) networks over time,[45] but it can have negative effects on the original investment in a new network which may be discouraged as its provider will have to share its resources with its competitors. In this context it is perhaps worth noting that in this high tech industry digging up roadsides and laying ducts actually account for up to 70% of the costs of building a broadband network so the gains from sharing ducts can be considerable.[46]

At the other end of the spectrum from regulating the terms of access to networks that are based on private investment (thereby arguably discouraging private investment) looms the question whether

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43 According to the definition in the 2010 Recommendation, para 11 : "'Next generation access (NGA) networks' (NGAs) means wired access networks which consist wholly or in part of optical elements and which are capable of delivering broadband access services with enhanced characteristics (such as higher throughput) as compared to those provided over already existing copper networks. In most cases NGAs are the result of an upgrade of an already existing copper or co-axial network." Commission Recommendation on regulated access to Next Generation Access Networks (NGA) (2010/572/EU), OJ 2010, L251/35.

44 Cf. M. Cave, "Broadband Regulation in Europe – Present and future", (2007) *Competition and regulation in network industries* 405; M. Cave, "Snakes and ladders: Unbundling in a next generation world", (2009) *Telecommunications Policy* 80.

45 Sometimes called the "ladder of investment". This is the idea that building up experience and a subscriber base first as a service provider and then as a (partial) infrastructure provider will over time justify and motivate further infrastructural investment (ever nearer the en-used).

46 A. Kliemann and O. Stehmann, "EU state aid control in the broadband sector – The 2013 broadband guidelines and recent case practice", (2013) *European State Aid law Quarterly* 493.

public investment will then be required to promote the roll-out of such networks and allowed as compatible state aid. In addition a key question is whether the promotion of broadband by means of public funding does not crowd out private investment, leading to an overall result where roll-out of networks and services is inferior with public intervention than without it.[47] There is economic evidence to suggest that this effect does occur.[48] Before addressing these questions we will first look at the sectoral industrial policy context at EU level.

7.3. The Digital agenda

As was mentioned in section II above, the Europe 2020 communication lists the Digital agenda as one of its seven flagship initiatives and states specific targets to be attained EU-wide regarding broadband:

> "The aim is to deliver sustainable economic and social benefits from a Digital Single Market based on fast and ultra fast internet and interoperable applications, with broadband access for all by 2013, access for all to much higher internet speeds (30 Mbps or above) by 2020, and 50% or more European households subscribing to internet connections above 100 Mbps."[49]

As such this communication can be seen as an example of sector-specific industrial policy, a more recent successor to the 1994 Bangemann report that preceded and galvanized support for infrastructure liberalization.[50] At EU level the aim is predominantly to provide a stable legal framework. The Member States are encouraged to draw up national broadband roll-out strategies and to target public funding on areas that are not fully served by private investments. The EU is thought to be lagging its US and in particular East Asian competitors in the penetration of next generation fibre optic access networks. At the same time some commentators signal three distinct models of promotion of investment with regard to broadband:

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47 Ibid., p. 497.

48 Ibid., p. 498, citing Grajek and Röller, Regulation and investment in network industries: Evidence from European telecoms, SFB Discussion Paper 2009.

49 COM(2010) 2020 , above n. 4, p. 14,

50 Europe and the global information society, Report to the June 1994 Corfu European Council. This report was produced by a high level group of leading European industrialists under the chairmanship of the Information society DG's European Commissioner Martin Bangemann.

1. The US model, competition and deregulation based, with intermediate penetration rates;

2. The Asian model (Japan and South Korea in particular), based on public investments in broadband motivated by industrial policy, with the highest relative penetration rates so far;

3. The EU model, with a system of managed competition and so far the lowest average penetration.[51]

At the same time it is estimated that a 10% increase in Broadband penetration could yield a 1 to 1.5 % point increase in annual GDP over a five year period – an achievement which is obviously welcome in the current economic climate.[52] The EU policy mixture also includes some EU level public investment. The 2010 Digital Agenda states that national, EU and EIB funding instruments should be used for targeted investment in broadband where the business case is currently weak. More importantly, it states that Member States should:

> "Develop and make operational national broadband plans by 2012 that meet the coverage and speed and take-up targets defined in Europe 2020, using public financing in line with EU competition and state aid rules."[53]

This shows a clear presumption that public financing in line with the state aid rules is possible and indeed desirable. In the context of sectoral regulation the 2010 Digital Agenda also announces the adoption of a Recommendation that will balance investment risk when setting access prices, appropriate access remedies allowing a reasonable investment pace to alternative operators and the promotion of co-investment and risk sharing (see further below).[54] There is thus a combination of (i) promoting public financing on the one hand (subject to state aid control) and (ii) providing guidance on the applicable legal instruments to facilitate private investment (subject to sector-specific controls). As we

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51 J. Huigen and M. Cave, "Regulation and the promotion of investment in next generation networks – A European dilemma", (2008) *Telecommunications Policy* 713. Their thesis is that private investment is most likely to occur in competitive infrastructure markets.

52 Communication from the Commission, The Digital agenda for Europe – Driving European growth digitally, COM(2012) 784, p. 8; Communication from the Commission, Single Market Act II: Together for growth, COM(2012) 573, p. 13.

53 COM(2010) 245, above n. 6, p. 21.

54 Ibid., pp. 19-20. See also below n. 74.

will see access conditions are also imposed as a condition for the receipt of state aid in this area, mixing (or connecting) the state aid regime with that on sector-specific regulation.

In 2012 the Digital Agenda was updated by a new Communication.[55] Among its seven priorities this new text listed:

> "Regaining world leadership for network services, by stimulating private investment in high-speed fixed and mobile broadband networks, enabled by legal predictability improved planning and targeted private and public EU and national funding."[56]

The legal predictability referred to a 2013 Recommendation on non-discrimination rules for access to "incumbent" networks (normally a terminology reserved to the legacy copper networks that were construed on the back of special and exclusive rights) that has not yet been adopted, as well as (in the context of sectoral SMP based regulation) a 2014 review of the Commission's Recommendation on relevant markets subject to ex ante regulation. The Commission is now (Summer 2013) calling for a stable regulatory framework, pointing out that the recoupment time for investment is long – 20 to 30 years.[57] With abovementioned references to targeted private and public funding for broadband deployment we enter the realm of state aid. Moreover the state aid broadband guidelines do not only promote investment but also the involvement of the NRAs inter alia in determining the market conditions and setting access requirements. The Broadband guidelines were issued in 2009 respectively in 2013 and will now be discussed in turn.

7.4. The 2009 Broadband guidelines

In 2009 the Commission published its first set of guidelines concerning the application of the state aid rules to the rapid deployment of broadband networks, covering both basic and NGA networks.[58] These

55 COM(2012) 784, above n. 7.

56 Ibid., p. 4.

57 With a tabloid worthy title: "Regulator mess hurting broadband investment: consumers and businesses stuck in slow lane." European Commission MEMO/13/756.

58 Communication from the Commission, Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks (2009/C 235/04), OJ 2009, C235/7. Cf. L. Papadias, F. Chirico and N. Gaal, "The new state aid broadband guidelines: Not all black and white" (2009) *Competition Policy Newsletter* 3: 17.

guidelines state that they were adopted in the context of the Lisbon strategy of achieving 100% high speed internet connectivity by 2010 and the Commission's plans to drive Europe's recovery from the financial and economic crisis. Unsurprisingly therefore the starting point of the 2009 Broadband guidelines is that broadband roll-out is desirable, and that state aid to promote such roll-out may well be justified. Against this backdrop, the 2009 Broadband guidelines sketch the way in which the Commission will carry out the compatibility test under Article 107(3) TFEU –a test on which as I have mentioned above the Commission has a monopoly. It is worth noting here that the advantages that must be demonstrated in the Article 107(3) TFEU context must be shown to exist at EU level (not the national level as in the internal market, nor at the level of the undertaking and its consumers as in antitrust and mergers). The Guidelines serve to provide guidance and transparency regarding the Commission's approach to market parties and governments, but also provide a framework for determining the consistency of the Commission's state aid practice if specific decisions are challenged– serving legal certainty.[59]

The main three steps of the compatibility test are:

(i) whether a market failure or other legitimate public policy objective are involved;

(ii) whether the aid is well designed, i.e. appropriate, has an incentive effect and uses the minimum effective means;

(iii) whether the effects on trade and competition are limited so a positive overall balance is achieved.

As was mentioned in the previous section a public interest objective consisting either of efficiency – such as market failure – or of equity (such as universal service: the delivery of services at accessible prices to any user throughout the territory concerned) is necessary for a finding of compatibility. The emphasis on market failure in the 2009 Broadband guidelines is clear:

[59] A discussion of the earlier cases where the Commission already applied its categorization in black, white and grey areas is found in M. Hencey et al., "State aid rules and public funding of broadband", (2005) *Competition Policy Newsletter* 1: 8; and L. Papadias, A. Riedl and J.G. Westerhof, "Public funding for broadband networks – recent developments", (2006) *Competition Policy Newsletter* 3: 13.

> "Where the market does not provide sufficient broadband coverage or the access conditions are not adequate, State aid may play a useful role. Specifically, State aid in the broadband sector may remedy a market failure, i.e. situations where individual market investors do not invest, even though this would be efficient from a wider economic perspective, e.g. due to the positive spill-over effects. Alternatively, State aid for broadband may also be viewed as a tool to achieve equity objectives, i.e. as a way to improve access to an essential means of communication and participation in society as well as freedom of expression to all actors in society, thereby improving social and territorial cohesion."[60]

Some commentators have criticized asymmetric regulation (imposing one-sided obligations on parties, typically those who enjoy market power or SMP) and the reliance on the market failure argument in the broadband context as fundamentally misdirected. This is because they believe that in fact equity objectives such as universal service predominate. In their view an uneven territorial and social distribution of broadband access with a heavier presence in densely populated and wealthier central regions –even if this leads to a so-called "digital divide" (between so-called digital "haves" and digital "have-nots")– is an outcome that is in perfect conformity with market principles and from an economic perspective not a market failure nor even undesirable.[61]

The methodology of the 2009 Broadband guidelines is based on a distinction between three fundamentally different types of areas.

> (i) These are, first, "white" areas where no broadband is available and where private investors are not planning roll-out in the near future (three years). In such cases state aid may promote territorial cohesion and economic development and is in fact required to achieve ubiquitous coverage. Here aid is likely to be compatible with the internal market.

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60 2009 Broadband Guidelines, above n. 55, para 39. Ibid., at para 4 they refer to the Communication from the Commission, State aid action plan – less and better targeted state aid: a roadmap for state aid reform 2005-2009, COM(2005) 107final, which introduced a focus on the role of state aid regarding market failure. This approach was recently confirmed by the General Court in Case T-79/10 *Colt Télécommunications France v Commission*, Judgment of 16 September 2013.

61 Cf. C. Koenig and S. Fechtner, "The European Commission's hidden asymmetric regulatory approach in the field of broadband infrastructure funding", (2009) *European State Aid Law Quarterly Journal* 463; C. Koenig and V. Bache, "The guidelines for the application of state aid rules in relation to the rapid deployment of broadband networks – remedy for a market failure?", (2012) *Journal of European Competition Law & Practice* 261.

(ii) Second, there are "black" areas where at least two broadband network providers are active and broadband services are provided competitively under facilities based competition. Any aid provided in black areas will not be compatible with the internal market and is therefore illegal.

(iii) Third, there are "grey" areas where a single provider of broadband may be present as a de facto monopoly but where certain areas may not be served adequately either in terms of coverage or of price and there are no less distortive measures available. Here a more detailed evaluation is necessary to determine whether state aid would be compatible. The Commission will assess:

- Whether market conditions are adequate;
- Whether in the absence of regulation adequate third party access is available;
- The existence of entry barriers;
- Whether competition and/or regulatory remedies have been tried.

It is worth noting therefore that the Commission is prepared to go one step further than promoting broadband network investment where this would otherwise not have occurred (white areas) to promoting such investment where private investment is in principle already taking place (grey areas).

To determine the proportionality of intervention the 2009 Broadband guidelines set out a number of conditions: the need for a detailed mapping and coverage analysis, for an open tender procedure selecting the most economically advantageous offer, technological neutrality, the use of existing infrastructure, mandating third-party wholesale access to subsidized infrastructure, the benchmarking of pricing and finally the existence of a claw-back mechanism to avoid overcompensation.

Moreover in such cases the network provider benefitting from aid must give open access to its network. By tying public investment in broadband networks to access conditions the Commission is promoting

services based competition that would otherwise not have occurred in equal measure to promoting roll-out itself. Services competition can form a stepping stone or a step up the investment ladder towards more infrastructure based forms of competition. Hence the industrial policy motive of public investment in broadband infrastructure is attenuated by the promotion of competition within the state aid framework. Yet like public financing for infrastructure imposing third party access obligations may also crowd out private investment in infrastructure.

Under the 2009 Guidelines the same type of assessment as I have just discussed for high speed broadband is made for NGA networks where white, black and grey areas are defined based on largely identical criteria. In order to limit the distortions of competition however the beneficiary should be required to provide third party wholesale access for a minimum of seven years. There is some measure of coordination of sectoral obligations via the NRAs. Finally the beneficiaries of public investment should offer full unbundling and offer all different types of network access, becoming a carrier's carrier enabling services competition as well as infrastructure competition. Here too this facilitates the intermediate mode known as the "ladder of investment" which allows services based positions to gradually transform into infrastructure based forms of competition.[62]

7.5. The 2013 Broadband Guidelines

In 2013 new Broadband Guidelines were issued, referring explicitly to Europe 2020 and the Digital Agenda.[63] These guidelines emphasize that alongside tackling market failure the pursuit of cohesion policy was justified, notably addressing the "digital divide". Most national broadband strategies aiming to achieve the Digital Agenda objectives relied in part on public funds:

> "The purpose of State aid control in the broadband sector is to ensure that State aid measures will result in a higher level, or a faster rate, of broadband coverage

62 Cf Cave, above n. 44; and n. *45.

63 Communication from the Commission, EU Guidelines for the application of State aid rules in relation to the rapid deployment of broadband networks (2013/C 25/01), OJ 2013 C25/1. Cf L. McCallum and O. Stehmann, "The New EU State Aid Broadband Guidelines: What changes for electronic communication network operators", (2013) *Journal of European Competition Law & Practice* 316; Kliemann and Stehmann, above n. 46.

> and penetration than would be the case without State aid, while supporting higher quality, more affordable services and pro-competitive investments. The positive effects of the aid should outweigh the distortions of competition."[64]

At the same time the guidelines stressed that the highest broadband coverage had been achieved in those Member States where there was infrastructure competition. There are some noteworthy differences with the 2009 Broadband guidelines. These regard in particular SGEI, the concept of market failure, third party wholesale access and the role of NRAs. Also the concept of next generation access (NGA) has been broadened to include wireless and mobile technologies, thereby raising the bar for public intervention.[65]

SGEI: the 2013 Broadband guidelines address in detail the concept of services of general economic interest (SGEI) and the *Altmark* test discussed in section VI above. Against this background it is important that services that are already provided satisfactorily by private parties in terms of price, quality, continuity and access cannot be subject to a SGEI designation.[66] Hence where there is a private broadband network in place that meets these conditions the state aid rules do not admit the creation of a publicly funded SGEI to duplicate the same.

Also because an SGEI mission is compulsory operators of an SGEI would not be able to refuse third party access in a discriminatory manner. This is remarkable because generally SGEI are typically based on the provision of universal services directly to end users. The approach adopted in the Broadband guidelines however implies that SGEI conditions should not be directed toward universal service at retail level as might have been expected but rather indicates wholesale obligations favouring competitors, and the competitive provision of services to end users. In fact the Commission states explicitly that an SGEI mission should aim to provide a passive, neutral and open infrastructure which would provide access seekers with all types of networks access and allowing effective

64 2013 Broadband Guidelines, above n. 63, para 6.

65 Kliemann and Stehmann, above n. 46, p. 500.

66 2013 Broadband Guidelines, above n. 63, para 19, with reference to para 48 of Commission Communication on the application of state aid rules to SGEI and para 13 of the Commission Communication on a framework for state aid in the form of public service compensation, both above n. 35.

competition at retail level. It is this competition that would then ensure the provision of competitive and affordable retail services. This appears to reflect an important development in the Commission's thinking about universal service and how it should be achieved:

> "Therefore the SGEI mission would only cover the deployment of a broadband network providing universal connectivity and the provision of the related wholesale access services, without including retail communication services."[67]

This is consistent with the principle of promoting services level competition instead of mandating retail level universal service provision, even though it means perpetuating regulation (or managed competition) originally designed for legacy networks into the era of fibre-optic NGA networks that are largely constructed ex nihilo (at least in physical terms) and not on the back of incumbency grounded in special and exclusive rights.

Market failure: here the Commission points towards the existence of positive externalities with relation to investment in NGAs of which the benefits cannot be wholly internalized by market parties. At the same time broadband networks can generally only profitably cover part of the population even though here again positive externalities would create a multiplier effect across sectors. For both reasons a market failure thus exists that could be remedied by means of state aid. In addition state aid may seek to remedy inequalities for equity reasons, which can equally justify compatibility.

Third party access and involvement of NRAs: in addition more detail is provided on the role of NRAs in designing pro-competitive state aid measures including providing local authorities with guidelines on third party's effective wholesale access. The latter, wholesale access to subsidized broadband infrastructure, should be aligned with that based on SMP under sectoral regulation. It is unclear whether this reflects the fact that the sector-specific framework does not yet reflect the pertinent relevant

[67] 2013 Broadband Guidelines, above n. 63, para 24. The 2010 Monti report had still proposed incorporating broadband access at end user level as part of universal service. M. Monti, A new strategy for the single market: At the service of Europe's economy and society. Report to the President of the European Commission, José Manuel Barroso, 9 May 2010.

markets (the current 2007 Recommendation on relevant markets[68] will be updated in 2014)? A period of at least 7 years is envisaged for such obligations, with prices based on benchmarking. NRAs are to be consulted on any aid granted and will have to monitor the development of the market.

Ultra high speed broadband: in addition to basic broadband and NGA aid to ultrafast networks will now be allowed even in black areas under exceptional circumstances. This is the case if a "step change" can be demonstrated when as the result of public intervention significant new investments will be made and the subsidised infrastructure bring significant new capabilities. The goal of reaching the Digital Agenda objectives is mentioned explicitly in this context:

> "In light of the Digital Agenda objectives, in particular achieving 50 % penetration to Internet connections above 100 Mbps, and taking into account that especially in urban areas there may be higher performance needs compared to what commercial investors are willing to offer in the near future, by way of derogation to paragraph 77, public intervention could exceptionally be allowed for NGA networks able to provide ultra-fast speeds well above 100 Mbps."[69]

In economic terms it is difficult to conceive of urban areas with urgent needs that can only be met by public intervention. In any event the EU level industrial policy context of this approach to ultra-fast speed networks, which seems to fit ill with the overall logic of black, white and grey areas, is made explicitly clear. It appears justified to conclude that the EU level setting of quantitative targets in an industrial policy context – even if these targets are necessarily arbitrary except as an order of magnitude in terms of aspirations – is thus affecting the actual application of state aid policy in this sensitive area. It has been suggested that in practice the threat of litigation may moderate the impact of the requirements set out above as the evaluation of their effect is controversial.[70] This is

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68 Commission Recommendation of 17 December 2007 on relevant product and service markets within the electronic communications sector susceptible to ex ante regulation in accordance with Directive 2002/21/EC of the European Parliament and of the Council on a common regulatory framework for electronic communications networks and services, OJ 2007, L344/65.

69 2013 Broadband guidelines, above n. 63, para 82. Para 77 states that in such areas aid for an additional network "is likely to seriously distort competition and is incompatible with the internal market under Article 107(3)(c) of the TFEU".

70 Kliemann and Stehmann, above n. 46, p. 515.

however a recipe for uncertainty that sits ill with the purpose of having Guidelines in the first place.

Having discussed the policy Guidelines on broadband we now move on to discuss come examples regarding the practical application of the state aid rules to the sector.

7.6. The broadband case law

At the time when I am writing this paper the Commission has published just over 120 formal state aid decisions regarding broadband.[71] The broadband schemes examined have generally been found to be compatible state aid under Article 107(3) TFEU or exempted as forming SGEI under Article 106(2) TFEU and consistent with the *Altmark* test. Effectively, so far only one scheme has been blocked as being incompatible, and only three have been subject to a second phase state aid investigation. That is to say virtually all notified schemes have been cleared in the first phase of state aid scrutiny.

Below I will provide an example of the main types of finding.

– *Pyrénées-Atlantiques* (2004):[72] this case involved a broadband network in a peripheral region of France that aimed both to bridge a regional digital divide and to promote competition with the incumbent. The model chosen was that of a public concession. The Commission tested the French measure against the *Altmark* criteria and found that it passed on all four counts. Hence there was no aid involved. One important aspect was the finding that a public service obligation set nationally constituting an SGEI could go beyond the universal services defined at EU level in particular because promoting access corresponded to EU objectives. Moreover the network provided would only be passive, leaving to competitive provision the actual delivery of services to the user (the SGEI-USO model as discussed above).

[71] http://ec.europa.eu/competition/sectors/telecommunications/broadband_decisions.pdf Cf. L. Papadias, A. Riedl and J. Westerhof, "Public funding for broadband networks – recent developments" (2006) *Competition Policy Newsletter* 15.

[72] Commission Decision of 16 November 2004 on the measure no. N 381/2004 – France, Projet de réseau de télécommunications haut débit des Pyrénées-Atlantiques.

– *Metropolitan area networks* (2006):[73] in this Irish case the Commission clarified that where market operators are prepared to invest in provision of infrastructure neither such investment nor providing infrastructure can be qualified as a typical task of a public authority. It also explained that the scope of the SGEI exception does not extend to measures aimed at providing city level wholesale infrastructure (optical fibre rings) but not including a mandate to enable broadband access to the general public by providing wholesale access to broadband services connecting all users who wish to be connected.[74] Nevertheless the aid concerned was found to be compatible with the internal market, inter alia as it was based on an open tender and because third party access was imposed.

– *Appingedam (2006):*[75] this case involved a peripheral region in The Netherlands where the municipality of Appingedam wished to invest in both the passive layers of a glass fibre network and in an active layer comprising services to households and businesses. The Commission found there was no market failure because broadband services were in fact already provided by two competing network operators. Prices were not higher than in the rest of the country and there was no evidence of a broadband gap or digital divide. Hence the Commission found there was state aid that could not be justified. This appears to be the only example of a state aid broadband case where it did so.

– *City of Amsterdam (2007):*[76] here the important market investor principle (MEIP) was applied to the case of the investment in a FTTH broadband access network by the city of Amsterdam

73 Commission Decision of 8 March 2006 on the measure no. N 284/2005 – Ireland, Regional broadband programme: Metropolitan area networks ("MANs"), phases II and III.

74 This appears to be at odds with the position in the Broadband guidelines that SGEI should precisely not provide services to end users directly but should promote competitive provision based on third party access.

75 Commission Decision of 19 July 2006 on the measure no. C35/2005 (ex N 59/2005) which the Netherlands are planning to implement concerning broadband infrastructure in Appingedam.

76 Commission Decision of 11 December 2007 on the state aid case C 53/2006 (ex N 262/2005, ex CP 127/2004) Investment by the city of Amsterdam in a fibre-to-the-home (FttH) network. Cf. N. Gaal, L. Papadias and A. Riedl, "Citynet Amsterdam: an application of the market economy investor principle in the electronic communications sector", (2008) *Competition Policy Newsletter* 82.

(2007). The MEIP was held to be respected in spite of the fact that the city's investments would predate those of the two commercial parties involved. Especially the fact that private shareholders took part and that the risks (regarding losses) were shared equally and no single shareholder could exercise sole control were held to be decisive. Because consequently no aid was involved these investments even in a so-called "black" area (already served by two competitive providers) was considered acceptable.

The notified broadband aid schemes have overwhelmingly been found to be compatible. It may be that the guidance provided by the Commission has been exceptionally clear –leading non-compatible schemes to be abandoned prior to notification or subsequently withdrawn. This is frequently the case with mergers where there are also few instances of formal blocking decisions; likewise there are relatively few findings of dominance abuse. It may also be that the Guidelines are simply at the same time unduly relaxed towards state investment and draconian in terms of asymmetric (access) regulation, thereby crating their own demand (because in this way private investment is doubly discouraged)– as some commentators have claimed.[77] For the purposes of this paper it is not necessary to decide which is which. Whatever is thought of the quality of the state aid policy of the EU it appears that in any event the compatibility between the state and broadband policy of the EU is clear and that the state aid rules provided a framework for as well as a certain measure of EU control over public investment at national level.

Before concluding we will briefly examine two Recommendations of respectively 2010 and 2013 regarding the conditions that NRAs may impose upon parties with SMP in NGA networks. This is relevant in the context of the relationship between the two broadband regimes – that imposed based on the state aid rules, and that of the sectoral regulation for electronic communications. The relevance of proper coordination is a common theme behind the Commission's efforts in this area, where it even states that if public funding is in short supply, a coherent framework should not be.[78]

[77] Cf. Koenig, above n. 61; Cave, above n. 44.

[78] Cf. above, n. 54.

7.7. The 2010 Recommendation on regulated access

This Recommendation is relevant to SMP positions in (i) the markets for wholesale network infrastructure access (such as unbundled network access) and (ii) the wholesale broadband access market (bit stream services).[79] These markets are predefined in the Commission's earlier Recommendation on relevant markets which set out the markets that NRAs must analyse for the purpose of deciding whether SMP regulation is necessary.[80]

The 2010 Recommendation provides that infrastructure access to civil engineering infrastructure in accordance with the principle of equivalence and to the terminating segment as well access to the fibre loop in the case of fibre to the home (FTTH) should be offered, to be included in the local loop unbundling offer. Fibre to the neighborhood (FTTN) access should likewise be offered. Prices should be cost-oriented and reflect the risk involved in the cost of capital. Existing wholesale access should continue and generally regulatory obligations should migrate from the existing network to the new fibre based infrastructure. Detailed pricing principles are set out in the annex.

We therefore see convergence between the conditions set for third party access in the state aid context (public investment in networks in grey areas predicated on the provision of such access) and in the framework of sectoral ex ante regulation.

7.8. The (draft) 2013 Recommendation on non-discrimination

This latest Recommendation (to date still a draft) is likewise relevant to the markets for wholesale network infrastructure access and to the wholesale broadband access market. It provides further guidance on cost orientation for wholesale access prices and details the non-discrimination obligation that is important for vertically integrated SMP operators. Worth noting is the condition that if the technical replicability

[79] Commission Recommendation on regulated access to Next Generation Access Networks (NGA) (2010/572/EU), OJ 2010, L251/35.

[80] Above n. 68.

of a new retail offer is not ensured the SMP operator must amend its wholesale input in a manner that guarantees technical replicability. This approach seems to reflect almost the opposite of the traditional *Bronner* (1998) criterion on access under the general competition rules – only if an equal volume of traffic handled by the competitor could still not justify duplication is mandatory access to the pre-existing network considered to be indispensable.[81] The Commission thus makes a liberal use of the specific setting to distinguish from general competition policy principles on access here. The question is for how long this approach can be legitimate now the special and exclusive rights once used as a justification were abolished twenty years ago and wholly new networks are involved.

Significantly however the 2013 Recommendation also includes the possibility of not imposing price controls on passive NGA wholesale inputs

> – if a legacy access network offered by the SMP operator which is subject to cost orientation can exercise a significant competitive constraint;
>
> – or if operators providing retail services over at least one alternative infrastructure not controlled by the SMP operator can exercise a significant competitive constraint.

These conditions essentially match those of the black, grey and white areas found in the State aid guidelines on broadband. They are consistent with an approach that seeks to protect infrastructural investment in the context of make or buy decisions. This suggests at least at a conceptual level the existence of consistency between the (vertical) sectoral regulation of broadband, and the sectoral application of the (horizontal) state aid rules within an overall balancing exercise between industrial policy goals and the requirements of competition policy.

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81 Case C-7/97 *Oscar Bronner GmbH & Co. KG v Mediaprint Zeitungs- und Zeitschriftenverlag GmbH & Co. KG, Mediaprint Zeitungsvertriebsgesellschaft mbH & Co. KG and Mediaprint Anzeigengesellschaft mbH & Co. KG* [1998] ECR I-779, paras 45-46. On symmetrical versus asymmetrical access regulation cf. Koenig and Fechtner, above n. 61.

8. Conclusions

Above I have gone into some detail on the broadband case study. Prior to that discussion I looked at the industrial and competition policy of the EU more broadly, but briefly. What did we learn from the case study in relation to the connection between industrial and competition policy? Here I refer back to the three more specific questions set in section IV.

(i) Is competition policy in the broadband case compatible with industrial policy?

(ii) Are these polices as they are interrelated both aimed at structural adjustment?

(iii) Is competition policy affected or compromised by industrial policy objectives?

In general terms I believe that in general and theoretical terms competition policy and industrial policy are still compatible at EU level and the scheme set out in the 1990 Communication on industrial policy that focuses on promoting structural adjustment, with competition policy as a prerequisite for success (via the internal market) still holds. The shock suffered –but survived– by economic liberals and competition policy advocates in the 1990s when an industrial policy title was introduced into the Treaty itself by Maastricht was mirrored when the instrument (which had never been an objective) of competition policy was symbolically but not legally downgraded from the body of the Treaty to a mere protocol in 2007 by Lisbon. In both cases the values derived from competition policy continue to set the scene in practice.

At the same time a more complex picture emerges when we look at the case study of broadband. The compatibility holds but it is questionable whether this is still about structural adjustment: rather it concerns a combination of innovation and infrastructural investment with industry guidance. Also the relationship with general competition policy is changed. Initially the approach to telecommunications was one of liberalization that appeared to be predicated upon a transition from national monopolies to competitive provision within the confines of general competition law. In the end however such a transition did not in fact occur. Instead we appear to be stuck with a self-perpetuating (or

at least open-ended) system of sector specific regulation, albeit based on, or closely related to, the general competition rules that are of parallel application. At the same time, via public investment in broadband, we see the state that had originally exited the public monopolies by taking them to market re-entering the scene by means of infrastructural investments in broadband.

There appear to be three reasons for this counterintuitive development:

(i) In the first place it is due to the liberalization paradox: introducing more market-based competition means not a decrease in public involvement but a shift with increased need for regulation (leading to the emergence of "managed competition"). Yet in principle the resulting sector-specific regime could still have been seen as a transitory phenomenon to be followed by a minimalist regime based on the horizontally applicable competition rules.

(ii) Second, we see that the sector-specific regulation perpetuates itself and spills over from regulation of legacy monopoly networks to new networks: mobile, to a lesser extent satellite and cable, and broadband. In the case of NGA networks constructed largely ex nihilo it comes as a surprise to see third party access and unbundling obligations being moved in place. The context is no longer liberalization but technological change. It appears that regulation is here to stay even if its justification has become more complex. Although not examined here, perhaps self-perpetuation of the regulatory network involved (BEREC and the NRAs) also plays a role?

(iii) Third, and more directly relevant to the research questions addressed here, the broadband example shows that the competition rules themselves, in this case regarding state aid, are co-opted in the process. Both efficiency (market failure) and equity (universal service) are acceptable as objectives under the state aid guidelines on broadband which are explicitly placed in the context of the Europe 2020 initiative and its Digital Agenda for Europe. This is illustrated most clearly by the policy on ultra high speed broadband where the principles underlying the Broadband

guidelines (public investment only in white and some gray areas) are significantly relaxed, arguably compromising state aid policy. We will now focus on this third aspect.

Public investment in broadband, although within boundaries set by specific guidelines, is overwhelmingly judged to be in conformity with the state aid rules by the Commission. All this is occurring in the context of rapid technological change and growing demand for broadband networks and services, which would not normally be considered an indication that public intervention is required. Moreover on the one hand public investment is allowed but on the other hand where it occurs an access regime is introduced, both under the state rules and the sectoral framework. This regime in large part determines the rate of return on these investments and the degree of competition to which private investors are exposed. Legal certainty of course is desirable – so therefore is the 2010 Regulated access Recommendation – but it is difficult to achieve where regulation seeks to reconcile contradictory tendencies. Thus in the 2009 and 2013 state aid Broadband guidelines we see a combination of seeking to promote efficiency and equity based policies: universal service and fighting the "digital divide". A few remarks here will have to suffice.

– Under the Broadband guidelines supplying public funding for NGA networks generally also means incurring the obligation to turn them into common carriers or utilities. SGEI is redefined as a second order obligation to provide access to third parties who will serve end users on competitive terms. Is this a desirable outcome? At the same time the ambition is to promote competing NGA networks. The effects of the entry of such common carriers on competition are still unclear but are likely to be negative as far as private investment is concerned.

– As the result of this EU policy, do we see more integration taking place or inter-state trade promoted? This is doubtful. So far networks and services are still organised along national lines even if more cross-border investment is taking place. How problematic therefore is the effect on trade as a justification for intervention while we see regulation being perpetuated across new generations of infrastructure?

> – Providing (indirectly) universal service may be required for an appeal to the SGEI exception under the state aid rules, but is universal service really an appropriate industrial policy objective? It would appear not to be so if industrial policy aims at structural adjustment. It is true that the Europe 2020 communication and the 2010 Digital Agenda list specific numbers of household connections as targets of industrial policy. However so far broadband access (as opposed to dial-up internet access) has not been defined as a part of universal service under the sector-specific Directives themselves.[82]

Hence there appear to be some tensions and inconsistencies between market making polices on broadband and the more traditional task of vetting public intervention under the state aid rules that raises questions about the relationship between ex ante sectoral regulation and the general competition rules, including state aid. But for present purposes –illustrating the relationship between EU competition and industrial policy– these do not have to be resolved here.

The content of EU industrial policy is not just determined by the balance between the market based policies on internal market and competition of the EU versus protectionist Member States seeking to create national champions. It is codetermined by the economic crisis – and European integration always derived its effectiveness from its success at generating economic rewards for closer cooperation. At the same time a strict monetary policy is adhered to – and the EU has always lacked the funds to conduct a pro-active industrial policy based on public spending. It will therefore let the Member States do the spending (including on broadband as we have seen) but will try to frame this spending in terms of EU law and legality under the competition rules. In the case of state aid this means providing both a carrot (approval and legal certainty, a framework for investment) and a stick (withdrawing investment guarantees, illegality, recoupment and fines).

This makes the balance between industrial versus competition policy in the EU context a precarious but a dynamic one. Hence I propose going one step further than saying they are fundamentally compatible in

[82] Directive 2002/22/EC (Universal Service Directive), above n. 41.

the context of structural adjustment, as I did in the original (1997) analysis. They are also compatible in the context of managed competition. I don't think this necessarily means a first step on a slippery slope as long as the Commission retains the consistency between the manner in which it interprets and applies the rules in the various sectors and in this way also retains an additional layer of control. The broadband guidelines (where the Commission is in the driving seat of the highly centralized state aid policy) and the sectoral recommendations (where the Commission has only limited formal coordination powers in a highly decentralised setting vis-à-vis the NRAs) are good examples of this.

The broadband example shows how the EU becomes deeply involved in sectoral regulation at national level –even where the effect on trade is notional– and is generally relatively permissive in terms of state intervention in an area where high profile industrial policy objectives of the EU are at issue. It goes beyond the scope of this paper to discuss the counterfactual: what would have happened if there had been no EU broadband policy? However my guess would be this would not have been likely to have led more market oriented competition (closer to the US model cited above) but either to more naked state intervention (closer to the East Asian model) or to a stronger position for the incumbent and quite possibly both. Managed competition is thus a half-way house between state and market.

In this paper the general competition rules on antitrust and mergers remain in the background. Likewise I have not been able to pay much attention to sector specific competition law – the rules on SMP applied by the NRAs coordinated by the Commission. We have seen however that an area that I had so far not examined in this context, that of state aid, is highly relevant. Hence I would suggest that one of the lessons on the relationship between EU competition and industrial policy is that the impact of the former is much broader –and therefore more capable of providing a nuanced response and consequently more complex– than previously realized. This means meeting a greater demand for consistency and guidance across the various strands of competition policy, or competition policies may well become the greater challenge than controlling the potentially anticompetitive demands of industrial policy per se.

Part VI

EU Competition policy and sectorial regulation

14

Enforcement patterns – public and private enforcement in regulated industries

MORTEN HVIID AND SEBASTIAN PEYER*

ABSTRACT

The debate about the role of competition regulation, and public and private competition law enforcement rarely extends to a detailed discussion of the enforcement architecture. This is despite many countries providing for three groups of enforcers: one or several sector regulators, a competition agency and various private enforcers. This paper reports on what can be learned about their interactions through a natural experiment arising from the German energy market where a sector regulator was introduced relatively late, 2005, and after considerable pressure from the European Commission. The paper contributes to the debate about the optimal enforcement of competition rules by illustrating how the enforcers, without apparent debate, have avoided overlaps in enforcement.

KEYWORDS: Competition Regulation, Public Enforcement, Private Enforcement, Competition Law, Sector Regulators, Competition Agency.

1. Introduction

The debate about the role of competition regulation, and public and private competition law enforcement rarely extends to a detailed discussion of the enforcement architecture. Studies of regulation look

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at the role of regulation, liberalisation and the transfer of power.[1] Other research has scrutinised the respective advantages and disadvantages of public and private competition law enforcement.[2] Yet, the current model in many countries provides for three groups of players or agents: one or several sector regulators, a competition agency and various private enforcers. All enforcement modes aim to (re)establish or maintain competition in markets. Ex-ante regulation, typically undertaken by a sector regulator, is used when markets fail because of monopolies or externalities. Ex-post public and private competition enforcement actions aim at deterring or remedying anticompetitive activities in otherwise functioning markets.[3]

In regulated markets all three enforcement modes are present. Given that those three groups of agents pursue arguably the same or similar objectives –to make markets work well for consumers– a justifiable concern is that three players to enforce one goal is a sub-optimal use of resources. Worse, the design of enforcement runs the risk that efforts are not merely duplicated but can lead to contradictory interventions and remedies. Critics of regulation also argue that private enforcement, i.e. actions in the courts initiated by consumers or firms, provide an adequate safeguard against market failure.[4] In the absence of empirical evidence about the interaction between regulator, competition agency and private enforcers it is impossible to either confirm or refute these arguments.

In this article we will look at the enforcement patterns and relationships between regulator, competition agency and private enforcers

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1 William Roberts Clark, 'Agents and Structures: Two views of Preference, Two Views of Institutions' International Studies Quarterly (1998) 42, 245-270; David Coen, Adrienne Héritier and Dominik Böllhoff, 'Regulating the Utilities: Business and Regulator Perspectives in the UK and Germany' (Working paper, Anglo-German Foundation for the Study of Industrial Society, October 2002); Edward L Glaeser and Andrei Shleifer, 'The Rise of the Regulatory State' (2003) 41(2) Journal of Economic Literature 401-425.Andrei Shleifer, 'Understanding Regulation' (2005) 11(3) European Financial Management' 439-451.

2 Steven Shavell, 'The Optimal Structure of Law Enforcement' (1993) 36 Journal of Law & Economics 255–287; Steven Shavell, 'The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System' (1997) 26 Journal of Legal Studies 575–612; A. Mitchell Polinsky, 'Private Versus Public Enforcement of Fines' (1980) 9 Journal of Legal Studies 105–127; Ilya Segal and Michael Whinston, 'Public vs Private Enforcement of Antitrust Law: A Survey' (2007) 28 European Competition Law Review 306–315.

3 Injunctive relief, a private remedy, may be used as an ex-ante enforcement mechanism.

4 For a discussion see Shleifer (fn 1) 440-441.

in regulated markets in Germany. The Federal Network Agency regulates telecommunication, railway, postal and energy markets. The Federal Cartel Office is the competition watchdog. We assume that private litigation is the third enforcer of competition rules although in reality private enforcement refers to multiple litigation brought by numerous claimants. The fact that consumers and firms bring competition law cases to defend their individual rights provides a unifying motif and justifies to regard private enforcement as one player rather than hundreds and thousands.

Our data comprises of public and private enforcement and regulatory activity in postal, telecom, gas and electricity markets from 1998 (public enforcement) or 2004 (private enforcement) to 2009. We will use a dataset containing information about private litigation in Germany combined with data based on the press releases and annual reports of the Federal Network Agency (FNA) and the Federal Cartel Office (FCO). We have chosen regulated markets in Germany because gas and electricity regulation was introduced in 2005 several years after these markets had been liberalised. The late switch to regulation allows us to observe changes in the activity of the other two agents, the competition authority private enforcement, presumably being caused by the appearance of a third player.[5] The data also allow a comparison between matured regulated markets, such as post and telecoms, and the newly regulated energy markets. In addition, private parties have actively enforced the competition rules for some time, providing data for our analysis.

With the help of this dataset we will show that an increase in regulatory and competition agency enforcement activity does not reduce the number of private enforcement actions. We will also argue that there is little overlap in the type of actions that are initiated regardless of the activity levels of both public and private enforcers. To prove this point we analyse the remedies that are being used across industries by the three agents. Our paper shows that rather than duplicating enforcement, the regulator, competition authority and private enforcers divide the labour of making markets work well.

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5 The idiosyncrasy of German energy regulation is discussed in Gert Brunekreeft, 'Regulatory Threat in Vertically Related Markets: The Case of German Electricity' (2004) 17 European Journal of Law and Economics 285–305; Gert Brunekreeft, 'Regulation and Third-party Discrimination in the German Electricity Supply Industry' (2002) 13 European Journal of Law and Economics 203-220.

In the next section of this paper we are going to outline the enforcement architecture in regulated markets in Germany. Section three describes the enforcement dataset and section four analyses the data in detail. Section five concludes.

2. The german enforcement architecture in regulated markets

As of 2009, the final year of our data, the German competition enforcement architecture in the gas, electricity, postal and telecom markets consisted of three different forces: the Federal Network Agency (FNA), the Federal Cartel Office (FCO) and private enforcers, i.e. individuals pursuing court actions to enforce competition law. We will refer to these enforcers as enforcement agents. In this section we will briefly explain their respective functions.

The Federal Cartel Office (FCO) enforces the provisions of the Act Against Restraints of Competition (ARC), the German competition act.[6] The ARC regulates mergers, prohibits anticompetitive agreements between firms and bans the abuse of a dominant market position. The Federal Network Agency (FCA) oversees postal, telecommunication, gas, electricity and railway markets enforcing sector specific legislation.[7] The predecessor of the FNA regulated telecommunication and postal services until 2005 when it gained oversight in the gas and electricity markets and became the FNA.[8] The FNA and the FCO closely coordinate their activities. The regulation of a particular sector does not exclude ex-post oversight by the FCO, especially with respect to an abuse of a dominant position. Some decisions by the regulator require at least consultation with the FCO whereas still others require FCO approval. The FNA focuses on the regulation of formerly monopolistic network industries and the network related problems but the regulator is also able to investigate allegations of an abuse of dominance. The FCO monitors the parts of the distribution chain which are open to competition and are not network-bound. Hence, the competition authority cannot control grid access if

6 The federal states have also competition authorities that enforce small-scale cases.

7 Namely the Telecommunications Act, Postal Services Act, Energy Economy Act and Railway Act.

8 Railway regulation was added in 2006.

sector-specific legislation applies but is still able to open investigations based on the general prohibition of anticompetitive unilateral conduct, for instance, looking into allegations of excessive prices in consumer markets.

Private enforcement refers to activities of firms and consumers seeking legal remedies against alleged violations of EU or German competition law in the courts. We regard private enforcement as one enforcement agents despite the fact that private enforcement is the result of various private actions being brought by different individuals. Private enforcement in Germany has long played its part in the enforcement of the competition rules.[9] Since 2004 most private legal remedies are directly provided for in the ARC. Claimants can file for a permanent or temporary injunction, have contracts declared void, seek damages or ask the court to reverse a monetary transfer that was based on a void anticompetitive agreement (unjust enrichment).[10]

The German framework of competition enforcement in regulated sectors is characterised by a parallel application of regulatory tools, FCO actions and private enforcement. For postal and telecommunication markets, the parallel enforcement began as early as 1998 when the regulator for these industries was created. In the liberalised gas and electricity markets regulation begun in 2005 changing the dual FCO and private enforcement regime.

3. Regulatory developments in the sectors covered

In this article we focus on four markets: telecommunication, postal services, gas and electricity. We have excluded the railway industry because this market was liberalised in 2006 and does not provide a sufficient number of data points. The four sectors of interest

9 Sebastian Peyer, 'Private Antitrust Litigation in Germany from 2005 to 2007: Empirical Evidence' (2012) 8 Journal of Competition Law and Economics 331–359.

10 For German antitrust remedies in general see, for instance, Hans P Logemann, *Der kartellrechtliche Schadensersatz: Die zivilrechtliche Haftung bei Verstößen gegen das deutsche und europäische Kartellrecht nach Ergehen der VO (EG) Nr. 1/2003 und der 7. GWB-Novelle* (Duncker & Humblot, Berlin 2009); Jörg Fritzsche, *Unterlassungsanspruch und Unterlassungsklage* (Springer, Berlin 2007).

were liberalised in 1998.[11] However, regulation of telecoms[12] and postal services[13] differed from regulation of gas and electricity. The Regulatory Authority for Postal Services and Telecommunication, the predecessor of the FNA, became the regulator for these two markets.

The current structure of the energy regulatory regime can be retraced in three different stages: the market prior to liberalisation until 1998, the period of liberalisation between 1998 and 2005, and the beginning of the regulatory era in 2005.[14] Prior to 1998, there was little scope of competition law enforcement actions in gas and electricity markets. Exclusive agreements between market participants were excluded from competition scrutiny. The system of demarcation and concessions led to almost perfect market foreclosure, limited choice for consumers and left little scope for public or private enforcement.[15] The European Commission's Electricity Directive 96/92/EC, which was soon followed by the Gas Directive 98/30/EC, triggered the liberalisation of the German energy markets in 1998.[16] Germany abandoned its system of exclusive local and regional supply areas but did not install a regulator for energy. It was thought that the FCO and private parties would be able to control the exercise of market power and agreements in the sector with the help of the ARC.[17] The negotiated third-party access to networks and the

11 Markets for postal services were opened up to competition, with some exceptions for low value postage and letters.

12 Commission Directive 96/19/EC of 13 March 1996 amending Directive 90/388/EEC with regard to the implementation of full competition in telecommunications markets [1996] OJ L074/13; Directive 98/10/EC of the European Parliament and of the Council of 26 February 1998 on the application of open network provision (ONP) to voice telephony and on universal service for telecommunications in a competitive environment [1998] OJ L101/24, Directive 97/33/EC of the European Parliament and of the Council of 30 June 1997 on interconnection in Telecommunications with regard to ensuring universal service and interoperability through application of the principles of Open Network Provision (ONP) [1997] OJ L199/32.

13 German Postal Act of 19 December 1997.

14 Markus M Müller, 'Consolidating the New Regulatory State in Germany? The New Energy Regime of 2005, German Politics' (2006) 15 German Politics 269–283.

15 Bundeskartellamt, 'Marktöffnung und Gewährleistung von Wettbewerb in der leitungsgebundenen Energiewirtschaft, Diskussionspapier für die Sitzung des Arbeitskreises Kartellrecht am 07. Oktober 2002' (2002) http://www.bundeskartellamt.de/wDeutsch/download/pdf/AKK_02.pdf

16 Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996 concerning common rules for the internal market in electricity [1997] OJ L027/20; Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal market in natural gas [1998] OJ L204/1.

17 Martin Lodge, 'Competing Approaches to Regulation' in: Eliassen, Kjell A. and Sjøvaag, Marit (eds.), *European Telecommunications Liberalisation* (Routledge, London, 1999).

ex-post control of terms and conditions left plenty of room for disputes, overwhelmed the FCO[18] and assigned the courts with, for example, the task of price setting.[19] Regulation 1228/2003 and Directives 2003/54/EC and 2003/55/EC triggered the final alteration of the regulatory system.[20] Germany eventually adopted a regulatory approach for grid access and network charges. The FNA became the regulator for post, telecoms, gas and electricity.[21]

The extension of the regulatory remit of the existing network regulator rather than the creation of a new separate regulator is helpful for the purpose of this case study. In the words of the former President of the FNA, Matthias Kurth:

> "Integrating the different sectors has already proved a great advantage in our regulatory work and has made it possible to hit the ground running as concerns energy and rail regulation. We have been able to use numerous synergies, and at the same time we have found the questions to be the same."[22]

Were this not the case, we would expect there to be a considerable transition phase. With the chosen arrangements, this transition phase was clearly minimal.

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18 Bundeskartellamt, 'Marktöffnung und Gewährleistung von Wettbewerb in der leitungsgebundenen Energiewirtschaft, Diskussionspapier für die Sitzung des Arbeitskreises Kartellrecht am 07. Oktober 2002' (2002) http://www.bundeskartellamt.de/wDeutsch/download/pdf/AKK_02.pdf p.29.

19 Monopolkommission, '„Wettbewerbspolitik im Schatten ‚Nationaler Champions'", Fünfzehntes Hauptgutachten der Monopolkommission 2002/2003' (Bonn 2004) p.183.

20 Regulation (EC) No 1228/2003 of the European Parliament and of the Council of 26 June 2003 on conditions for access to the network for cross-border exchanges in electricity [2003] OJ L176/1; Directive 2003/54/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in electricity and repealing Directive 96/92/EC [2003] OJ L176/37; Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC [2003] OJ L176/1.

21 We ignore the regulatory and competition enforcement agencies of the 16 German states. They investigate cases in close cooperation with the federal agencies and pick up on infringements that are restricted to one state. Of the 16 federal states nine have set up their own regulatory authority which is often a branch of the state's economics ministry. As a general rule, states regulate energy firms that do not have more than 100,000 direct or indirect customers and that do not possess inter-state networks according to Section 54 of the Energy Act (2005). The enforcement of the ARC is similarly divided between the Federal Cartel Office and state agencies. In contrast to regulated industries, all states monitor and enforce the GWB with the help of state authorities. A case falls within the jurisdiction of a state competition authority if the conduct in question does not have an effect on a market beyond the boundaries of the state.

22 Press release regarding the annual report for 2006 from the Bundesnetzagentur, 27th February 2007, http://www.bundesnetzagentur.de/SharedDocs/Pressemitteilungen/EN/2007/070227AnnualReport2006.html

4. Data description

We use a dataset consisting of regulatory, public and private enforcement cases to describe the relationship between the three enforcement modes. In this section we outline the nature, origin and limitations of the data.

The regulatory decisions stem from the FNA's online database reporting all proceedings.[23] Start and end dates, remedies and industry were coded. We excluded proceedings that dealt with investment budgets (81 cases), determined the equity yield rate (7 cases), and set income caps (356 cases). Since our analysis is concerned with the relationship between regulator, public and private enforcement, we focus on activities that may potentially lead to an overlap of enforcement and/or regulatory actions. Private enforcers or the FCO cannot ask for an income cap to be set or enquire about investment budgets. The sample of regulatory activity from 1998 through 2009 contains 1031 proceedings. For the majority of these proceedings we know the start and end date or, at least, the start year. The dataset contains information about the origin of the regulatory investigation, i.e. whether or not it was based on a complaint or the regulator investigated the case ex officio. We are able to separate proceedings according to the industry in which they were brought. Finally, the sample contains data about the remedy the regulator considered or imposed for roughly a third of the regulatory cases in the observation period (306 cases).

The FCO's activity was measured in the number of proceedings that were brought per year from 1998 to 2009.[24] The data stem from the FCO's biannual reports, its decision database and press releases.[25] Earlier biannual reports of the FCO offer summary statistics of proceedings that do not allow conclusions as to the sector in which these proceedings took place. We therefore relied on press releases and published decisions to identify investigations. All proceedings are included regardless of their

[23] The decision database is available at http://beschlussdatenbank.bundesnetzagentur.de

[24] A number of investigations in the gas sector began at the end of 2009 and the beginning of 2010. Our sample somewhat artificially separates these proceedings. Only those that started in 2009 became part of the sample.

[25] All documents are electronically available at www.bundeskartellamt.de

outcome. The majority of public cases are settled or dropped because the authorities accept undertakings offered by the firms or do not find sufficient evidence to support an infringement decision. This affects the reporting of investigations. Proceedings that ended with a formal decision are better reported than those that settled. We report the remedies that were considered or imposed, start and end dates of proceedings, and the industries in which the investigations took place. The exact start and end dates are known for some but not all proceedings. To avoid a false sense of precision, the start year for each investigation is used. The year can be derived from the investigation's record number. Our dataset relies on reported investigations and decision in regulated industries. It does not provide an overview about the full extent of the FCO's activity in other sectors and when the authority uses more informal methods in order to achieve compliance with the competition rules.

Finally, our dataset comprises of private competition cases initiated in regulated industries in Germany between 2004 and 2009.[26] The dataset does not contain private enforcement data from 1998 until 2002, skewing the analysis of enforcement activity. The quality of pre-2004 data did not allow its inclusion into the dataset. Prior to 2004 the case reporting is unreliable. However, the level of private enforcement activity in 2004 suggests that private litigation must have existed prior to 2003 and 2004. Empirical studies of private antitrust enforcement in the United States and the United Kingdom show that the number of private antitrust cases tends to grow slowly.[27] Therefore, it appears unlikely that no private litigation existed in regulated sectors prior to 2003 and 2004 and then jump-started in the eve of energy regulation with almost 50 reported cases as we will show below.

The initial data are based on disputes which were notified to the FCO and have subsequently been refined using legal search engines.[28] The dataset consists of most cases that were initiated between 2004 and

[26] While there are private cases initiated before 2004, the quality of that data is of such a nature that we cannot make reliable inferences.

[27] Barry J Rodger, 'UK Competition Law and Private Litigation' in Barry J Rodger (ed), *Ten Years of UK Competition Law Reform* (Dundee University Press, Dundee 2010) 53; Richard A Posner, 'A Statistical Study of Antitrust Enforcement' (1970) 13 Journal of Law & Economics 365–420.

[28] Courts are under a duty to report private competition cases to the Federal Cartel Office, pursuant to section 90(1) of the ARC.

2009. It also includes some proceedings from 2003. The dataset is likely to underreport two types of cases: proceedings brought by consumers against energy firms or *vice versa* and cases of a particularly active, multiple-case litigant (MCL). Due to a change of the data administration at the FCO some of these proceedings are missing. Our sample contains cases from four regulated industries: postal services, telecommunication, gas and electricity. Railway and water cases were excluded. We also removed disputes from the sample that have no relation to regulatory issues like, for instance, disputes about joint ventures or franchise issues in the telecommunication sector. Competition issues in regulated sectors can broadly be defined as problems of network access, network charges, contractual types of market foreclosure and, more generally, the abuse of market power with respect to prices, terms and conditions.

The sample of private competition cases is based on decided cases and legal disputes that involved the courts. It is not a representative sample of all disputes.[29] A sample based on court decisions or court proceedings is likely to underreport legal issues that settled pre-trial. While the sample reports all investigations of the FNA and most cases investigated by the FCO, private cases may be underreported. In the absence of better data, we use litigated proceedings as a proxy for private enforcement activity in regulated markets. The sample of private cases may also be incomplete as it suffered from reporting backlogs and bottlenecks.

Our dataset contains information about the remedies in the respective proceedings. The private remedies are based on the primarily sought legal relief. Claimants may ask for more than one remedy, for example, requesting the defendant to stop the anticompetitive conduct (injunction) and, subsequently, ask the defendant to pay for the loss suffered until the illegal conduct ceased. Whether or not a remedy was qualified as primary or secondary depends on the use in the claim form or court decision. We do not differentiate between interim and permanent remedies. Cases with unknown remedies are excluded from the analysis. We will make reference to so-called sword and shield cases in our assessment of remedies in private antitrust litigation. Sword cases are commonly understood as disputes in which the competition law violation is brought

[29] George L. Priest; Benjamin Klein, 'The Selection of Disputes for Litigation' (1984) 13 Journal of Legal Studies 1-55.

by the claimant. In a shield case the defendant invokes a violation of competition law as a defence against the claimant's legal action.[30]

5. Enforcement patterns

With the extension of the powers of a regulator to two additional sectors, one might intuitively expect the following effects on enforcement: The regulator is likely to increase its enforcement activity in the newly added sectors and, depending on how many additional resources the regulator was provided with, compensates for the increased activity in the new sector with a reduction of activities in the sectors already covered by the regulator. Because the regulator is likely to pick up new enforcement activity, one would normally expect to observe a reduction in enforcement elsewhere. Whether this means that the FCO or private enforcers bring few cases depends on the nature of the regulator's activity and is one of the issues we will investigate below. If we do not observe a reduction of energy related cases among the other enforcers, this could be due to a duplication of efforts, especially if we do not observe a reduction of FCO activity, in which case resources are clearly wasted. Alternatively, it may be that the enforcement activity of the regulator improves the understanding of the competition provisions among private enforcers, inducing the latter to bring more legal proceedings on the basis of that provision. We would also expect to see an increase of non-FCA enforcement of telecoms and post to compensate for any reduction in FCA activity in those sectors. More generally, we would like to explore how enforcement activities are divided across the three enforcers.

5.1. Frequency of enforcement actions in regulated industries

Our dataset contains a total of 1672 cases that were initiated between 1997 and 2009. The regulator initiated most proceedings in our dataset (1031) compared to 154 reported investigations of the FCO and 487 private cases in regulated sectors. These numbers do not serve as an

[30] In a typical shield case the defendant retains some of the network access charges or a fraction of the price for energy due to issues over the reasonableness of a tariff or unilateral price increase. The defendant is sued by the network operator or energy provider for payment and, in turn, claims that the contract or tariff violates competition law.

indicator for performance as the FCO and private enforcers are active in other industries as well. The regulator exclusively focuses on regulated sectors so we are likely to have included most if its activity.[31] **Table 1** shows how these cases are distributed across sectors. Note that energy regulation began in 2005 so that all earlier energy cases were either brought by private parties or the FCO.

Table 1. Frequency of cases in regulated sectors

StartYer	Telco	Post	Gas	Elec	Total
1997	3	0	0	0	3
1998	10	0	0	0	10
1999	69	2	0	9	80
2000	46	30	2	0	78
2001	71	4	0	27	102
2002	66	2	1	13	82
2003	129	4	3	10	146
2004	129	7	23	26	185
2005	37	56	26	86	205
2006	39	6	32	164	241
2007	38	3	68	78	187
2008	48	1	93	79	221
2009	37	3	27	65	132
Total	722	118	275	557	1672

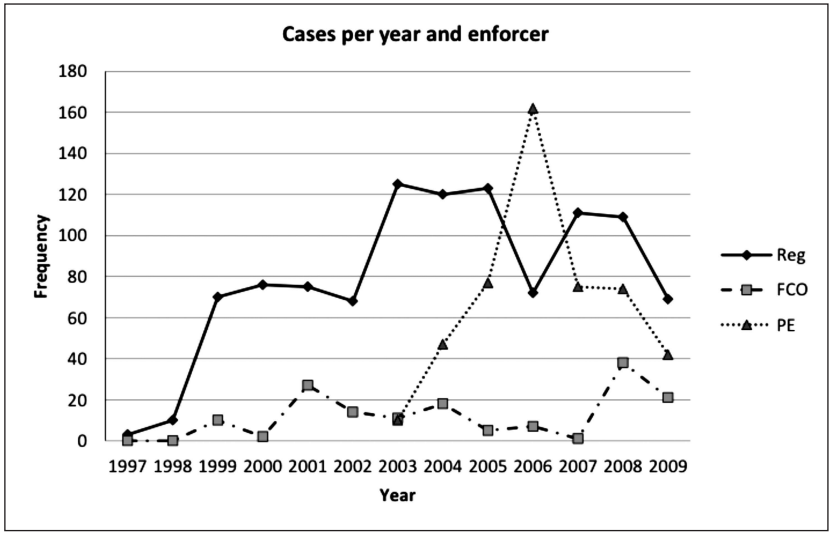
Two points emerge from this table. Firstly, two sectors account for the majority of investigations: electricity and telecoms. Secondly, the number of cases varies greatly across time and sector. Telecommunication investigations spike in 2003 and 2004. In the postal sector almost three-quarters of cases were initiated in the years 2000 and 2005. We observe more gas cases in 2007 and 2008 and electricity proceedings reached a peak in 2005 and 2006.

To understand how these cases are distributed, we have sorted our data points according to the enforcement mode that was used. The result is shown in **Figure 1**. It presents the overall number of cases for each type

[31] We excluded a number of cases. For details see previous section.

of enforcement per year. The figure demonstrates the importance of all three forms of enforcement with the specialist sector regulator and private actors shouldering the heaviest burden in terms of case numbers. In 2006 private enforcement even exceeds the number of comparable regulatory interventions.

Figure 1. Frequency of cases per enforcer and year



The data in Figure 1 also point to one anomalous year, 2006 where the number of private cases spiked and the number of regulatory interventions momentarily collapsed. Investigating this further, it emerges that the spike is caused by a single firm engaging in multiple litigations, the only such case in the data. We will refer to this firm as MCL (Multiple-Case Litigant) in the following. At the same time, the FNA brought fewer investigations. The drop in FNA enforcement activity may in part be due to new energy regulation coming into force in July 2005, but this will be explored further below. It is also important to remember that we are only focusing on a part of the activity of the FNA. The FNA may have diverted substantial resources to prepare the 2007 revision of the 2002 price-caps in the energy markets.

5.2. The special case of a multiple-case litigant

On closer inspection of private enforcement levels, it emerges that 131 of the electricity cases are brought by the MCL. Of these, 106 stem from 2006, thereby explaining most of the peak in **Figure 1.** The first MCL cases in our dataset are from 2003 but the vast majority, 125 of the 131 cases, are from the period 2005-2007. The MCL successfully established a precedent in 2005. We assume that the decision paved the way for further legal proceedings.[32] The court ruled that electricity network charges set by the network operating company must be specified with reasonably exercised discretion, thus, opening the gate for the judicial control of access fees. The fact that the highest court confirmed the possibility of controlling network charges in another ruling in early 2006 may also have encouraged legal proceedings against grid owners.[33] We can only speculate on why cases did not simply settle after these rulings had been handed down.

The typical MCL case alleges 'unreasonable discretion' on part of the network operating company when setting grid access charges. Network tariffs are usually unilaterally set by the network operator, but the precedents established by the Court of Justice allow for an ex-post control of those charges. In the MCL cases, the claimant normally asks for a repayment of overpaid fees implicitly claiming that the contract, or the clause stipulating the network fee, is void due to unreasonable exercise of discretion. As we shall see below, in most of these respects, the MCL cases are generally very similar to each other, although they may differ on some points of law, but they are qualitatively different from the other cases in the electricity sector. In the remainder of the section we will aggregate the MCL cases and count them as one case in order not to exaggerate the use of this particular remedy.

5.3. Division of labour among enforcers

Without the MCL cases, the distribution of private enforcement activity is much more evenly distributed over time. Even with the adjustment, we still observe a considerable number of private proceedings

[32] Bundesgerichtshof of 18 October 2005, KZR 36/04 *Stromnetznutzungsentgelt I.*

[33] Bundesgerichtshof of 07 February 2006, KZR 8/05 *Stromnetznutzungsentgelt II.*

running parallel to FNA and FCO activity in regulated industries. **Figure 1** shows that the level of FCO enforcement and private enforcement does not decrease as we would have expected with the introduction of regulation. There may be two reasons for this, either that the different enforcers concentrate on particular sectors or that they pursue particular problems as exemplified by the pursuit of different remedies.

To further our understanding we first separate the enforcement activities according year and industry. The results are presented in **Table 2**.

Table 2. Frequency of cases across enforcer and industry

Frequency of cases per enforcer and industry

	Reg				FCO				PE			
StartYear	**Telco**	**Post**	**Gas**	**Elec**	**Telco**	**Post**	**Gas**	**Elec**	**Telco**	**Post**	**Gas**	**Elec**
1997	3											
1998	10											
1999	68	2			1			9				
2000	46	30					2	0				
2001	71	4						27				
2002	66	2					1	13				
2003	122	3			1	1	2	7	6		1	2
2004	115	5				1	17		14	1	6	23
2005	26	50	8	39			3	2	11	6	15	33
2006	32	3	9	28			6	1	7	3	17	30
2007	28	2	23	58	1				9	1	45	12
2008	43	1	17	48	1		37		4		39	29
2009	28	3	8	30	3		6	12	6		13	23

Table 2 reveals a number of interesting points. Firstly, the FNA began to investigate competition issues in the gas and electricity markets immediately after it was given the power to do so. In doing so, it took away some but not all of the case load from the FCO. Half of the FCO cases in the gas sector occurred after 2004 as did a quarter of the energy

sector cases. The regulator has hence not made the powers of the FCO obsolete in these two areas. Note that this contrasts markedly with the two other sectors, telecoms and post, where there is hardly any FCO engagement. Equally surprising, the number of private cases related to gas and electricity markets did not go down. It stayed well above the steady trickle of private telecommunication proceedings. Issues in the postal markets appear to be almost exclusively FNA matter.

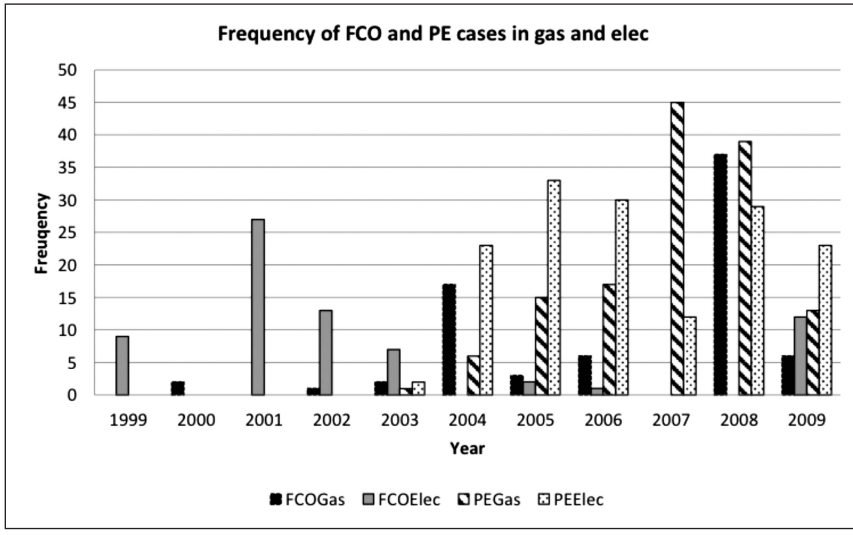
A second insight from Table 2 is that even in a sector such as telecoms with an established regulator, there are cases across the whole period, i.e. the number of cases did not go down over time. From that observation alone, it is clear that the regulator cannot completely supplant private action. Thirdly, the data go against our hypothesis that the number of cases should fall with the introduction of the regulator. In 2004, the year before the FNA began to investigate energy markets, private cases were already brought in gas and electricity sectors. In subsequent years both industries show an *increase* in the number of private cases. This gives a first indication that introducing a regulator far from stifled or reduced private enforcement by offering a cheaper alternative.

If it is the case that the regulator did not relieve firms and consumers from the burden of law enforcement, a comparison of private litigation with the activity of the FCO in gas and electricity shows another interesting pattern in **Figure 2**. Using the data from Table 2 we compare FCO and private enforcement activity.[34] What emerges from the data is that prior to regulation in electricity and gas, the investigations focused primarily on electricity. With the introduction of energy regulation the number of opened electricity proceedings dropped to almost zero. A year before the FNA took over regulation of gas and electricity, the FCO scrutinised a number of firms in the gas market. While we would expect fewer gas proceedings, they peaked again in 2008 well after the regulator had been installed. It is true that the nature of proceedings differs depending on whether they were brought by the regulator or by the Federal Cartel Office. The regulator only scrutinises the network level whereas the competition watchdog monitors the use of market power in retail markets and markets generally open to competition. One possible explanation for the peak of gas investigations in 2008 is the introduction

[34] No cases in gas and electricity markets were reported for 1997 and 1998.

of section 29 into the ARC in 2007. Section 29 ARC is a special provision to better control the abuse of market power in gas and electricity and, especially, prices in the energy sector.

Figure 2. Frequency of FCO and PE cases in gas and electricity

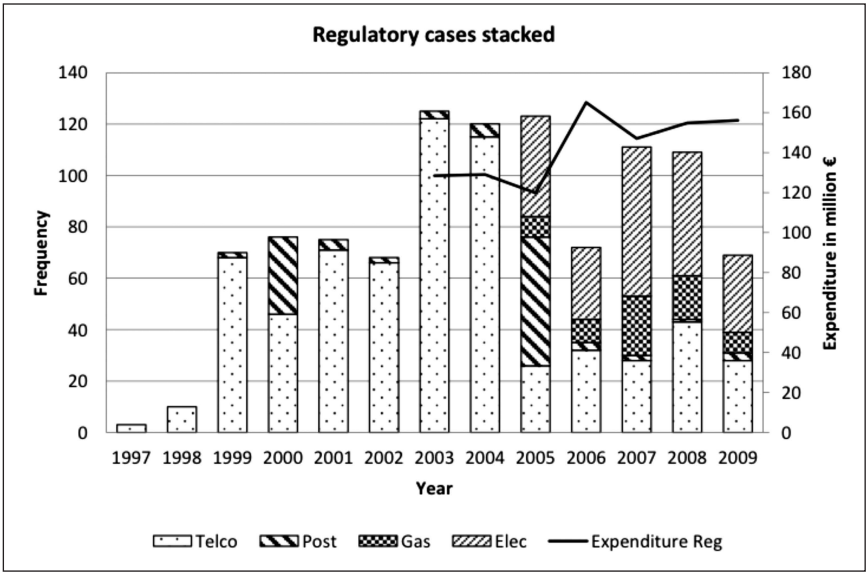


Similarly to private enforcement, the competition authority does not cease its activities in regulated sectors. What is even more interesting is that the number of private actions does not drop as the competition law enforcer becomes more active but increases with a lag of three and four years for gas and electricity respectively. The activity of the BKartA and the test cases it run before the courts against some firms may have sent a signal to private parties that they are being overcharged. Table 2 and Figure 2 illustrate that FCO and private enforcers do not reduce their enforcement activities as much as one would expect given that an expert regulator has begun to oversee gas and electricity markets.

The number of regulatory telecommunication cases dropped considerably in 2005 (see Table 2). While it was expected that the FNA would investigate energy markets, given its new role, the reduced number of telecommunication actions appears to be odd. **Figure 3** demonstrates in which sectors the FNA investigated cases. The regulator increases its

activity and, at the same time, reduced the number of telecommunication proceedings. No market events are reported that would suggest that competition in telecommunication markets had improved in 2005 that it would have justified to reduce the number of investigations. On the contrary, the overall number of FNA proceedings remained fairly constant

Figure 3. Regulatory activity per year and expenditure



from 2003 to 2005. **Figure 3** shows that the regulator decreased the number of investigations in the telecommunications sector after it had been given the task of energy regulation. We suspect that the FNA lacked the resources to maintain the level of telecommunication investigations from previous years when it had to commit staff to energy regulation in 2005 in particular with the price-cap review due in 2007. The FNA's expenditure from 2003 to 2009, which we use as a budget proxy, did not increase in the years prior to 2005 or in 2005.[35] In 2006 the FNA's spending increases, maybe an indicator for a rising workload and restructuring. The slump of cases in 2006 may also support the hypothesis that the

[35] Source: http://bund.offenerhaushalt.de/0910.html

FNA's resources were bound by restructuring. If our assumptions holds true and the FNA had to regulate energy markets with hundreds of firms without a major increase of its budget, the shifting of resources from existing to new tasks seems logic. Our descriptive analysis suggests that the FNA moved part of its resources away from telecommunications towards energy. Whether or not the restructuring of the agency distracted energy and resources from its core task is hard to say on the basis of the data available.

5.4. The remedies

The activities of the three enforcers overlap in most sectors and years as we have shown above. But even if private proceedings and public investigations are brought at the same time, enforcement efforts are less likely to be duplicated as long as FCO, FNA and private enforcers seek different remedies. If, for example, the FCO requires firms to discontinue anticompetitive pricing practices while private parties seek compensation for past losses caused by that anticompetitive practice, the two enforcement actions do not overlap but rather complement each other. We investigate the relationship between FCO, FNA and private enforcement in regulated sectors more closely by identifying the remedies that were used. In this context, remedies refer to the broad aim of the respective legal action such as compensation or change of contract terms. We report the remedies that private claimants, FCO and FNA considered or sought but do not describe their respective outcome. The data do not allow conclusions as to the rate of success of those remedies. The remedies are described regardless of their nature as either interim or permanent remedies.

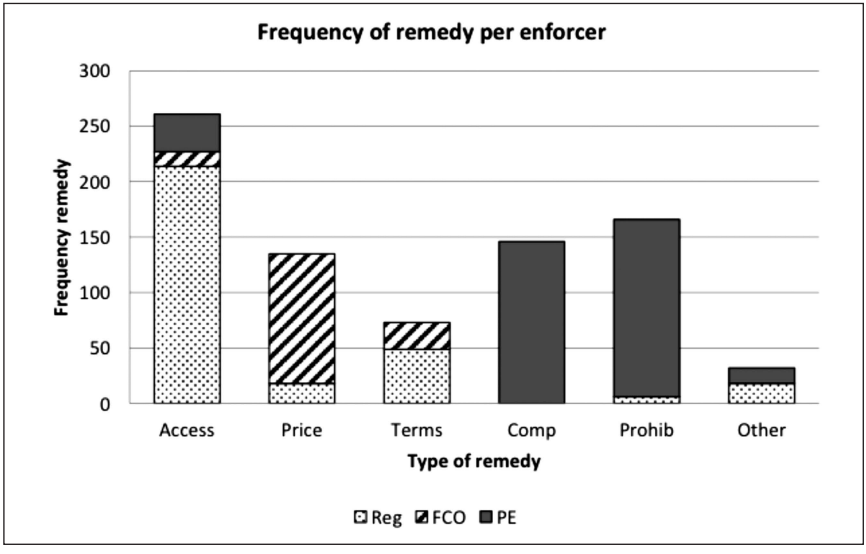
The remedies are known for 813 proceedings of the 1541 data points.[36] For many FNA cases the remedies could not be clearly determined and those proceedings were left out of the remedy analysis. We divided the known remedies into six different categories: Access regulating remedies, price regulating remedies, remedies that regulate terms or conditions, compensation related remedies including unjust enrichment claims, remedies that prohibit or void a certain practice,

[36] We have aggregated the MCL cases.

and other remedies that do not fall within any of the previous brackets. These categories can overlap and we made value judgements sorting individual cases. In a number of instances the FCO sought price-regulating remedies against energy suppliers. These cases mostly settled in exchange for monetary concessions offered by the firms to consumers, i.e. price freezes or price discounts that firms were to pass-on to end-users. In the dataset these cases appear as proceedings with a price regulating remedy although they also contain a compensation element in the shape of a financial benefit to consumers. In other proceedings the defendants adjusted and changed future prices or terms although the claimants sought compensation in the first place. The claimant that asks the defendant to repay overpaid fees or compensation for illegal network charges inherently seeks to adjust prices for the future. We have used the most prominent or primary remedy in those instances.

In **Figure 4** we have stacked the frequency with which the FNA, FCO and private enforcers use the categories of remedies. It demonstrates that

Figure 4. Frequency of enforcers' remedy choice



compensation remedies and prohibition remedies are almost exclusively enforced by private enforcers. It must be noted that private parties have

probably sought prices or term altering remedies too but have used the prohibition remedy for procedural reasons. Claimants may find it easier in the courts to have certain behaviour prohibited as opposed to requesting a specific action from the defendant. Figure 4 shows that FNA and FCO focus their enforcement actions on anticompetitive prices and contract terms.

In general, the data in Figure 4 show little evidence for an overlap of remedies. The odd-one-out is access the remedy. All three enforcers actively pursue this remedy. Since the FNA regulates networks and predominantly deals with issues regarding network access, we would have expected to see a greater proportion of FNA access investigations. To analyse the "Access to infrastructure or networks" further, the full time profile is given in **Table 3** below.

Table 3. Frequency of access remedy per enforcer and year

	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09	Total
Reg	2	0	28	36	22	16	32	26	8	7	12	14	11	214
FCO	0	0	9	2	0	0	1	0	0	1	0	0	0	13
PE	0	0	0	0	0	0	2	8	10	4	3	4	3	34

A number of points are worth picking up from the table. The FCA brings the majority of these cases, something we would have expected given that a special regulator exists to, *inter alia*, solve network access problems. What is more interesting is that the FCO and private enforcer remain active and seek access remedies. We make two observations here. Firstly, the FCO's involvement in these cases is almost exclusively in the years just around the formation of the FCA, suggesting that the FCO picks up some of the workload while the FCA establishes its capacity and reputation. However, none of these access cases deals with telecommunication as **Table 4** shows: all proceedings apart from two in 2000 (gas) dealt with issues in electricity markets. It may indicate that, in the absence of energy regulation, the FCO felt that a stronger market oversight similar to telecommunications was needed. Secondly, the involvement of the private enforcers is concentrated in the years where the ambit of the FCA was to be extended to electricity and gas. These

cases could simply arise due to private actors learning what the FCA is likely to enforce. However, the fact that there are no cases outside this narrow window would suggest that this explanation is less plausible. In both instances it looks as if other enforcers stepped in to support the FCA in periods where the workload would exceed its capacity.

Table 4. Frequency of access remedies by FCO and PE per industry and start year

Industry	Enforcer	1999	2000	2003	2004	2005	2006	2007	2008	2009
Telco	FCO									
	PE			2	2	1	1			
Post	FCO									
	PE					4				
Gas	FCO		2							
	PE				1	3	1	2	4	3
Elec	FCO	9		1			1			
	PE				5	2	2	1		

No access remedies were sought in years 1997, 1998, 2001 and 2002. These years are not included in this table.

Another type of remedy, "terms and conditions" also saw involvement by both public enforcers. **Table 5** below arranges the FCO and FNA cases for this by year of the case. Again, it looks as if the FCO steps in to support the FCA with its workload around the time of expansion of the regulator's ambit.

Table 5. Frequency of terms remedies by FCO and FNA per start year

StartYear	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08	'09
Reg	0	0	0	0	4	4	3	6	2	8	4	9	9
FCO	0	0	0	0	0	0	6	18	0	0	0	0	0

Looking at the raw numbers suggests a strong element of division of labour and of cooperation to alleviate stress in the overall system

of enforcement. While the division of labour between the FCA and FCO could have arisen through formal negotiations, this can obviously not be the case when it comes to private enforcement which is solely driven by private and individualistic incentives. It is then curious that the incentive structure for bringing cases has been so clear that no coordination mechanism was needed, even in the transition years.

With respect to price remedies we observe a similar pattern in **Table 6** where the FCO brought cases in liberalised but unregulated energy markets. Surprisingly, the FCO does not entirely cease its activity. In 2008 and 2009 it initiated a number of investigations into end-user prices. This may also reflect the division of labour with the regulator. The latter focuses on the wholesale level and the FCO picks up on violations on the retail or consumer level that cannot be remedied by the FNA.

Table 6. Frequency of price remedy by FCO and FNA per start year and industry

Industry	**Enforcer**	**'99**	**'00**	**'01**	**'02**	**'03**	**'04**	**'05**	**'06**	**'07**	**'08**	**'09**
Tel co	Reg	0	0	0	1	0	2	1	0	0	0	0
	FCO	1	0	27	0	1	0	0	0	1	1	3
Post	Reg	1	0	0	0	0	0	0	0	1	0	0
	FCO	0	0	0	0	0	0	0	0	0	0	0
Gas	Reg	0	0	0	0	0	0	5	5	0	0	0
	FCO	0	0	0	1	0	0	3	6	0	37	0
Elec	Reg	0	0	0	0	0	0	1	0	1	0	6
	FCO	0	0	0	13	3	0	2	0	0	0	12
	Total	2	0	27	15	4	2	12	11	3	38	21

Assuming that the three possible decision makers are equally likely to make mistakes, the individual simply cares about who is quickest to reach the decision. Once we allow for differences in costs, but keeping errors constant, the individual clearly would prefer the regulator or competition authority to bring the case. It is also clear that even if the courts were slightly quicker or slightly less prone to making mistakes, a public enforcement solution would dominate. Hence we should see a

relatively quick drop in cases requesting an injunction or the voidness of a contract.

Table 7. Frequency of private enforcement compensation and prohibition remedies across years and industry

Remedy	Ind	2003	2004	2005	2006	2007	2008	2009	Total
Comp	Telco	0	3	6	1	5	3	4	22
	Post	0	0	0	1	1	0	0	2
	Gas	0	0	2	0	8	6	2	18
	Elec	1	8	18	23	4	28	22	104
Prohib	Telco	2	8	4	5	4	1	2	26
	Post	0	1	2	2	0	0	0	5
	Gas	1	4	9	13	35	29	8	99
	Elec	1	7	10	3	7	1	1	20

It is clear from **Table 7** that neither compensation nor prohibition cases systematically decrease. Prohibition appears to be the preferred remedy for private enforcers in the gas markets whereas compensation is chosen more often in electricity. The choice of compensation in electricity may be due to the particular market structure with many local and regional network monopolies. Competitors that seek access to these markets must use the incumbent's network. If the newcomer is overcharged, as it was the case in many of the MCL cases, the victim may seek a repayment of overcharges or compensation. In the absence of clearer data we can only speculate whether there have been more competitor claims in the electricity sector as compared to the gas sector.

6. Conclusions

Our analysis illustrates how the enforcers, without apparent debate, have avoided overlaps in enforcement. As we have shown above, public enforcement activity –whether it be the regulator or the competition agency– does not replace private enforcement. On the contrary, it seems that increasing the number of public enforcement actions also leads to an

increase in private enforcement actions. Although the parallel increase of actions suggests an overlap and duplication of enforcement efforts, we have shown that FCA, FCO and private enforcers use different remedies. We interpret this as a sign for complementary enforcement.

The paper's findings contribute to the debate about the optimal enforcement of competition rules. Better enforcement of competition rules will ultimately reinforce competitive markets. However, one aspect of optimal enforcement of competition rules is seldom discussed: how public enforcement and regulation affect private enforcement and *vice versa*. It appears that in regulated and, maybe, complex markets public enforcement is needed to flag up violation or issues that will then also be tackled by private enforcers. Since private enforcers in German regulated markets have used remedies that differ from those used by the public agencies, we suspect that this may also apply to other markets where enforcement structures with more than one player are in place. We do not have evidence that this coordination or cooperation in competition law enforcement also works from private to public but anecdotal evidence suggests that many public proceedings, especially with regards to anticompetitive abuse, are based on private complaints.

It is also interesting to note that for private players it does not seem to matter whether or not the market interventions are proactive (regulation) or reactive (competition law). What appears to be important is the signal they receive about potential problems in the market. Provided that a framework for private actions has been established, consumers, customers and competitors are willing to bring their cases to court. Our analysis shows the important and underestimated role of private enforcers as an institution to solve market problems.

There is no indication that the regulator is a substitute for private action. It looks more like the regulator lead to more litigation through an increased empowerment of consumers. This may arise because of decisions which can be followed up for compensation or through better information about illegality arising from the activity of the regulator. Arguably the key driver of private action in Germany is the relatively low costs of taking legal action. The seemingly high rate of litigated cases in our data as opposed to settled disputes points to this. Moreover, since in many cases these legal proceedings are against not just a current but also

future supplier, it must be the case that either there are no hard feelings about being sued or that the defendant has no way of retaliating in the future.

If competition rules are to be enforced more optimally, it important to understand the effects each of the three modes of competition enforcement has on the other two types, especially against the background of an on-going discussion in Europe about regulation and deregulation of sectors. Reducing funding for public enforcement may lead to a reduction of private enforcement. It appears unlikely that private enforcement can substitute public enforcement. Public enforcement will also not replace private enforcement as it will probably not be able to provide compensation to injured parties.

15

Achieving European internal market in regulated sectors by misuse of Competition Law; The margin squeeze disaster

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ABSTRACT

The economic and social advantages of the European internal market good functioning are beyond doubt, and thus neither effort nor means implemented in achieving that goal are worthless. However, pursuing this aim cannot –or should not- be done at the cost of misuse –and abuse- of Competition Law, when other tools fail or simply their implementation is not as effective as the Council or the Commission intend. This seems to be the case in some regulated sectors –namely, telecommunications- where competition law is occasionally serving as a regulatory tool that comes as a complement to the traditional means such as the promulgation of Directives, or the role played by National Regulation Authorities themselves. Accordingly, we show in this paper that the prohibition of the abuse of dominant position –enhanced in article 102 of the Treaty of Functioning of the UE- is currently being used to develop and implement the Commission's industrial policy agenda, and as mean to avoid market fragmentation. As such, it deviates from what should be its main objective, promoting efficiency and fostering innovation and competitive markets. In particular, given the unsatisfactory results of the regulatory framework and the painful inexistence of a single and efficient internal market in the provision of certain services, both the EC and the European courts are heavily relying on antitrust remedies to impose the economic operators duties that are regulatory in nature, at the expense of legal coherence, lacking the necessary tools and performing a task to which they are ill-suited. This is highlighted by recent high-profile cases, all of them regarding telecom operators –such as *Deutsche Telekom*, *France Telekom*, *Telefonica*, *TeliaSonera*- sanctioned with astronomic antitrust fines due a recently created form of dominant abuse: margin squeeze. As we shall see, the practical implementation of the prohibition, the contradictory results of application of regulatory and

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antitrust standards, and the level of legal uncertainty regarding the test of this anticompetitive conduct is far from being satisfactory, in terms of legal consistency and economic analysis. To avoid such pitfalls a simple remedy is proposed in this paper: the merger –as some countries, as Spain, have just recently done with the approval of its new CNMC (*ComisiónNacional de los Mercados y la Competencia*)– of the antitrust and the regulatory authorities, in order to ensure a coherent application of both legal bodies and provide markets –and economic operators– with a higher degree of legal certainty and economic predictability.

KEY WORDS: Internal market, regulated sectors, competition policy, legal coherence, margin squeeze.

1. Introduction

The economic and social advantages of the European internal market good functioning are beyond doubt, and thus neither effort nor means implemented in achieving that goal are worthless. For example –and most timely and conveniently for our purpose here– early this September the European Commission has adopted its most ambitious plan in 26 years of telecoms market reform. Launched by Commission President Jose Manuel Barroso in his 2013 State of the Union speech, the "Connected Continent" legislative package[1], when adopted, will reduce consumer charges, simplify red tape faced by companies, and bring a range of new rights for both users and service providers, so that Europe can once again be a global digital leader.

While successive waves of reform –to some of which we will refer in this paper– have helped transform the way telecoms services are delivered in the European Union, the sector still operates largely on the basis of 28 national markets[2]. There is no telecoms company operatingall along the whole EU, and both operators and customers face differing prices and rules.

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1 *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Telecommunications Single Market* – COM (2013) 634, available at the website: https://ec.europa.eu/digital-agenda/en/news/communication-commission-european-parliament-council-european-economic-and-social-committee-a-0 (accesed 19 November 2013).

2 See *Commission proposes major step forward for telecoms single market*, Press Release IP / 13 / 828, Brussels, 11 September 2013.

However, pursuing this aim cannot –or should not– be done at the cost of misusing tools which are designed for other goals, because the results are far from satisfactory. This is the case with the current abuse of Competition Law, by which policy goals are being pursued when other tools fail or simply their implementation is not as effective as the Council or the Commission intends.

This seems to be specifically the case in some regulated sectors –namely, telecommunications– where competition law is occasionally serving as a regulatory tool that comes as a complement to the traditional means such as the promulgation of Directives, the launching of the abovementioned 'legislative package' or the role played by National Regulation Authorities themselves.

We show in this paper that the prohibition of the abuse of dominant position –enhanced in article 102 of the Treaty of Functioning of the UE– is currently being used to develop and implement the Commission's industrial policy agenda, and as mean to avoid market fragmentation. As such, it deviates from what should be its main objective, promoting efficiency and fostering innovation and competitive markets. Although we do not develop an in-depth analysis here, same could be said about some merger control cases; yet we will also refer to them.

It is thus evident that over the years a pattern has emerged whereby, in the absence of satisfactory single market regulation, the Commission –endorsed by the Courts when challenged by particulars or Member States– has occasionally resorted to competition law in order to secure single market objectives. In particular, given the disappointing results of the regulatory framework and the aching inexistence of a single and efficient internal market in the provision of certain services, both the EC and the European courts are heavily relying on antitrust remedies to impose the economic operators duties that are regulatory in nature, at the expense of legal coherence, lacking the necessary tools and performing a task to which they are ill-suited.

This is highlighted by recent high-profile cases, all of them regarding telecom operators –such as *Deutsche Telekom*, *France Telekom*, *Telefonica*, *TeliaSonera*– sanctioned with astronomic antitrust fines due a recently created form of dominant abuse: margin squeeze. It is

somehow astonishing that exactly the opposite outcomes are found at the other side of the Atlantic, where American courts are reluctant to apply competition rules to regulated behavior of telecom operators. We find, therefore, that the same punished conduct –price squeeze– in the EU jurisdiction avoids antitrust sanctions in the US jurisdiction, in cases such as *Trinko* or *LinkLine*.

As we shall see, the practical implementation of the prohibition, the contradictory results of application of regulatory and antitrust standards, and the level of legal uncertainty regarding the test of this anticompetitive conduct is totally unsatisfactory, in terms of legal consistency and economic analysis.

To avoid such pitfalls a simple remedy is proposed in this paper: the merger –as some countries, as Spain, have just recently done with the approval[3] of its new Comisión Nacional de los Mercados y la Competencia (the CNMC hereinafter)– of the antitrust and the regulatory authorities, in order to ensure a coherent application of both legal bodies and provide markets –and economic operators– with a higher degree of legal certainty and economic predictability.

If it is clear that the conduct of telecom operators is subject to both sectoral regulation and competition law, seems also adequate that concurrent enforcement of those two normative bodies can be properly achieved by a single agency applying –concurrently– both. However, in any given industry, and also in this peculiar one, to put it bluntly, following the most authorized doctrine, "competition law cannot and should not be used to achieve regulatory objectives"[4].

Question is, which ultimate goals should prevail? Because, whereas competition policy serves only to one objective[5], promoting consumer welfare through achieving efficiency, regulation should attend

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3 Act 3/2013, of 4 June, of enhancing the Competition and Markets National Commission, «BOE» num. 134, 5 june 2013, pp. 42191 to 42243.

4 Geradin, D. and O'Donoghue, R., 'The Concurrent Application of Competition Law and Regulation: the Case of Margin Squeeze Abuses in the Telecommunications Sector', *GCLC Working Paper 04/05*, p. 65; available at: http://www.gclc.coleurop.be (accessed 14 June 2013).

5 See Giorgio Monti, *EC Competition Law*, Cambridge 2007, p. 20; and the speech by Commissioner NeelieKroes - SPEECH/05/512 – *Delivering Better Markets and Better Choices*, European Consumer and Competition Day.

to multiple –and somehow conflicting[6]– ones: promotion of effective competition, the internal market, and the users' interest. The prevalence of one or another ultimately dictates the way both antitrust law and sectoral regulation are enforced.

For example, as shown as early as in 1966's *Grundig Consten*[7], communitarian history demonstrates that competition law can be used to prevent the use of national law (in this case on IP rights) to partition the single market. It seems clear then that there is a close interaction between the rules and objectives of competition law and single market regulation. To some authors[8], it appears that no fewer than three positions can be identified, whereby competition law:

1. Supplements single market regulation and vice versa,
2. Is the rock upon which the single market and its regulation is built, and
3. Drives the development of the single market and its regulation.

Yet, the line between these positions needs to be clarified, and its influence in the cases before the European Commission and Luxembourg Courts elucidated. That is what we intend to do in this paper; accordingly, after this introductory section, we devote Section II to the regulatory framework in which firms must conduct their business, characterized by a concurrent application of sectoral regulation and competition law. After highlighting –in Section III– with some recent high-profile cases, regarding the anticompetitive practice of margin squeeze how this apparently 'coherent regulatory framework' has failed, we propose –in Section IV– a simple way of achieving coherence in the enforcement of both normative bodies: the unification, in a single agency or regulator, of the competition authority and the sectoral regulator. Section V provides some concluding remarks.

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6 De Streel, A., 'The relationship between Competition Law and Sector Specific Regulation: the case of electronic communications', *Reflets et Perspectives*, XLVII, 2008/1, p. 56.

7 Joined Cases 56 and 58/64 ÉtablissementsConsten *and Grundig v Commission*, [1966] ECR I-299.

8 Bergqvist, C., 'Use and Abuse of Competition Law in Pursuit of the Single Market. Has Competition Law Served as Regulation Subject to a Quasi Industrial Policy Agenda?,' Paper submitted for *Aims & Value Conference*, in Copenhagen, September 2012. Conference book to be published autumn 2013.

2. Concurrent application of sectoral regulation and competition law

It has been argued that in Europe, industrial policy and competition policy, "conjure up a great ideological divide"[9]. The reasons are simple: whereas modern competition policy is basically inspired by the neoliberal conceptions of the Chicago School[10], that place great confidence in the capacity of self-correction in free markets,it seems clear that industrial policy rests on a more interventionist assumption. In their understanding, markets are prodigious in failures that should be corrected by government direct intervention.

Therefore, those two bodies of provisions embrace different set of underlying assumptions, analysis techniques and enforcement tools. Those differences, of course, find their corollary in the fact that, usually, their application to firms and markets is entrusted to different organisms: antitrust authorities –either administrative o judicial– and regulatory agencies. Yet, when the enforcement is not properly coordinated, or this set of underlying assumptions not thoroughly understood, the result is in turn a set of 'ambiguities'[11] –to say the least– which cause a lot of trouble for both the agencies and the economic operators. This is why recent literature[12] refers to this debate as an 'abuse' rather than a 'use' of competition law.

However, recent history shows that these differences are not totally divergent; on the contrary, after its primary convergence[13], their ulterior taking apart, once again amalgamation is perceived, especially

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9 Geradin, D., "Industrial Policy and European Merger Control – A Reassessment", available at: http://ssrn.com/abstract=1937586 (accessed 24 November 2013).

10 For a recent 'application' of the antitrust wisdom embodied in this school, in the current file against Google for allegedly anticompetitive practices regarding its search engine, see Bork, R. and Sidak, J. (2010), 'What does the Chicago School teach about internet search and the antitrust treatment of Google', Journal of Competition Law & Economics, 8(4), 663-700.

11 Hocepied, C. and De Streel, A. [2005], 'The ambiguities of the European electronic communications regulation', in E. Dommering and N. van Eijk (eds), The *Round Table Expert Group on Telecommunications Law*, University of Amsterdam, pp. 139-190.

12 Bergqvist, C., *op.cit.* [2012].

13 Nihoul, P., 'Convergence in European Telecommunications: A Case Study on the relationship between Regulation and Competition Law', International Journal of Communications Law and Policy, Issue 2, Winter 1998/99.

in regulated markets. Trends that may, in time, reverse, and then again, rise. And so on.

Take, for example, telecommunications industry, referred to nowadays as the 'electronic communications' industry. Before its liberalization from the 80's and onward (also called de-regulation process), sectoral regulation was implemented mainly in order to establish the parameters of the state-owned company, the former monopolist. In a subsequent stage of the process, this same regulation was enacted to set clear rules for the incumbent, in terms of rights and duties regarding potential competitors, newcomers in the market. Finally, and once the new competitive market has reached its full development, a lesser degree of regulation is required; in fact, it should –progressively– diminish to become a minimum, and led the way to the ex-post regulation, namely, competition law.

It is obvious that a transition from a regulated market to a competitive market is not an easy journey. Also, despite Chicago School's credo, market forces are not able –by themselves– to go through it. In its first stages, it is necessary to develop competition by means of public policy. In the industry we are considering, a number of regulatory tools[14] were deployed to achieve this aim: interconnection, local loop unbundling, mandatory access, number portability, information to competitor duties, etc.

For our purpose here regulation can be defined as "the employment of legal instruments for the implementation of social-economic policy objectives"[15]; from the concept itself, differences with competition law arise and are easily perceived. We devote this section to show how, even though the European Commission permanently speaks about a 'coherent regulatory framework'[16], consistency and legal certainty is far

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[14] See, for a more detailed account of this "history", Green, J. R. and Teece, D. J. (1998), 'Four approaches to Telecommunications Deregulation and Competition: the USA, the UK, Australia and New Zealand', Industrial and Corporate Change, 7 (4), 623-635, at. 624.

[15] Den Hertog, J., (2000), General Theories of Regulation, in *Encyclopedia of law and economics*, Vol. 3, The Regulation of contracts, pp. 223-270.

[16] *Guidelines on the application of EEC Competition rules in the telecommunications sector* (1991/C 233/02), pp. 2 -26, at 15. The so-called 'Access Notice' declares that they are both "important and mutually reinforcing for the proper functioning of the sector"; *Notice on the application of the competition rules to access agreements in the telecommunications sector – framework, relevant markets and principles* (98/C 265/02), pp, 1-27, at 18.

from being achieved in the interaction between sectoral regulation and competition law.

As some authors have thoroughly studied[17], there are different approaches –legal and economic– to the remedies under both antitrust and regulation normative. The economic meaning of a remedy emphasizes market failure. The market failure may result from the unchecked exercise of market power, or from the uncompensated generation of an external cost or benefit, or from an insufficiency of information with which to make efficient choices concerning consumption, production, or investment. Whereas lawyers think of a remedy as what to do after a finding of illegal conduct, economists think of a remedy as what to do after a finding of market failure.

For our purpose here, the difference between the legal and economic conceptions of remedy highlights another important distinction, namely, the difference between *ex ante* and *ex post* interventions in the market. Under the *ex post* approach, a remedy is imposed if and only if an illegal conduct is first proven. And it is the government or a private plaintiff that bears the burden of proving their case. This arrangement describes the operation of monopolization law under Section 2 of the US Sherman Act or the concept of abuse of a dominant position in Article 102 EC in the EU.

By contrast, *ex ante* remedies are generally imposed through sector-specific regulation, though such remedies may also be imposed on the basis of antitrust rules. This is, for instance, the case where remedies are imposed as a condition for clearance of a merger between telecommunications operators. In both the US and the EU, antitrust enforcement authorities have used merger control procedures as a way to extract significant concessions from the merging entities.

Concerning the institutional design in network industries, the ones we want to focus in now, remedies can thus come from two main sources: *ex ante* or *ex post* enforcement, and/or sector-specific regulation. Ideally, both approaches would give the same outcome, in terms of competitive or

[17] Geradin, D. and Sidak, J., 'European and American Approaches to Antitrust Remedies and the Institutional Design of Regulation in Telecommunications' (December 18, 2003). Available at: http://ssrn.com/abstract=351100 (accessed 14 June 2013).

anti-competitiveness of a certain conduct. We shall see that, at least in the recent *Telefonica* and *Deutsche Telekom* decisions, this has not been the case.

The first communitarian efforts to liberalize regulated markets across the EU took place in 1987, with the Green Paper on the development of the common market for telecommunications[18]. In 1988 the Commission launched its report on the 'Internal Market for Energy', which was soon followed by the Green Paper on The Development of the Single Market for Postal Services (1991) and the Guidelines for the Development of Community Postal Services (1993)[19].

Briefly –the full history is a long tale[20]–, in the late 1990s, the Commission engaged in the process of reviewing the regulatory framework of EC telecommunications (now referred to as "electronic communications"[21]) and came up with the so-called *1999 Review*, a report outlining the future regulation in this ever-more-important sector. This report contains broad sets of proposals to adapt the existing regulatory framework to new technological (the process of convergence) and market (growing competition) circumstances. In full line with one of the views we're going to express and the end of this work, the Commission placed itself on the side of the growing consensus that competition law and principles should progressively replace sector-specific regulation. Thus, the Commission observes that "the aim of the Review is to create a regulatory regime which can be rolled back as competition strengthens, with the ultimate objective of controlling market power through the application of Community competition law"[22]. Eventually, the 1999 Review

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18 European Commission, *Towards a Dynamic European Economy – Green Paper on the Development of the Common Market for Telecommunications Services and Equipment*, COM (87) 290 final.

19 See European Commission, *Green Paper on the Development of the Single Market for Postal Services*, COM (91) 476 final; also, European Commission, *Guidelines for the Development of Community Postal Services*, Communication from the Commission to the Council and the European Parliament, COM (93) 247 final.

20 See a full account of the tale at Tapia, J. and Mantzari, D., 'The Regulation / Competition interaction', in Damien Geradin & Ioannis Lianos (eds.), Research Handbook on EU Law, (Edward-Elgar, July 2012), Ch. 15, available at: http://ssrn.com/abstract=2044722 (accessed 14 June 2013).

21 De Streel, A. (2007), 'Antitrust and Sector-Specific Regulation in the European Union: The Case of Electronic Communications', in R. Dewenter and J. Haucap (eds), Access Pricing: Theory and Practice, Elsevier, pp. 327-371.

22 European Commission, *Towards a New Framework for Electronic Communications Infrastructure and Associated Services: The 1999 Review*, Com (1999) 539.

led to the adoption of the new EC regulatory framework on electronic communications.

This new regulatory framework is composed of five directives: one framework directive[23] and four specific directives respectively dealing with authorisations, universal service, access and interconnection, and data protection and privacy in the telecommunications sector. In order to take into account the so-called "convergence" between the telecommunications, media, and information technology sectors, this framework not only covers telecommunications, but all forms of electronic communications and services to the exclusion of content-related aspects, which are dealt with by separate legislation.

More interestingly to our concerns here, the new framework is based on the so-called SMP regime[24]. Pursuant to this regime, regulatory obligations can be imposed on operators holding SMP in one given market after a four-step analysis, which requires coordinated efforts of the European Commission and the National Regulatory Agencies (NRAs).

First, the Commission periodically adopts a Recommendation, which identifies, in accordance with the principles of competition law, the products and services markets within the electronic communications sector, the characteristics of which may be such as to justify the imposition of regulatory obligations set out in specific directives.

Second, taking "utmost" account of this Recommendation and the Commission guidelines on market analysis, the NRAs define relevant markets appropriate to national circumstances, in particular, relevant geographic markets within their territory, in accordance with the principles of competition law.

Third, the NRAs analyse relevant markets, where appropriate in cooperation with the national competition authorities, to determine whether they are competitive or not.

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23 Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications, networks and services (OJ L45, pp. 33-50).

24 *Guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services*, 2002/C 165/03.

Lastly, when the NRA concludes that the market is effectively competitive, it cannot impose or maintain any specific obligations on the operators active in this market, and in cases where sector-specific obligations already exists the NRA must withdraw them.

It is easily perceived that this regime relies heavily on the principles of competition law[25]. Consequently, this system shares its basic tools and analytical framework. However, as we shall see in the following section looking atsome margin squeeze cases, this regime produces dissimilar outcomes. Moreover, given its forward-looking nature, the analysis of dominance will often work on the basis of predictions or speculations than on existing evidence. By contrast, antitrust analysis is reactive, its intervention only triggered when an actual conduct has taken place. This is one of the big discrepancies, in the *Telefonica*case, between the Spanish NRA and the European Commission, as well as *Deutsche Telekom*'s arguments before the CFI in its appeal of the corresponding sanction.

Although the sector regulation is aligned[26] to antitrust methodologies, it seems clear that, so far, the interface between *ex ante* regulation and *ex post* antitrust intervention has not been satisfactorily dealt with. Yet, paragraph 81 of Article 102 Guidelines[27] recognizes need to take historic advantages and *ex ante* regulation into account when assessing potential elimination of competition.

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25 For a full analysis of this regime, see De Streel, A., [2003], 'The Integration of Competition Law Principles in the New European Regulatory Framework for Electronic Communications', World Competition, Vol. 26, Issue 3, pp. 489-514.

26 For a full explanation of that alignment, see Buiges, P. [2004], 'A Competition Policy Approach', in P. Buiges and P. Rey (eds.), The Economics of Antitrust and Regulation in Telecommunications, E. Elgar, pp. 9-26.

27 Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings issued in December 2008, [2009] OJ C45/7: "*In certain specific cases, it may be clear that imposing an obligation to supply is manifestly not capable of having negative effects on the input owner's and/or other operator's incentives to invest and innovate upstream, whether ex ante or ex post. The Commission considers that this is particularly likely to be the case where regulation compatible with Community law already imposes an obligation to supply on the dominant undertaking and it is clear, from the considerations underlying such regulation, that the necessary balancing of incentives has already been made by the public authority when imposing such an obligation to supply. This could also be the case where the upstream market position of the dominant undertaking has been developed under the protection of special or exclusive rights or has been financed by state resources. In such specific cases there is no reason for the Commission to deviate from its general enforcement standard and it may show likely anticompetitive foreclosure without considering whether the above three cumulative circumstances are present.*"

In fact, many commentators conclude that in the industry of electronic communications the Commission behaves more like an industrial regulator than a mere antitrust authority, and has been more 'interventionist' in this sector than in the other fields of the economy[28]. And when the Courts endorse its decisions, it can be said that so they do. This is precisely what lies at the core of the margin squeeze cases, with which we deal in the following section. When the Commission has imposed antitrust sanction for allegedly anticompetitive practices, both in *Telefonica* and *Deutsche Telekom* cases, the corresponding NRA –the CMT and the RegTP- had previously approved the pricing practices of the telecommunications operators.

There is abundant literature that criticizes this 'extensive' use of antitrust in the electronic communications sector. Some[29] argue that the merger approach has been too stringent because economic studies show that anti-competitive leverage is not as frequent as the Commission holds. In his seminal work, a well-known author[30] argues that competition law has been expanded beyond its reasonable limits and the institutional and legitimacy settings of antitrust do not justify its quasi-regulatory role. It is also recalled that, more generally, American authors[31] remind the dynamic characteristics of the industries and the necessary adaptation of antitrust policy.

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28 De Streel, A. [2008], *op.cit.*, p. 57. This contention is based in the fact that it has adopted three general guidelines that explained how antitrust rules would apply to some competitive problems and that were not based a stock of previous individual cases: in 1991 on the application of competition rules to the telecommunications sectors, in 1998 on the application of antitrust rules to access agreement, and in 2000 on the application of antitrust rules to the compulsory access of the local loop. In addition to it, The Commission conducted also six sector enquiries or quasi-sector enquiries where the Commission sent questionnaire to all the operators to better understand the dynamics of the marketplace and possibly identify anti-competitive practices in 1997 on the high prices for International calls, in 1998 on the high prices for fixed-to-mobile calls, in 1999 on the delivery conditions of leased lines, in 2000 on the high prices for mobile international roaming, and on the access to the local loop, in 2004 on the sales of sports rights to 3G and Internet.

29 Veljanovski, C. [2001], 'EC Antitrust in the New Economy: Is European Commission's View of the Network Economy Right?', European Competition Law Review 22, pp. 115-121.

30 Larouche, P. [2002], 'A closer look at some assumptions underlying EC regulation of electronic communications', Journal of Network Industries 3, pp. 129-149.

31 Audretsch, D. B., Baumol W. J. and Burke, A. E. [2001], 'Competition policy in dynamic markets', *Int. J. Ind. Organ.*, Issue 19, pp. 613-634; Evans, D. and R. Schmalensee [2001]: "Some economic aspects of antitrust analysis in dynamically competitive industries", NBER Working Paper 8268; Katz, M.L. and Shelanski, H. A. [2004], 'Merger Policy and Innovation: Must Enforcement Change to Account of Technological Change?', NBER Working Paper 10710.

However, there are also a certain number of authors –and most notably, some of the more authorised doctrine among them– who justify[32] an interventionist stance of antitrust in the electronic communications sector, even arguing for a case to actively promote entry of competitors that are equally efficient or even less efficient. To conclude this section we must say that such a proposal needs to be very carefully assessed –on solid economic grounds- before even being considered as a policy cause of action.

3. The margin squeeze disaster: cases

All the issues we are dealing with in this paper are clearly –and sufficiently– highlighted by the margin squeeze cases, decided by the European Commission since 1999, and utterly confirmed by the European Courts.

It is not our aim here to develop an in-depth analysis of this controversial practice[33]; we merely attempt to show how the prohibition of margin squeeze by telecom operators has become the paradigm of this misuse of antitrust policies we are dealing with in this paper. As such, it has beenvoiced accurately by a certain number of commentators[34] as the use of competition law rules as a regulatory tool.

So far we have shown the complex relationship between competition law and sector specific regulation. It is now turn to underline how an unsatisfactory solution to these complexities applies to actual operators' practices and conduct, when challenged before agencies or courts. If sectoral regulation is used to open and develop markets, could competition law help in further promoting this task? We shall see in this section that the answer varies considerably at both sides of the Atlantic.

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[32] De Streel, A. [2008], *op. cit.*, p. 61. Of course, this author explains that an economic case for such a 'different antitrust' may be justified in a sector where dominant position due to previous incumbency is prevalent. Yet, it should always be grounded with sound economic reasoning and it should be strictly limited to the network industries that were developed under legal monopoly protection and not extended to other sectors of the economy.

[33] We have done that analysis in Díez, F., 'Telecoms Regulation, Antitrust and Margin Squeeze: Widening the Already Wide Gap between US and EU Competition Policy?' (January 9, 2011). Available at: http://ssrn.com/abstract=1828723 (accessed 14 June 2013).

[34] Auf'mkolk, H., 'From Regulatory Tool to Competition Law Rule: The Case of Margin Squeeze under EU Competition Law', available at: http://ssrn.com/abstract=1959126 (accessed 14 May 2013).

While US courts have denied the possibility of applying antitrust law in regulated markets, in cases such as *Trinko* and *linkLine*, the EU is not only accepting that possibility, but applying competition rules in an 'expansive' way in cases such as *Telefonica* and *Deutsche Telekom*.

This section will be structured as follows: a brief explanation of the margin squeeze ban is presented in subsection I, in order to contextualize the prohibition in the present debate of concurrent application of competition law and sectoral regulation. Subsection II offers a recount of the leading cases regarding this novel –in terms of article 102 TFUE's catalogue of anticompetitive practices– antitrust violation. Here we will focus on *Deutsche Telekom*, since it contains the main features of the prohibition, as envisaged by the EC and the Luxembourg courts, whereas *Telefonica* and *TeliaSonera*just follow that precedent. To shed some light to this complex debate, an illustration of what is happening at the other side of the Atlantic is presented in Subsection III, which highlights the different approach regarding this prohibition taken by the American Supreme Court, on grounds –precisely– of the concurrent application of both antitrust laws and sector specific regulation. This is –to our understanding– clearly stated in *Trinko* and *linkLine*. Finally, Subsection IV express why we have called this scheme a "disaster" in the title of this paper, and that would lead as to the following section, and our modest proposal to fix it.

3.1. The margin squeeze prohibition

A margin squeeze is an insufficient margin between the price of an "upstream" product A and the price of a "downstream" product A+B of which A is a component. A "price squeeze" occurs when an upstream monopolist sells a key input that it controls to a downstream competitor at a high price, and to its downstream customers at a low price, such that the downstream competitors are effectively "squeezed" out of the downstream market.

The European Commission's decisions on this practice –see, for instance *Telefonica*[35]– deals with the incumbent's price structure as

[35] European Commission Decision of 4 July 2007, regarding a proceeding under Article 82 EC Treaty (Case COMP/38.784 – *WanadooEspaña v. Telefonica*).

reflected by the difference between its wholesale and retail prices. It isprecisely this difference and not the specific level of the retail and /or wholesale prices which is of importance in margin squeeze cases. As we have already stated, the full analysis of the technical issues involved in such a finding is a very lengthy and complicated matter[36] consequently, its exhaustive account falls outside the scope of this paper.

There was a wide consensus[37] in holding that charging a price squeeze which prevents an efficient competitor from competing downstream works like a refusal to supply, so the same framework of analysis should be used[38]. In particular, the following conditions should be met for the finding of antitrust liability:

(i) Input needs to be objectively necessary to compete effectively in the downstream market; there is not actual or potential substitute to the input (and replication would not be undertaken);

(ii) Elimination of effective competition – likelihood is greater if the products downstream are closer substitutes, no capacity constraint;

(iii) Consumer harm: the negative consequences of the refusal to supply should outweigh the negative consequences of imposing an obligation to supply.

Regardless the ever-lasting discussion about refusals to deal[39] and the conditions under which is considered anticompetitive and liable under antitrust rules, it seems clear that the undertaking's conduct

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[36] *Vid.*, for detailed analysis, Fernández Alvarez-Labrador, M. [2006] 'Margin Squeeze in the Telecommunications Sector: An Economic Overview', *World Competition*, 29 (2),.

[37] Presentation by Miguel de la Mano, at the ABA Antitrust Section Spring Meeting 2009, *Thoughts on Margin Squeeze (and Refusal to Supply)* held in Washington, 25 March 2009.

[38] Most unfortunately, this consensus has been reversed by the latest jurisprudence on margin squeeze, Judgment of the Court (First Chamber) of 17 February 2011, *Konkurrensverket v TeliaSoneraSverige AB*, Reference for a preliminary ruling: Stockholmstingsrätt - Sweden. Preliminary ruling - Article 102 TFEU - Margin squeeze on competitors.Case C-52/09.

[39] See, for a comprehensive review, Humpe, C. and Ritter, C. [2005] 'Refusal to supply', Global Competition Law Centre (College of Europe), Research Paper, June 2005.

should meet an objective test[40], be anticompetitive in the market, and not only affect the particular vulnerability of a rival requesting supply or access.

3.2. The cases

By a Decision[41] dated on 21 May 2003, the Commission found that *Deutsche Telekom* (DT) was abusing its dominant position through unfair prices. DT holds a dominant position on both the markets for both wholesale and retail access to the local loop. Regarding wholesale access,DT was the only German network operator having a network with nation-wide coverage. In order to provide a variety of services to end users, new entrants need access to this infrastructure on a wholesale basis. Regarding retail access, even after five years of competition, DT still had around 95% market share and the remaining 5% was divided up between a large numbers of DT's competitors.

According to the Commission, because of the insufficient spread between DT's local loop access prices and the downstream tariffs for retail subscriptions, new entrants had no scope to compete with DT for end consumers. The Commission's decision compared upstream access to the local loops with a bundle of different types of retail offerings, namely analogue, ISDN and ADSL connections. In order to achieve a coherent comparison, the Commission used a weighted approach taking into account the numbers of DT's retail customers for the different access types on retail level.

The Commission's assessment reveals, for the period 1998 through 2001 that DT charged competitors more for unbundled access at wholesale level than it charged its subscribers for access at the retail level. This sort of conduct constitutes an allegedly "clear case" of margin squeeze, because it leaves new entrants no margin to compete for downstream retail subscribers. As of 2002, prices for wholesale access were lower than retail subscription prices but the difference was still not sufficient to

[40] Lang, T., [1995] 'Defining Legitimate Competition: Companies' Duties to Supply Competitors, and Access to Essential Facilities', 1994 Fordham Corporate Law Institute 245, B. Hawk ed., p. 245.

[41] Decision 2003/707/CE, relating to proceeding under Article 82 EC (Case COMP/C-1/37.451, 37.578, 37.579 – *Deutsche Telekom AG*), OJ 2003, L 263, p. 9.

cover DT's own downstream product-specific costs for the supply of the end-user services. Even after the latest reduction of the wholesale prices by the German regulatory authority (RegTP), which became effective on 1 May 2003, this margin squeeze remained in place.

According to the Commission's 8th Implementation Report of December 2002, two years after the EU-Regulation on local loop unbundling came intoforce; only one million subscriber lines have been unbundled across Europe. The large majority of them (855.000) are in Germany, where unbundling was mandated by national law already as of 1998, but even in Germany unbundled lines account for less than 5 % of the total. By its judgment[42] of 10 April 2008 the Court of First Instance endorsed the Commission Decision in basically all its terms and findings.

To sum up[43] the established doctrine in this regard, we need only to look at the arguments posed by the CFI in order to reject *Deutsche Telekom*'s appeal, where the European Court asserts the grounds for the applicability of competition law to an undertaking subject to ex ante regulation:

a) In any given and concrete case, ex ante regulation always leaves room for independent undertaking's behaviour, which may lead to anticompetitive practices (paragraph 121).

b) The administrative control of the incumbent's prices does not necessarily exclude the undertaking's freedom of conduct; therefore it does not preclude its liability (paragraph 107).

c) The NRA's intervention does not preclude European Commission's duty to intervene in order to enforce article 102 EC Treaty (paragraph 113).

d) The margin squeeze conduct, in itself, leads to the restriction of the competitive conditions of the market, or at least may have such effect (paragraph 238).

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42 Case T-271/03, Judgment of the Court of First Instance, 10 April 2008, *Deutsche Telekom AG v. Commission of the European Communities*.

43 See, for a comprehensive revision of this sentence, Laguna de Paz, J. C., 'Abuso de posición dominante por `comprensión de márgenes´ aplicando precios sujetos a regulación *ex ante*: STPI *Deutsche Telekom*', Revista de Competencia, Distribución y Consumo, nº 3 (2008).

The CFI's message is crystal clear: complying with regulation is no defence in a competition law investigation. More specifically, regulatory compliance with price controls is not sufficient to avoid competition actions under Article 102 of the EC Treaty where the network operator has flexibility in setting retail prices. The debate, thus, remains open, and as the most authorised doctrine[44] has pointed out, there are a bunch of issues here quite unresolved.

3.3. The Transatlantic divide

In the US jurisdiction this theory of liability was first recognized in *United States v. Aluminum Co. of America*[45]. In *Alcoa*, Judge Hand considered whether the price Alcoa charged its rivals for its upstream input, plus Alcoa's own costs in producing the downstream product, exceeded the price Alcoa charged for its downstream product. Finding that it did, and that Alcoa had monopoly power in the upstream market, Judge Hand concluded that this was sufficient to constitute a violation of Section 2, as Alcoa's downstream competitors were "squeezed" out of the market by these price differences.

The leading case for understanding margin squeeze in the US was brought by *linkLine Communications*, an Internet service provider (ISP) in California, and three other ISPs that resold wholesale digital subscriber line (DSL) services provided by AT&T, an incumbent local exchange carrier (ILEC)[46].

In 2003, linkLine brought suit in federal court alleging that AT&T violated Section 2 of the Sherman Act[47], by monopolizing the DSL mar-

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44 Geradin, D. and O'Donoghue, R. [2005], 'The Concurrent Application of Competition Law and Regulation: the Case of Margin Squeeze Abuses in the Telecommunications Sector', Global Competition Law Centre, *Working Paper* 04/05. Available at SSRN: http://ssrn.com/abstract=671804 (accessed 14 June 2013).

45 148 F.2d 416 (2nd Cir. 1945)

46 Pursuant to a 2005 order of the FCC, ILECs are no longer required to sell DSL transmission services to independent ISPs and DSL providers. However, as a condition of the 2007 FCC order approving its merger with BellSouth, AT&T remains bound to provide DSL transport service to independent firms such as linkLine at a price no greater than the retail price of AT&T's retail DSL service. AT&T thus participates in the DSL market at both the wholesale and retail levels by providing ISPs with wholesale DSL transport service and by selling DSL service directly to consumers at retail.

47 15 U.S.C. § 2.

ket in California. The key allegation was that AT&T engaged in a price squeeze to minimize linkLine's profit margins by setting a high wholesale price for DSL transport and a low retail price for retail DSL service in order to prevent rival firms from competing in the retail market.

In the district court, AT&T moved to dismiss the case on the ground that linkLine's claims were foreclosed by *Verizon Communications Inc. v. Law Offices of Curtis v. Trinko, LLP*[48], in which the Supreme Court held that a firm with no antitrust duty to deal with its rivals has no obligation to provide those rivals with a "sufficient" level of service. The court denied the motion, holding that *Trinko*did not address price-squeeze claims.

Although quite interesting and revealing for the purposes of this paper, we need –for the sake of concretion– to leap over the positions taken in this case by the DOJ and the FTC and go straight to the Supreme Court's opinion, released on Feb. 25, 2009[49].

In *linkLine*, the Court[50] substantially foreclosed price-squeeze claims under U.S. antitrust law where a vertically integrated defendant has no clear antitrust duty to deal with its retail competitors at wholesale. Accordingly, *linkLine* represents an extension of a recent line of Supreme Court opinions that have taken a narrow view of liability under Section 2 of the Sherman Act.

Initially, the Court addressed, and rejected, the assertion that the case was moot. Following the Court's grant of certiorari, linkLine took an unconventional approach by asking the Court to vacate the 9th Circuit Court of Appeals' decision (which held in its favour) and for permission to amend its complaint in order to assert a claim of "predatory pricing" apart from its price-squeeze theory claim.

It is widely known that in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*[51], the Supreme Court established two requirements for a

48 540 U.S. 398 (2004).

49 *Pacific Bell Telephone Co., d/b/a AT&T California v. linkLine Communications, Inc.*, 555 U.S. 364 (2009), available at: http://www.supremecourtus.gov/opinions/08pdf/07-512.pdf (accessed 14 June 2013).

50 The Supreme Court's opinion was authored by Chief Justice John Roberts and joined by Justices Scalia, Thomas, Kennedy and Alito. Justices Breyer, Ginsburg, Stevens and Souter concurred only with the judgment.

51 509 U.S. 209 (1993).

predatory pricing claim: (1) below-cost retail pricing and (2) a "dangerous probability" that the defendant will recoup any lost profits. Before the Supreme Court, *linkLine* took the position that its claims must meet the *Brooke Group* test.

However, the Court refused *linkLine*'s request to vacate the 9th Circuit's decision, and rejected several *amici's* assertion that the case had become moot, because the parties continued to seek different relief (AT&T was seeking reversal of the 9th Circuit's decision) and because it was not clear that *linkLine* had unequivocally abandoned its price-squeeze claim[52]. In both *linkLine* and *Trinko*, the defendant was under a *statutory* or *regulatory* obligation to deal with competitors, but not an independent *antitrust* duty to deal.

In *Trinko*, Verizon was required by the federal Communications Act to lease its network elements to competing firms at wholesale rates. The *Trinko* plaintiffs asserted that Verizon denied its competitors access to its interconnection support services, making it difficult for its competitors to fill their customers' orders. The Supreme Court's decision in *Trinko* held that the because Verizon had no antitrust duty to deal at wholesale with its rivals at all, claims of a denial of access to interconnection support services under terms and conditions that the rivals find commercially advantageous were not actionable under Section 2 of the Sherman Act.

In *linkLine*, the Court reasoned that a "straightforward application" of its decision in *Trinko* foreclosed any challenge to AT&T's wholesale prices, where AT&T had no antitrust (as opposed to regulatory) duty to deal with its competitors at wholesale.

Seeing no difference between the "insufficient assistance" claims rejected in *Trinko* and the *linkLine* plaintiffs' price-squeeze claim, the Court opined that "for antitrust purposes, there is no reason to distinguish between price and non-price components of the transaction." As

[52] As we have already stated earlier in this paper, price-squeeze claim requires a different kind of unilateral conduct and requires that the defendant operate in two markets: a wholesale ("upstream") market and a retail ("downstream") market. A firm with market power in the upstream market can squeeze its downstream competitors by simultaneously raising the wholesale price of service while cutting its own retail prices. Price-squeeze plaintiffs assert that a defendant must leave them a "fair" or "adequate" margin between the wholesale and retail price.

AT&T had no antitrust duty to provide service to the plaintiffs at all, it therefore had no duty to provide service at the wholesale prices that the plaintiffs would have preferred.

The Court next stated that the other component of a price-squeeze claim is the assertion that the defendant's *retail* prices are too low. But in order to avoid chilling aggressive price competition, which benefits consumers, the Court has carefully limited the circumstances under which plaintiffs can state a violation of the antitrust laws by alleging that the defendant's prices are too low—most notably, the stringent predatory pricing test set forth in *Brooke Group*.

The Court goes on with its discussion with a sweeping restatement of the aged *Colgate* doctrine that except in "rare instances (…) businesses are free to choose the parties with whom they will deal, as well as the prices, terms and conditions of that dealing"[53]. It refers to two possible exceptions but quickly notes that neither is present in this case: (i) "predatory pricing," defined in *Brooke Group* as "below cost prices that drive rivals out of the market and allow the monopolist to raise its prices later and recoup its losses" and (ii) the possibility, citing *Aspen Skiing*, that in unspecified "limited circumstances" a monopolist may have a "duty to deal" with its competitors[54].

Relying centrally on its prior decisions in *Brooke Group* and *Trinko*, the Court frames the issue as "whether such a price-squeeze claim may be brought under § 2 of the Sherman Act when the defendant is under no antitrust obligation to sell the inputs to the plaintiff in the first place".[55] The Court holds that such a claim may not be brought; reasoning that a "price squeeze" involves unilateral pricing decisions at two levels, wholesale and retail, and that each of these markets must be analyzed separately.

First, with respect to the wholesale level, the Court points out the District Court had held AT&T had no "antitrust duty to deal," the Court of Appeals had "assumed that any duty to deal arose only from FCC

53 *linkLine*, slip Op., at 7 (citing *United States v. Colgate & Co.*, 250 U.S. 300, 307 (1919).

54 *Id.* at 8 (citing *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 US 585, 608-611 (1985).

55 *Id.* at 9.

regulations," and the question on which the Court granted certiorari "made the same assumption." Thus, given the absence of any *antitrust* duty to deal at the wholesale level, there can be no violation based on unilateral pricing decisions at wholesale, for "Trinko . . . makes clear that if a firm has no antitrust duty to deal with its competitors at wholesale, it certainly has no duty to deal under terms and conditions that the rivals find commercially advantageous".[56]

Second with respect to the retail component of the "price squeeze" allegation (*i.e.*, that defendants' prices were too low), the Court starts by expressing continued scepticism about any antitrust theory of liability that would challenge prices as being too low, and concludes that absent a *Brooke Group* "predatory pricing" allegation, there can be no antitrust violation for defendants' unilateral pricing in the retail market[57].

The Court thus quickly concludes that plaintiffs' price-squeeze claim, looking to the relation between retail and wholesale prices, is thus nothing more than an amalgamation of a merit-less claim at the retail level, and a merit-less claim at the wholesale level. *linkLine*'s complaint contained no allegation that AT&T's conduct met the *Brooke Group* test. In this regard, the Court announced what undoubtedly constitutes its core tenet:

> "If there is no duty to deal at the wholesale level and no predatory pricing at the retail level, then a firm is certainly not required to price both of these services in a manner that preserves its rivals' profit margins".[58]

The Court further reasoned that institutional concerns counsel against recognizing price-squeeze claims. For example, courts would be required to simultaneously police both the wholesale and retail prices of a firm, and then determine what constitutes a "fair" or "adequate" margin between wholesale and retail prices.

Accordingly, imposing a "duty to deal" would involve courts acting as "central planners dealing day-to-day with the questions of proper price, quantity and other terms"[59]. The task would be even more difficult

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56 *Id.* at 9.

57 *Id.* at 11.

58 *Id.* at 12.

59 *Id.* at 13.

in this instance as courts would be aiming at a moving target, since it is the *interaction* between these two prices that may result in a squeeze. Finally, the absence of a clear rule or objective standard offers no "safe harbour" for a firm's pricing decisions. Determining what may be a "fair" or "adequate" price is a burden the Court is reluctant to place on market incumbents.

In passing, the Court quotes liberally from an appellate court decision by concurring Justice Breyer and characterizes price-squeeze claims as an unnecessary new theory of liability, consigning Judge Learned Hand's opinion in *Alcoa* to the dustbin of history, at least with respect to its holdings on price-squeezes. The harsh words used by the Court are worth quoting[60]:

> "We do not need to endorse a new theory of liability …" and "Given developments in economic theory and antitrust jurisprudence since Alcoa, we find our recent decisions in Trinko and Brooke Group more pertinent to the question before us".

The Supreme Court remanded the case to the district court with instructions to consider whether an amended complaint filed by *linkLine* properly states a claim under the heightened pleading standard articulated by the Court in *Bell Atlantic Corp. v. Twombly*[61]. *linkLine's* complaint was filed several years prior to the Court's *Twombly*opinion, which established a new, higher pleading standard for antitrust claims – specifically, that a well-pleaded complaint must show that relief is "plausible," and have enough "heft" to show that the plaintiff is entitled to relief.

3.4. Why the European scheme doesn't work?

Contrary to the abovementioned reluctance to apply antitrust rules to industries that already subject to sector specific regulation –circumscribing, therefore, the scope of antitrust law in network industries[62]–, the European Commission and the Luxembourg Courts are expanding competition law, applying its prohibitions where not only

60 *Id.* at 15 and 12.

61 550 U.S. 544 (2007).

62 See, for a detailed analysis of the *Trinko* case, contextualized in the debate of concurring application of competition law and sectoral regulation, Petit, N. [2004] 'Circumscribing the Scope of EC Competition Law in Network Industries? A Comparative Approach to the US Supreme Court Ruling in the *Trinko*Case', 13 Utilities Law Review, 6.

sectoral regulation already exists, but even when prior decisions by NRA's authorise pricing practices of the allegedly abusive telecom operators.

We have argued somewhere[63] that it is at least dubious that Telefónica is fully responsible for the abuse, given the Spanish telecoms regulator -the CMT- had given clearance to the prices for wholesale broadband access (i.e. the regional wholesale prices). It may be argued that this accounted for approximately 30% of the wholesale prices covered in the decision, and that the CMT never analysed the margin squeeze between Telefónica'snational wholesale prices and retail prices (which represented approximately 70% of the wholesale prices covered in the Decision).

The same happens with the *Deutsche Telekom* case; the undertaking argued –in vain– that it couldn't have infringed competition law if its wholesale prices had been supervised and approved by the RegTP, German's NRA, in accordance with sector specific Single Market regulation.

Although the reasons alleged by both operators have been properly rejected by the General Court, in the corresponding *Telefonica*[64] and *Deutsche Telekom*[65] sentences, it is clear that article 102 TFEU is being used against a margin squeeze infringement despite Single Market regulation clearly states that:

> "Pricing rules for local loops should foster fair and sustainable competition, bearing in mind the need for investment in alternative infrastructures, and ensure that there is no distortion of competition, in particular no margin squeeze between prices of wholesale and retail services of the notified operator"[66].

So, is competition law a corrective instrument when sector specific regulation fails to achieve its goals? InTelefonica, when analysing the existence of a margin squeeze between the regional wholesale and the

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63 Díez, F. and Fernandez, M. [2008] 'El estrechamiento de márgenes en los mercados de telecomunicaciones (Comentario a la Decisión de la Comisión Europea de 4 de julio de 2007, Asunto COMP/38.784 - *Wanadoo España contra Telefónica*)', *Revista de Competencia, Distribución y Consumo*, nº 2.

64 Cases T-336/07 and T-398/07, *Telefonica c. Comision*, 29 March 2012, available (in English) at the website: http://www.curia.europa.eu/juris/document/document/220094 (accessed 28 may 2013).

65 Case T 271/03 *Deutsche Telekom v Commission* [2008] ECR II- 477.

66 Regulation (EC) Nº 2887/2000 of the European Parliament and of the Council of 18 December 2000 on unbundled access to the local loop, OJ L336/4, of 30.12.2000, recital 11.

retail prices, the CMT used different data than the Commission, since it was working in a forward-looking context, it used estimates made on the basis of market and cost forecasts provided by Telefónica in 2001 (whereas the Commission used *ex post* data). Therefore although the CMT used the same methodology as the Commission, it was working with different data, which may explain why it came to a different conclusion.

Of course, this sort of argument may exonerate the CMT –meaning, Spanish government- from subsidiary liability for Telefonica's conduct, and the corresponding economic sanction. It is not clear up to what extent results a satisfactory explanation for the "system" as a whole, and what sort of legitimate confidence gives to undertaking operating in this industry, which obediently fulfil all their regulatory obligations, and yet are ultimately found guilty of anticompetitive pricing behaviour.

Yes, it has been argued also that Telefónica should have known that the estimates made by the CMT were not matched by its own business plan and its actual costs. Moreover, Telefónica was at all times free to end this margin squeeze by lowering its wholesale prices, given that its national wholesale prices were not regulated and its regional wholesale prices were only subject to maximum prices – it was free to set prices below the maximum. However, it never took this initiative until it was obliged to by the Spanish regulator in December 2006.

Because the prompt reactions that the European Commission was undermining the authority of the Spanish regulator, the former quickly stated that the Decision was against Telefónica, not against the CMT. We think, by contrast, that such an outcome should be considered extraordinary or exceptional. The fact that the Commission and the CMT found different results: in the telecommunications sector regulators put in place *ex ante* regulatory mechanisms allowing competition to develop, but can only do this on the basis of market and cost forecasts.

In so doing regulators lessen, but cannot entirely eliminate the risk of anti-competitive behaviour. Competition authorities act *ex post*, using historical data on effectively incurred costs. Accordingly, in many Member States, competition authorities have investigated and sanctioned *ex post* anti-competitive conducts in the regulated telecommunications markets, including broadband access.

As a preliminary conclusion, and as many commentators have pointed out[67], we can therefore point out that the concurrent application of Competition Law and Regulation in the Telecommunications Sector, as specifically highlighted by the cases of margin squeeze abuses in the Telecommunications sector, is not producing consistent results.

The diverging approach[68] to price squeezes in the US and Europe contributes to underscore this unsatisfactory outcome. Maybe the way to fix it is complex from a substantive point of view –the reconciliation of the two normative bodies involved, competition law and sectoral regulation–. But it is also true that something that may help is a concurrent enforcement, by way of 'merging' the agencies entrusted to apply those laws. We turn to it in the following section.

4. A modest proposal: concurrent enforcement in the telecommunications sector

Moving closer the regulator and the competition authority, two different institutions, functioning their own way and having different advantages and skills, may be the key solution to the issue mentioned above.

Competition authorities, "off market" regulator, usually intervening ex-post, have an advantage over regulators when it comes to ensuring an anti-competitive conduct do not jeopardize the benefits expected from the introduction of competition into regulated sector. Those authorities guaranty the uniformity of competition principles application across all sectors.

In the other hand, sector regulators, "in market" regulator, have a comparative advantage in obtaining and analyzing the data needed for

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67 *Vid.*, among others, Boukaert, K and Verbobven, F. [2003] 'Price squeezes in a regulatory environment', *CEPR Discussion Paper No. 3824*, available at: http://ssrn.com/abstract=405122 (accessed 14 June 2013); Crocioni, P. and Veljanovski, C. [2003] 'Price Squeezes, foreclosure and competition law. Principles and guidelines', Industrial Journal of Network Industries, Vol. 4.

68 As accurately described in Grimes, W. [2012] 'U.S. Supreme Court rejects price squeeze claim: a high point for divergence between US and European Law', South Western Law School Working Paper nº 1024, available also at: http://ssrn.com/abstract=1660803 (accessed 14 June 2013); see also Hay, G. and McMahon, K. [2012] 'The diverging approach to price squeezes in the United States and Europe', *Journal of Competition Law & Economics*, available also at: http://ssrn.com/abstract=1997384 (accessed 27 December 2013).

regulation. Thus, they can analyze the market and set the rules of the game ex ante.

While sector regulator seeks to prevent inefficient use of resources through regulation, competition authority seeks to do it through a free market force. Both aim at the same goal. Ideally, the consultation and collaboration between regulator and competition authority would able a coherent action ex-ante/ex-post.

But as we saw in the cases studied in the 3rd section of this paper, this is far from reality. To remedy this outcome, some countries have decided to merger the regulation and competition authority.

As we have pointed out in the introductory section, Spain has recently doneso, with the approval of its new CNMC (*ComisionNacional de los Mercados y la Competencia*). This new entity, created in 2013, was formed by the 'merging' of the former sector regulators (*Comision del Mercado de la stelecomunicaciones*, *Comision Nacional de la Energia*, *Comité de Regulacion Ferroviaria*, *Comision Nacional del Sector postal*, *Comision de Regulación Economica*, *Consejo de Regulacion Economica Aeroportuaria* and *Consejo Estatal de Medios Audiovisuales*) and it is also in charge of implementing Competition Law and ensures the application of the Spanish antitrust statue (*Ley 15/2007 de Defensa de la Competencia*), role previously entrusted to the Spanish Competition Authority (*Comision Nacional de la Competencia*).

It is also the case in Netherlands, where three regulators (The country's Consumer Authority, the Dutch Competition Authority (NMa) and the post-and-telecoms regulator, the OPTA) have merged to form a new independent agency, the Consumer and Market Authority (ACM).

This merger has many advantages: First, the new entity works more effectively because the various aspects of regulating the sector are brought together. The new entity now disposes of the knowledge and the data needed to oversee the market with more efficiency. The market surveillance can be better deployed. Secondly, merging the two functions avoid contradictory application of regulatory and antitrust standards, as both would be enforced by the same entity.

It also enables administrative simplification and costs decrease through economies of scale. In the context of crisis we face, it is mandatory

to reduce unnecessary costs, procedures and administrations. In Spain, according[69] to the Ministry of the Economy, the creation of the CNMC is expected to save 28 million of euros. In Netherlands, the same ministry announced[70] that this merger would save 7.4 million of euros a year.

At least, the merger of the sector regulator and the competition authority into an independent single authority avoid the influence or even the capture[71] of the regulator by the government or by private interests. Allegedly[72], it was the relative failure of the legislative strategy what lead to the creation and spread of the NRAs, deemed by many[73] as an excessive proliferation of agencies and a source of jurisdictional confusion. If they have to work alongside with NCAs, maybe merging both would avoid many of the conflicts and the problems we have described in this paper.

5. Concluding remarks

We have examined in this paper the existing chaos in the concurrent application of sector specific regulation and competition law to the telecom operators; we have shown also the source of jurisdictional confusion arising from the concurrent enforcement of those normative bodies by different set of agencies (NCAs, NRAs, etc.). However the greatest danger arises not from these procedural or substantive disputes, but from something deeper, more profound, the underlying problem: conflicts between competition law principles and regulatory objectives.

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69 http://economia.elpais.com/economia/2013/06/06/actualidad/1370519094_817515.html (accessed 24 November 2013).

70 http://postandparcel.info/54979/news/regulation/dutch-consumer-competition-and-postal-regulators-merge/ (accessed 14 December 2013).

71 See, for a detailed explanation of how the unification of both functions helps to avoid the classical 'regulator capture', as well as other advantages, after a close examination of the work done in the United States by the Department of Justice (DOJ) and de Federal Communications Commission (FCC), their NCA and NRA respectively, Baker, J. [2013] 'Antitrust Enforcement and Sectoral Regulation: the Competition Policy benefits of Concurrent Enforcement in the Communications Sector', Competition Policy International, Vol. 9, n. 1, Spring 2013, available at: http://ssrn.com/abstract=2313366 (accessed 14 June 2013).

72 Tapia, J., and Mantzari, D., *op. cit.*, at. 8.

73 Petit, N. [2004] 'The Proliferation of National Regulatory Agencies alongside National Competition Authorities: a source of jurisdictional confusion', *GCLC Working Paper Series 02/04*, available at: https://www.coleurope.eu/sites/04b_gclc_working_paper_02-04.pdf (accessed 14 June 2013).

It is a somehow established –and admitted– principle that competition law seeks to promote economic efficiency by protecting the competitive process, along with the market structure, and thus benefits consumers. Regulation, however, differs in that it seeks to correct market imperfections and failures over time; specifically important when we are dealing with recently liberalized markets, those journeying from monopolization to competition. Here, regulation's tasks include, where necessary, the creation for the incumbents of precise duties that could not be imposed under competition law.

Accordingly, competition law cannot and should not be used to achieve regulatory objectives. Some of these, which we have examined in this paper, include assisting the entry of additional operators on the market through mandatory access conditions imposed to the incumbent or favourable pricing mechanisms. Thus, it should be clear by now that the risk regulating through competition law is particularly severe when sector-specific regulators have concurrent powers to apply competition rules to the industry whose vigilance they are entrusted.

Also, it looks like competition authorities who enforce antitrust laws in recently-liberalised markets must recall again and again that their duty is to protect competition and not competitors. Therefore, only in exceptional circumstances incumbents –true, former monopolists, at least in the communications sector– can only be required under competition law to assist their competitors, and preserve their allegedly 'weak' situation; however, never should they be charged with a duty to compensate rivals for any advantages that they might be under, unless, of course, it is because the former's actions that the later suffer such a disadvantageous situation.

Few –if any– dispute now that consumers are best served by competition policies and enforcers actions that only protect competition on the merits. Acting in the way we have described in this paper, is simply promoting the uncertain gains of short-term inefficient entry over the present certainty of that essential premise.

Accordingly, and after revisiting the margin squeeze cases and the disastrous outcomes of concurrent enforcement of competition law and sectoral regulation by NRAs and NCAs, we simply propose a solution, consisting in merging both agencies, like Spain has recently done by creating the CNMC.

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Consumer activity in the British retail electricity market: cluster analysis approach[1]

MIGUEL FLORES* & CATHERINE WADDAMS PRICE**

ABSTRACT

Using a specially generated data set, we identify different groups of consumers according to their general consumption attitudes. We find substantial heterogeneity between groups of consumers, which is reflected in differences in the members' search and switching activity.

KEYWORDS: Switching Behaviour; Electricity Market; Competition Policy.

1. Introduction

When markets supplied by an incumbent monopolist are opened to retail competition and ex ante price controls are removed, the benefits of market liberalisation for consumers depend on consumers actively searching out and switching to better deals.[2]

Despite the efforts of some European countries to promote consumer activity, the European Commission finds that consumers often fail to take advantage of potential gains available from switching supplier in

1 We acknowledge funding from the UK Economic and Social Research Council (ESRC) and useful comments from participants at the University Institute for European Studies (Madrid).

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2 Consumer behaviour plays a crucial role in competition policy (e.g. Prendergast C., `Consumers and agency problems' (2002) 112 The Economic Journal C34-51; Waterson M., `The role of consumers in competition and competition policy' (2003) 21 International Journal of Industrial Organization 129-150; Wilson, C., and C. Waddams Price, `Do consumers switch to the best supplier' (2010) 62 Oxford Economic Papers 647-668) because the way in which consumers search and eventually switch provider can have a substantial impact on market power and competition.

liberalised energy markets.[3] The UK government and energy regulator have promoted consumer empowerment and activity, including constraints on tariffs which companies may offer to simplify consumer choice and stimulate activity. Despite these efforts the UK levels of switching have continued to fall to their lowest level since records began a decade earlier (12% in the year up to the first quarter of 2013, compared with 20% four years earlier[4]), suggesting concerns about whether consumers are sufficiently active to generate effective competition in the residential electricity market.

Understanding what determines activity, and how this varies between consumers, is crucial to maximise the effectiveness of policies targeting consumer searching and switching. The *aim* of this paper is to identify different groups of consumers according to their general consumption attitudes and test how different those groups are in terms of searching and switching activity, socio-economic characteristics and other important factors, such as consumers' own belief about potential gains and the time and effort required to search and switch supplier.

We use a specially designed survey conducted in January 2011 that includes information about search and switching behaviour in the electricity market, general attitudes to markets and consumption and specific views on the electricity market, socio-economic characteristics, and consumers' own beliefs about potential gains and the time and effort required to search and switch supplier. We analyse the data using cluster analysis to identify three different groups of consumers according to their general consumption attitudes. We then investigate the differences in search and switching behaviour between those groups.

We find evidence of heterogeneity between groups, which is reflected in differences in the members' search and switching behaviour. Our data set suggests that consumer activity has limitations to promote competition in the UK retail electricity market. We believe that identifying different types of consumer enables more targeted strategies and provides a promising basis for policy development.

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3 European Commission, `The functioning of the retail electricity markets for consumers in the European Union' (2010) Commission Staff Working Paper.

4 Source Department of Energy and Climate Change Quarterly domestic energy switching statistics (QEP 2.7.1).

1.1. Relevant Literature

There are behavioural explanations for low consumer activity in energy markets, such as a status quo bias toward the incumbent firm[5]. Some consumers lack experience in searching and switching to better deals, others may lack interest or capacity, and some may expect prices to be similar regardless of the supplier they choose, either because they believe that the market is competitive or because they suspect explicit or tacit collusion between suppliers.

Several papers study consumers' switching decisions in energy. In the Swedish electricity market Garling et al.[6] demonstrated experimentally the existence of switching inertia, and Ek and Söderholm[7] showed that potential gains from more active behaviour are positively related to the probability of changing supplier and/or renegotiating contracts with existing suppliers. We focus on different groups of consumers rather than, as they did, on the average consumer, and we consider separately the roles of searching and switching.

Wilson and Waddams Price[8] present evidence that consumers' capacity to choose efficiently between electricity suppliers is limited,[9] and suggest that observed consumer behaviour may be driven by pure decision error or inattention. Sitzia et al.[10] present experimental evidence of the importance of both complexity and inattention in energy markets contexts, and conclude that while easier comparisons may remove some barriers to activity, other important factors, in particular consumer inattention, are key to increasing switching performance.

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5 Samuelson, W., and R. Zeckhauser, `Status quo bias in decision-making' (1988) 1 Journal of Risk and Uncertainty 7-59.

6 Gärling, T., A. Gamble, and E. Asgeir Juliusson, `Consumers' switching inertia in a fictitious electricity market' (2008) 32 International Journal of Consumer Studies 613-618.

7 Ek, K., and P. Söderholm, `Households' switching behavior between electricity suppliers in Sweden' (2008) 16 Utilities Policy 254-261.

8 Wilson, C., and C. Waddams Price, `Do consumers switch to the best supplier' (2010) 62 Oxford Economic Papers 647-668.

9 They use the EA survey conducted in 2000, and the CCP survey from 2005.

10 Sitzia, S., J. Zheng, and D. Zizzo, `Complexity and Smart Nudges with Inattentive Consumers' (2012) CCP Working Papers 12-13.

Waddams Price et al.[11] show persistent variations in responses both across markets and between consumers,[12] suggesting that policies which identify potential gains and give consumers confidence in their estimates are likely to improve consumer activity. Giulietti et al.[13] examine switching behaviour in the deregulated UK residential natural gas market and find that longer-term savings are the main drivers of switching behaviour.

In the next section we describe the data set and variables. Section 3 identifies different groups of consumers using cluster analysis, and section 4 discusses the potential implications for policy design.

2. Data set

Our household survey was administered through face-to-face interviews with a representative sample of 2537 adults aged 16 and over in Great Britain in January 2011. From this group we analyse 1992 responses from those who are aware that they can choose their electricity supplier and who are (solely or jointly) responsible for making that choice.

Activity variables. A binary activity variable, *search*, takes the value of 1 if the respondent reports that during the last three years she explored the possibility that another electricity supplier could offer a better deal, and takes the value 0 otherwise. A second activity variable, *switch*, takes the value of 1 if the respondent reports changing electricity supplier during the same period, and takes the value 0 otherwise.[14]

Socio-economic variables. We use socio-economic variables for observable differences between respondents, including *age*, *gender*, *partner status* and *number of adults*. Information about whether the house is in a *rural area*, *internet use* and *tenure status* for each respondent are also included. To avoid anticipated reluctance to provide income information and consequent missing observations, we construct a

[11] Waddams Price, C., C. Webster, and M. Zhu, `Effective empowerment: Empirical estimates of consumer switching behaviour' (2013) CCP discussion paper forthcoming.

[12] They use the 2005 CCP consumer survey and distinguish between eight different markets.

[13] Giulietti, M., C. Waddams Price, and M. Waterson, `Consumer Choice and Competition Policy: A Study of UK Energy Markets' (2005) 115 The Economic Journal 949-968.

[14] We exclude the possibility of changing supplier because of moving house.

variable, *proxy income*, to capture the respondent's perception of the tightness of her budget. *Educational* and *employed status* were each included as binary variables.

Attitudes variables. Respondents were asked how far they agreed with six statements on general attitudes to markets. Each statement had six options, and was coded –1 if the respondent disagreed (strongly or unspecified), 1 if she agreed (strongly or unspecified) and 0 if she neither agreed nor disagreed or did not know. General market attitude was measured by agreement with the statement "When making bigger purchases (e.g. holidays or furniture) I usually spend quite a lot of time looking around for deals that might save a few pounds" (*big bargain hunter*). To assess time constraints, respondents were asked to rate: "I don't really have the time to spend looking around for deals that might save a few pounds" (*gain/time*) and "Life is too short to keep worrying about whether you are getting the best deal around" (*life too short*). Two statements measured 'loyalty', namely "Once I find a product or service that I think is OK, I tend to stick with it" (*status quo*) and "I would be upset if I purchased a product or service and later found out that I could have got a better deal" (*feel regret*).

Information/marketing variables. Respondents were asked whether they recalled receiving information or marketing from a range of potential sources, including advertising by other electricity suppliers (such as on the internet, billboards, newspapers, magazines etc.); direct marketing by telephone and by home visits; approaches in public places; direct mailing (post or email); or information from friends or family about a better deal from another electricity supplier. Each of these was represented by a binary variable where 1 indicates such communication was received, and 0 that the respondent does not recall any message in this category.

Expectations. Respondents were asked how much money they had expected to save per year by changing supplier, distinguishing between their expectations before and after they had looked around for better deals, and generating variables *presearchexgain* and *preswitchexgain* respectively. We also asked how confident the respondents were of those expected gains. We create binary variables for confidence about each of these alternatives: *confidpresearch* and *confidpreswitch*.

Participants were asked how long they expected to have to look around for better deals and the time they expected it would take to change electricity supplier once they had found one. We explicitly identify the amount of time anticipated before each activity took place, as *presearchextime* and *preswitchextime*, respectively[15]. Expectations about ease or difficulty of the searching/switching process are captured by the binary variables *presearchexeasy* and *presearchexeasyswitch*.

Switching experience. Respondents were asked whether they have changed the company that supply various other services, namely mobile telephone, broadband or dial-up internet, fixed-phone line rental, fixed phone calls package, car or home contents insurance, bank account or mortgage over the previous twelve years. The variable '*switch other*' took the value 1 if such a change had been made in any of these markets, and 0 otherwise.

Details of the variable definitions are in the Appendix.

[15] We were unsuccessful in our attempts to distinguish between expectations of switch time before and after searching.

3. Cluster analysis

We used Ward's method[16] to identify three groups - G1, G2 and G3 - of consumers according to their general consumption attitudes, as shown in table 1 below.

Table 1. Mean characteristics of each cluter

	G1	G2	G3	Sample
Attitudes used for grouping (mean)				
Big bargain hunter	0.97	0.99	0.06	0.63
Gain/time	-0.80	0.99	0.31	0.09
Life too short	0.01	0.44	0.77	0.41
Status quo	0.68	0.86	0.94	0.83
Feel regret	0.93	0.89	-0.11	0.52
Attitudes to electricity market (mean)				
Same price	0.21	0.56	0.62	0.46
Regular search	-0.35	-0.54	-0.77	-0.56
Activity in the electricity market: proportion which				
Searched	0.41	0.29	0.19	0.29
Switched	0.37	0.26	0.23	0.286
Number of observations	708	522	762	1992

The grouping process which clusters similar responses together results in some extreme values for the variables within each group. Members of G1 are less likely[17] to stick with a product/service and more likely to have time to look around for better deals. G2 is likely to stick with a product/service and has little time to look around for better deals. Members of G3 are most likely to stick with a product/service and least likely to spend time looking around when making big purchases (e.g. furniture or holiday).

[16] This is a standard hierarchical agglomerative linkage method, in which the fusion of two clusters is based on the size of an error sum-of-squares criterion. For more details see Everitt, B., S. Landau, Leese, and D. Sthal, `Cluster Analysis 5th Edition' (2011) Wiley Series in Probability and Statistics.

[17] Our comparison of the groups is restricted to variables which are significantly different at 1%.

Table 2. Descriptive Stadistics

Variable	Obs.				Mean				Std. Dev.			
	G1	G2	G3	Sample	G1	G2	G3	Sample	G1	G2	G3	Sample
switch	708	762	522	1992	0.37	0.23	0.26	0.29	0.48	0.42	0.44	0.45
search	708	762	522	1992	0.41	0.19	0.29	0.29	0.49	0.39	0.45	0.45
gender	708	762	522	1992	0.43	0.51	0.52	0.48	0.49	0.50	0.50	0.50
age	708	762	522	1992	48.4	55.2	48.8	51.1	16.3	18.4	16.2	17.4
educ	708	761	520	1989	0.28	0.26	0.31	0.28	0.45	0.44	0.46	0.45
house area	708	762	522	1992	0.87	0.86	0.86	0.86	0.33	0.35	0.35	0.34
marital status	708	762	522	1992	0.69	0.60	0.65	0.65	0.46	0.49	0.48	0.48
employed status	708	762	522	1992	0.54	0.46	0.61	0.53	0.50	0.50	0.49	0.50
adults	708	762	522	1992	2.08	1.90	2.02	2.00	0.88	0.81	0.87	0.85
internet use	708	762	522	1992	0.80	0.62	0.78	0.73	0.40	0.48	0.41	0.45
tenure	708	762	522	1992	0.67	0.68	0.67	0.67	0.47	0.47	0.47	0.47
proxy income	699	751	518	1968	2.45	2.65	2.52	2.55	0.90	0.96	0.93	0.93
same price	708	762	522	1992	0.21	0.62	0.56	0.46	0.90	0.71	0.76	0.81
regular searcher	708	762	522	1992	-0.35	-0.77	-0.54	-0.56	0.87	0.56	0.77	0.76
status quo	708	762	522	1992	0.68	0.94	0.86	0.83	0.68	0.27	0.48	0.51
life too short	708	762	522	1992	0.01	0.77	0.44	0.41	0.91	0.56	0.82	0.84
gain/time	708	762	522	1992	-0.80	0.31	0.99	0.09	0.40	0.85	0.08	0.92
feel regret	708	762	522	1992	0.93	-0.11	0.89	0.52	0.31	0.80	0.39	0.75
big bargain hunter	708	762	522	1992	0.97	0.06	0.99	0.63	0.20	0.87	0.08	0.71
advertising	708	762	522	1992	0.70	0.61	0.68	0.66	0.46	0.49	0.47	0.47
telephone	708	762	522	1992	0.39	0.37	0.39	0.38	0.49	0.48	0.49	0.49
doorstep	708	762	522	1992	0.55	0.56	0.54	0.55	0.50	0.50	0.50	0.50
public place	708	762	522	1992	0.36	0.25	0.29	0.30	0.48	0.43	0.46	0.46
mail/email	708	762	522	1992	0.43	0.41	0.44	0.43	0.50	0.49	0.50	0.49
friend/family	708	762	522	1992	0.23	0.16	0.18	0.19	0.42	0.37	0.39	0.39
switchgainpresearch	450	367	278	1095	89.3	77.7	88.2	85.09	109.9	143.6	118.2	124.2
switchgainpreswitch	466	371	289	1126	95.6	77.0	94.4	89.20	109.8	147.2	133.7	129.5
searchtime	602	558	423	1583	78.2	65.9	77.3	73.61	114.4	97.6	100.0	105.0
switchtime	601	559	418	1578	66.3	62.0	64.8	64.37	115.5	104.0	91.3	105.4
confidpresearch	415	318	253	986	0.74	0.64	0.64	0.68	0.44	0.48	0.48	0.47
confidpreswitch	440	331	267	1038	0.77	0.65	0.67	0.70	0.42	0.48	0.47	0.46
presearchexeasy	665	675	488	1828	0.81	0.79	0.79	0.80	0.39	0.41	0.41	0.40
presearchexeasyswitc	666	685	490	1841	0.79	0.76	0.78	0.78	0.41	0.43	0.41	0.42
switch other	708	762	522	1992	0.89	0.75	0.83	0.82	0.32	0.43	0.37	0.38

The groups display similar characteristics in their specific attitudes to the electricity market (though these were not used to assign respondents to groups): the first group expects to find price differences between suppliers, while the second and third groups expect prices to be similar. As a consequence of these expectations, no doubt, the first group is more likely to check the electricity deals available regularly, and is more likely to have searched and switched. Switching is less prevalent in group 3 than in the other groups, but members of group 3 are not significantly less likely to search for better deals than group 2. While a higher proportion of groups 1 and 2 have searched than have switched, more in group 3 have switched than searched. These observations demonstrate the considerable heterogeneity between groups in these regards. Table 2 reports the number

of observations, mean and standard deviation for all the variables by group, and for the whole sample, and table 4 reports the statistical significance differences of these variables between groups. The groups are broadly similar demographically, though more of the first group are female, and the third group is somewhat older. G3 used the internet less frequently, and has more comfortable household budget availability, and G1 has most experience in switching in other markets, while G3 is least experienced.

The expectations of potential gain and the time required and ease of search and switching show little significant variation between groups, but G1 showed more confidence in gains. More importantly, the groups differ in their ability to provide estimates of the time anticipated for searching and switching, the ease of these activities, the potential gains available and their confidence in the estimates of the gains. Just over half of G1 provided all the estimates, while only 42% of G2 and 31% of G3 did so. The characteristics of the subgroups are shown in table 3, and the tests of significant differences with their relevant parent group are reported in table 4. The subset who provided these estimates, who we refer to as G1a, G2a and G3a respectively, were, not surprisingly, each more active than their 'parent' groups; fewer expected the same price and more undertook regular search.

Those who could provide responses for all questions reported that they had expected significantly higher gains before they started searching, but in most other respects the subgroups expressed similar expectations to those in their respective full group[18]. In terms of demographics, the included subgroup G1a contained a higher proportion of men and is younger on average than its rather female dominated parent group; subgroups 2a and 3a have had more years of formal education than their respective full groups. Across the groups, a larger proportion of the included subgroup is in employment, and members use the internet more frequently than in the respective parent group. In group 3, a larger proportion of those included own their own house.

Some attitudes also vary between the full and included subgroups. Fewer in subgroup 1a stick to products they like and think that life is too short to worry about getting the best deal than in group 1 as a whole.

[18] Of course this comparison is complicated by missing values, but some respondent could answer some but not all the questions.

Across the whole sample fewer in the included subgroups than in their full groups believe electricity prices are similar, and more report that they are regular searchers: subgroups are more active, both in the electricity and in other markets than their respective parent groups.

Table 3. Descriptive sub group a.

	Mean			St. Dev.		
	G1a	G2a	G3a	G1a	G2a	G3a
switch	0.24	0.17	0.16	0.43	0.38	0.37
search	0.26	0.17	0.13	0.44	0.38	0.33
same	0.39	0.63	0.67	0.84	0.69	0.65
regular	-0.49	-0.63	-0.80	0.80	0.71	0.52
status	0.77	0.87	0.94	0.58	0.47	0.26
life too short	0.18	0.43	0.77	0.89	0.82	0.55
gain/time	-0.78	0.99	0.30	0.42	0.08	0.84
feel	0.94	0.88	-0.10	0.29	0.43	0.80
big	0.98	0.99	0.01	0.15	0.08	0.86
gender	0.38	0.49	0.50	0.49	0.50	0.50
age	50.3	49.8	56.1	17.6	17.1	19.2
educ	0.27	0.25	0.23	0.44	0.43	0.42
house area	0.89	0.86	0.86	0.32	0.35	0.35
marital status	0.63	0.64	0.55	0.48	0.48	0.50
employed status	0.49	0.56	0.43	0.50	0.50	0.49
adults	2.03	2.02	1.87	0.94	0.89	0.82
internet use	0.72	0.73	0.57	0.45	0.45	0.50
tenure	0.64	0.64	0.65	0.48	0.48	0.48
proxy income	2.38	2.44	2.61	0.86	0.93	0.98
advertising	0.67	0.67	0.61	0.47	0.47	0.49
telephone	0.39	0.41	0.35	0.49	0.49	0.48
doorstep	0.51	0.50	0.54	0.50	0.50	0.50
public place	0.34	0.29	0.22	0.48	0.46	0.41
mail/email	0.38	0.44	0.40	0.49	0.50	0.49
friend/family	0.20	0.17	0.15	0.40	0.38	0.36
switchgainpresearch	54.6	53.6	49.6	86.4	89.9	147.3
switchgainpreswitch	72.0	73.2	52.0	95.6	118.9	150.5
searchtime	66.4	73.2	66.2	73.0	86.5	105.9
switchtime	62.7	60.4	60.2	102.3	72.4	114.7
confidpresearch	0.80	0.78	0.63	0.40	0.42	0.49
confidpreswitch	0.84	0.76	0.61	0.37	0.43	0.49
presearchexeasy	0.79	0.79	0.78	0.41	0.41	0.41
presearchexeasyswitch	0.76	0.75	0.74	0.42	0.44	0.44
switch other	0.85	0.79	0.70	0.35	0.41	0.46

Table 4. t-test

Variable	G1 vs G2	G2 vs G3	G1 vs G3	G1a vs G1b	G2a vs G2b	G3a vs G3b
switch	***	not sig	***	***	***	***
search	***	***	***	***	***	***
gender	***	not sig	***	***	not sig	not sig
age	not sig	***	***	***	not sig	*
educ	not sig	*	not sig	not sig	***	***
house area	not sig	not sig	not sig	not sig	not sig	not sig
marital status	not sig	*	***	***	not sig	***
employed status	***	***	***	**	***	***
adults	not sig	**	***	not sig	not sig	*
internet use	not sig	***	***	***	***	***
tenure	not sig	not sig	not sig	*	*	***
proxy income	not sig	**	***	**	**	*
same price	***	not sig	***	***	***	***
regular search	***	***	***	***	***	**
status quo	***	***	***	***	not sig	not sig
life too short	***	***	***	***	not sig	not sig
gain/time	***	***	***	not sig	not sig	not sig
feel regret	*	***	***	not sig	not sig	not sig
big bargain hunter	**	***	***	not sig	not sig	**
advertising	not sig	***	***	**	not sig	not sig
telephone	not sig	not sig	not sig	not sig	not sig	not sig
doorstep	not sig	not sig	not sig	*	**	not sig
public place	**	*	***	not sig	not sig	***
mail/email	not sig	not sig	not sig	**	not sig	not sig
friend/family	**	not sig	**	*	not sig	not sig
switchgainpresearch	not sig	not sig	not sig	***	***	***
switchgainpreswitch	not sig	not sig	**	**	not sig	***
searchtime	not sig	*	**	**	not sig	not sig
switchtime	not sig	not sig	not sig	not sig	not sig	not sig
presearchexeasy	not sig	not sig	not sig	not sig	not sig	not sig
presearchexeasyswitch	not sig	not sig	not sig	not sig	**	not sig
confidpresearch	***	not sig	***	not sig	not sig	not sig
confidpreswitch	***	not sig	***	*	not sig	not sig
switch other	***	***	***	***	**	***

*, **, *** indicate statistical significance at the 10%, 5% and 1% levels, respectively.
not sig: the hypothesis mean variable x in group i = mean variable x in group j cannot be rejected.

4. Discussion

The *heterogeneity* between the groups is reflected in differences in the members' search and switching activity. G1a searches regularly and will switch only when they find a good deal, which is less likely since they are probably already on relatively favourable contracts. G3a

exhibits low search, consistent with their expectation that prices in the electricity market are similar. Moreover G3a consumers feel least regret at 'bad' decisions, so members of this group may switch provider without confirmation that they are getting the best deal available.

Our data set suggest that relying on consumers' activity to promote competition in the retail electricity market has limitations. Most of the consumers rarely check the deals available and many consumers do not proceed to switch even if they expect that they could save money by changing supplier.

More generally, the observed heterogeneity between groups of consumers suggests that more targeted policy strategies are required to improve consumer activity in the electricity market.

Appendix

Table A. Variable Descriptions

Variable	Definition
switch	=1 if the respondent changed electricity supplier, 0 otherwise.
search	=1 if the respondent explored deals available at other electricity suppliers in the last three years, 0 otherwise.
gender	=1 if male, 0 otherwise.
age	Number of years
education	=1 if degree, postgraduate, etc., =0 if no-quali□cation (education less than degree).
house area	=1 if non-rural, =0 if rural.
marital status	=1 if married or living with partner, =0 if single or widowed or separated or divorced.
employed status	=1 if working (part-time or full-time), =0 if not working.
adults	Number of adults in the household.
internet use	How often internet has been used. =1 if last week, =0 if less than last week.
tenure	=1 own home, = 0 if non-own home.
proxy income	Household budget availability. =1 if very tight, =2 if tight, =3 if comfortable, =4 if very comfortable.
sameprice	There isn't much point in changing electricity supplier because you end up paying pretty much the same whoever you are with. =1 if agree, =0 neither agree nor disagree, =-1 if disagree.
regularsearch	I regularly check the deals available at other electricity suppliers to be sure that I am not paying more than I need to. =1 if agree, =0 neither agree nor disagree, =-1 if disagree.
statusquo	Once I find a product or service that I think is OK, I tend to stick with it. =1 if agree, =0 neither agree nor disagree, =-1 if disagree.
lifetooshort	Life is too short to keep worrying about whether you are getting the best deal around. =1 if agree, =0 neither agree nor disagree, =-1 if disagree.
gain/time	I don't really have the time to spend looking around for deals that might save a few pounds. =1 if agree, =0 neither agree nor disagree, =-1 if disagree.
feelregret	I would be upset if I purchased a product or service and later found out that I could have got a better deal. =1 if agree, =0 neither agree nor disagree, =-1 if disagree.
bigbargainhunter	When making bigger purchases (e.g. furniture or holiday) I usually spend quite a bit of time looking around for deals that might save a few pounds. =1 if agree, =0 neither agree nor disagree, =-1 if disagree.
advertising	=1 if respondent reports seeing advertising from other suppliers, 0 otherwise.
telephone	=1 if respondent reports contact by telephone from other suppliers, 0 otherwise.
doorstep	=1 if respondent reports visit at home from other suppliers, 0 otherwise.
public place	=1 if respondent reports contact in public place by other suppliers, 0 otherwise.
mail/email	=1 if respondent reports receiving postal mail or email from other suppliers, 0 otherwise.
friend/family	=1 if respondent reports beeing told about possible better deals by friends or family, 0 otherwise.
switchgainpresearch	Amount of money (£) respondent could save per year by changing supplier before looked around for better deal.
switchgainpreswitch	Amount of money (£) respondent could save per year by changing supplier.
searchtime	Amount of time (in minutes) to find out about the deals available at other suppliers.
switchtime	Amount of time (in minutes) it would take to change supplier.
confidpresearch	=1 if before search the respondent is confident about amount expected to save per year to the nearest £5 by changing supplier, 0 otherwise.
confidpreswitch	=1 if before switch the respondent is confident about amount expected to save per year to the nearest £5 by changing supplier, 0 otherwise.
switchother	=1 if respondent has changed provider in another market (mobile, broadband internet, fixed phone line, car insurance, bank account, home contents insurance, mortgage) in the last twelve years, 0 otherwise.

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An attempt to increasing competition in public procurement: One example in the Basque Country

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ABSTRACT

Liberalisation seeks to achieve an efficient and competitive single market. Despite the efforts undertaken, liberalisation is not yet considered to be complete. The Services Directive allows companies to offer a range of cross-border services, but certain sectors, such as transport, still face the existence of separate national markets. Liberalization inside national markets faces the same problem and the implications in public procurement seem more frequent and relevant than in the private sector.
Considering the nature of Service of General Interest (SGEI) of transports, the provision of the service implies the use of public procurement procedures deeply regulated both at the European and national level. The use of public entities owned by one administration to provide the services of transport of other administration implies the presentation of bids in tenders opened by other administrations in concurrence with private entities. This could lead to competition issues in certain situations considering economic and legal aspects. This paper deals with the analysis of the situation inside Spain, considering the complex system of decentralized administrative powers and its application to public transport.

KEYWORDS: Public procurement, Advocacy, Road Transport; Administrative Competences.

1. Introduction

There is no doubt that one of the EU's main objectives is to achieve a single market. People, goods, services and capital must be able to circulate within the EU with the same freedom as within one country.

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Liberalisation seeks to achieve an efficient and competitive single market. Despite the efforts undertaken, liberalisation is not yet considered to be complete, and the services sector is opening more slowly than the goods market. The Services Directive allows companies to offer a range of cross-border services, but certain sectors, such as transport, still face the existence of separate national markets.

Transport is fundamental to society and the economy, as growth and job creation depend on it. The ability to compete in the economy is conditioned by the efficiency of transport systems. For all those reasons, the efficiency of transport services and the ability of companies to compete on an equal footing in this market are of the utmost importance, and the purpose of this report is highly relevant to the Basque economy.

Transport liberalisation efforts have been reflected in partial initiatives at EU level. Regulation No 1370/2007 on public passenger transport services by rail and by road, states that at the present time, many inland passenger transport services that are required in the general economic interest cannot be operated on a commercial basis. Thus, the Regulation recognises that the competent authorities of the Member States have the power to intervene to ensure the provision of these services.

For its part, Regulation No 169/2009, applying rules of competition to transport by rail, road and inland waterway, generalises the application of competition law, however it takes into account certain aspects of transport that require a differentiated response from the order.

This process of EU liberalisation is necessarily reflected in an equivalent liberalisation process in public services by Member States. Therefore, following the model and European guidelines, our system has evolved towards the privatised management of important public services.

The Sustainable Economy Act contains a chapter on sustainable transport and mobility, which, in Article 93 establishes the principles for the regulation of the transport sector. In particular, it states that 'the regulation of transport activities by Public Authorities shall comply with the following principles:

a) The protection of operators and user rights, particularly the right of equality in access to transport markets, participation, complaints and claims.

b) The enhancement of market conditions conducive to competition.

c) The efficient management by operators and Public Authorities[1].

It is therefore indisputable that the Administration must double its efforts in these markets so that the provision of services is performed efficiently, and so that the most competition friendly alternative from those available is chosen.

This study undertakes an analysis of the Administration's role in the markets and its impact on competition, taking into account the nature of the service of general economic interest of inland transport and the complex jurisdiction network co-existing in the different levels of administrations in Spain. All these issues, along with the tradition of Spain's Administrations to resort to their own resources or public undertakings, have an effect on the liberalisation of transport services and therefore on competition. The main focus of this reflection revolves around the possibility of an Administration's public undertaking submitting bids to tenders from other Administrations, and the issues that could arise from this situation in the protection of free competition principles. In order to conduct this analysis, a more comprehensive study was used on the role that the Administration can play in the markets and the implications of its actions.

2. The administration and its role in the markets

State activity is defined as all the material and legal acts, operations and tasks performed by the state by virtue of the powers conferred upon it by legislation, in order to achieve its objectives established by law. Accordingly, State activity requires the creation of organisations (including the Administration) to achieve these objectives and to exercise its duties. Only legal regulations can attribute authority directly to these agencies[2].

1 Act 2/2011 of 4 March on the Sustainable Economy (Article 93).

2 Spanish Constitution (Article 103 (1)) provides that 'The Public Authority serves general interests with objectivity and acts in accordance with the principles of efficiency, hierarchy, decentralisation, de-concentration and coordination, being fully subject to justice and the law.'

The administrative role is therefore evident in the compliance with a legal mandate aimed at the State being able to carry out its organisational objectives. Public service is among the Administration's activities (along with police services and development). Public service is, directly or indirectly, the activity that aims to meet general needs, either directly through state bodies, whether through concessions or private businesses, subject to a special public law regime.

In domestic law, the State has recognised, along with its strict public law duties, the capacity for economic initiative. Article 128 of the Spanish Constitution recognises public initiative in economic activity. There is, therefore, an expression of the Supreme Court in our constitutional system, which is 'the co-existence of two economic production sectors, the private and the public, which constitute what has come to be referred to as a mixed economy system'[3].

In order for the State to intervene in the economic initiative, various types of agencies have been created, broadening the meaning of the traditional administration considerably. Public limited companies, as part of the Administration, shall, as established by Article 103 (1) of the Spanish Constitution, serve general interests with objectivity and fully compliance to justice and the law. Furthermore, according to Article 31 (1) of the Spanish Constitution, 'public expenditure shall make an equitable allocation of public resources, and its programming and execution shall comply with the criteria of efficiency and economy'.

In the application of these principles, the Supreme Court has repeatedly established the limits of that public initiative in economic activity. The Supreme Court stresses that the fundamental issues that accompany the public undertaking, regardless of its legal form, comprise: that the organisation is controlled and conditioned by the Administration, i.e. its instrumental character. It also highlights that the activity carried out by the public undertaking must coincide with the objectives that the Administration has assumed[4]. The Supreme Court continues, explaining

[3] Court Decision, Administrative Division, Ruling of 10 October 1989. Second recital. [Spanish Supreme Court].

[4] See Decision of 28 September 1978 [Spanish Supreme Court], second recital.

that the profit is compatible with the public undertaking provided that it is subordinated to the general interest[5].

> '(...) while private individuals may set up companies with complete freedom, without further condition than the purpose being lawful (Article 38 of the Spanish Constitution), all actions by Bodies of the Public Authority must tend to the public interest and must always concur (Article 103 (1) of the Spanish Constitution), whether they are acts of authority, such as business actions, as for the latter, Article 31 (2) of the Spanish Constitution also requires an equitable allocation of public resources, and that its programming and execution shall comply with criteria of efficiency and economy, which is not compatible with public business actions that are devoid of justification' (...)

In short, the creation of public undertakings for business purposes is legally possible, but it is subject to the double condition that the business activity that is to be carried out with the public undertaking is undoubtedly of public interest, which is appreciable and appreciated at the time of its creation, and that in the exercise of the public undertaking's economic business activity is subject, without direct or indirect exception or privilege, to the same competition rules governing the market[6].

Thus there are two axes on which State intervention tilts in the economy, which are intrinsically and inextricably linked: the involvement of a valued and significant public interest and the respect of free competition. The Administration must be able to prove the concurrence of both ends at all times in the performance of its public undertakings to justify their existence and activity.

In any case, the element of public use or public interest (and not economic or tax purposes, or administrative provisioning) is essential and must govern any State intervention in the market through undertakings[7]. Furthermore, general motivation is not enough; the reason to justify the State's business performance must be explicit and specified in concrete motivations[8].

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5 See Decision of 16 April, 1987 [Spanish Supreme Court]; Decision of 21 July 1987[Spanish Supreme Court].

6 As reference resolutions, see Court Ruling of 10 October 1989 [Spanish Supreme Court], *cit.* third recital and in the same regard, Court Ruling of 15 November 1985 [Spanish Supreme Court].

7 Ariño Ortiz, *Public undertakings, private undertakings, general interest companies*, (2007), 56.

8 Ariño Ortiz, *Public undertakings … cit*, p. 57 gives the following examples as sufficient justification of public interest: reasons of national security, economic policy reasons for considering the strategic sector, high risk or very long-term investment of a project that make it impossible to be borne by the private sector or management by natural monopolies.

The existence of numerous sectors that have traditionally acted as a monopoly (for natural or legal reasons and with different justifications) has had legal and economic consequences that have led to a rethinking of the system (in hand with EU requirements in many cases). The transition from a monopoly regime to a liberalised system must be gradual and it generates new issues and sometimes problems, although they may have historical bases, which are necessary to gradually correct for the sake of competition and efficiency[9].

However, even outside the liberalisation process, the intervention of the Administration as a direct provider of certain services in markets in which there are existing private operators with capability and willingness to provide a service, may affect the conditions for effective competition, due to *its potential to affect competitive neutrality*[10].

3. The liberalisation of passenger transport services in the eu and its member states

The European Union considers the achievement of the single market or interior market as one of its main objectives. People, goods, services and capital must circulate within the EU as freely as within one country. Liberalisation seeks to achieve an efficient and competitive single market[11].

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9 On how the role of public undertakings has varied over time but has never justified itself, Ariño Ortiz, *Economy and State. Crisis and reform in the public sector*. (1993), 147.

10 This competition distortion has been defined (with respect to the intervention of local agencies) as the possibility of the public action favouring the position of public operators, thus providing it with competitive advantages that the rest of the operators do not have. This intervention could even harm the results of competing private providers of public agencies to the point of them having to leave the market. The effect of *competitive neutrality* on the markets may enforce its monopoly position of the service in the past or its current monopoly position in related markets in which it competes with private operators (e.g. launching linked offers). Another way of influencing *competitive neutrality* may arise from its privileged access to specific assets or valuable information and, above all, its economic and financial advantage through its possible public funding, which lowers production costs. See Espinosa García, 'Local public services and competition' in Guillen Caramés, *Competition law and regulation in the activities of public authorities*, (2011), 213 et seq.

11 European Commission, *Europe without borders (single market)* on http://europa.eu/pol/singl/index_en.htm (in all web pages cited in this study the last date of access is 7 May 2013). European firms selling in the EU have unrestricted access to nearly 500 million consumers – giving them a solid basis for staying competitive in the world economy. Not to mention the attraction of such a vast unified market for foreign investors, as well as a valuable defence against periodic recessions.

Despite the efforts undertaken, liberalisation has a long way to go, and the services sector is opening more slowly than the goods market. The Services Directive allows companies to offer a range of cross-border services, but certain sectors, such as transport, still face the existence of separate national markets[12].

Transport is fundamental to society and the economy, as growth and job creation depend on it. The ability to compete in the economy is conditioned by the efficiency of transportation systems[13]. For all those reasons, the efficiency of transport services and the ability of companies to compete on an equal footing in this market is of the utmost importance, and the purpose of this report is highly relevant to the Basque economy.

Transport liberalisation efforts have been reflected in partial initiatives at community level:

Regulation No 1370/2007 on public passenger transport services by rail and by road establishes that at the present time, those inland passenger transport services required in the general economic interest cannot be operated on a commercial basis[14]. Thus, the regulation recognises that the competent authorities of the Member States have the power to intervene to ensure the provision of these services.

On the other hand, Regulation No 169/2009, applying rules of competition to transport by rail, road and inland waterway, proclaims the application of competition law on a general basis, although taking into account certain aspects of transport that require a differentiated response from the order[15].

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12 See Directive 2006/123/EC European Parliament and The Council of 12 December 2006 on services in the internal market. OJEU L 376/36. 27 December 2006.

13 The transport sector directly employs about ten million people and accounts for about 5% of the European Union's GDP. In addition to European companies, transport and storage logistics accounts for 10-15% of the cost of the finished products. Furthermore, the quality of transport services greatly influences people's quality of the life. Therefore, an average household spends 13.2% of their budget in the transport of goods and services. European Commission, *Europe without borders (single market) cit.*

14 Regulation (EC) No 1370/2007 of the European Parliament and of the Council of 23 October 2007 on public passenger transport services by rail and by road and repealing Council Regulations (EEC) No 1191/69 and No 1107/70. (OJEU of 3 December 2007)

15 Council Regulation No 169/2009 of 26 February 2009 applying rules of competition to transport by rail, road and inland waterway. The specialities that it includes primarily make reference to technical agreements and those carried out by groups of small and medium enterprises.

In the case of discretionary passenger transport by road that takes place at the level of Member States, liberalisation occurred in 1992[16]. After a transitional period which expired in 1995, non-scheduled transport was liberalised.

The liberalisation of rail transport is currently in a transitional phase. The European Commission's recent proposal for a fourth railway package established 2019 as the year to complete liberalisation[17].

This process of Community liberalisation is reflected in an equivalent liberalisation process in public services by the Member States[18]. Therefore, following the model and European guidelines, our system has evolved towards the privatised management of important public services.

Passenger transport service by road is among them, but only partially[19]. As far as the railway sector is concerned, first steps have been taken towards liberalisation, starting with the separation of infrastructure management and the provision of services of this type of transport that are already undertaken in our Community[20].

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16 The liberalisation referred to was operated at the time by Council Regulation (EEC) No 2454/92 of 23 July 1992 laying down the conditions under which non-resident carriers may operate national road passenger transport services within a Member State. OJEU L 251/1 of 29 August 1992.The above regulation has not been effect since 10 June 1999 and has been amended several times. The regulation currently in force in the subject is Regulation (EC) No 1073/2009 of the European Parliament and of the Council of 21October 2009 on common rules for access to the international market for coach and bus services, and amending Regulation (EC) No 561/2006 of 9 July 2012.

17 See Commission Communication of 17 September 2010 on the establishment of a single European railway area COM (2010) 474 final, and the fourth package of 30 January 2013 composed of six legislative proposals focused on four key areas: approvals at EU level, creating a common structure, access to the rail network and skilled labour.

18 See the Basque Competition Authority Report regarding the Proposal of Regulation that approves the Regulation of the Law on Passenger Transport by Road of 13 July 2011, in www.competencia.euskadi.net.

19 See on this point National Competition Commission *Process monitoring report on the renewal of state concessions for intercity passenger transportation by bus*, (2010). National Competition Commission *Report on extensions of intercity concessions for passenger transport by bus owned by the region*, (2010). Similarly, although it reflects an earlier point in the process, National Competition Commission *Report on minimum pricing in the transport of goods by road*. (2008) and National Competition Commission, *Report on competition in intercity passenger transport by bus in Spain*. Madrid. 2008. All are available on the website of the National Competition Commission: http://www.cncompetencia.es/Inicio/Informes/InformesyEstudiossectoriales/tabid/228/Default.aspx?pag=2

20 See Law 6/2004 of 21 May on the Basque Railways Network, which contains a complete reference to the Community legislation involved. Although it had been announced that liberalisation would be fully realised in July 2013, on 23 February, a Royal Decree-Law was published on Measures to Support Entrepreneurs, Stimulate Growth, and Create Jobs which includes the requirement for new entrants

The Sustainable Economy Act, in its chapter on transport and sustainable mobility establishes as shown before, the principles of the regulation on the transport sector, and requires authorities to guarantee operator and user rights, particularly equality rights in access to transport markets, participation, complaints and claims, the fostering of conditions conducive to competition, and efficient management by operators and public authorities.

It is therefore indisputable that the Administration should double its efforts in these markets so that the provision of services is performed efficiently, and so that the most competition friendly alternative from those available is chosen.

4. Services of general economic interest and inland transportation

Services of General Economic Interest (SGEI) can be defined as essential activities that citizens must be provided with. SGEI are commodities that comprise all service activities, commercial or not, considered to be of general interest by the public authorities and subject to specific public service obligations.

The role that SGEI play in the shared values of the European Union, and their role in promoting social and territorial cohesion are recognised by Article14 of the TFEU. Therefore, both the Member States and the Union shall take care that such services operate on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfil their missions. Similarly, the Charter of Fundamental Rights of the EU, Article 36, under Title IV on solidarity, recognises and respects access to services of general economic interest in order to promote the social and territorial cohesion of the Union[21].

These SIEG are characterised by their variety, as they reach diverse sectors such as telecommunications, energy, postal services,

to have a 'valid authorisation' which the ministry shall grant. Royal Decree-Law 4/2013 of 22 February on measures to support entrepreneurs, stimulates growth, and creates jobs. The fact that the Board of Ministers establishes the number of potential competitors in each line determines the entire process of opening up the sector to competition for the moment.

21 OJEU C 83/389 of 30 March 2010.

transport, etc. Thus there is a wide discretion of national, regional and local authorities in providing, commissioning and organising services of general economic interest *'as closely as possible to the needs of users'* and with *'a high level of quality, safety and affordability, equal treatment and the promotion of universal access and of user rights*[22] .

Despite these statements, which seem to separate these services from competition law *a priori*, the TFEU, in Article 106 (2) states that *'Public undertakings entrusted with the operation of services of general economic interest (...) shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them'.*

The rail passenger transport sector and road passenger transport sector have been defined as SGEI by the above mentioned Regulation No 1370/2007.

This Regulation (Article 5 (3)) determines that any authority which has recourse to a third party other than an internal operator, shall award public service contracts on the basis of a competitive tendering procedure[23]. The procedure adopted for competitive tendering must be open to all operators, shall be fair and shall observe the principles of transparency and non-discrimination.

This Regulation allows States to grant the operator (public or private), within the framework of a public service contract, 'compensation' in return for the discharge of public service obligations. If an obligation directed to establish maximum tariffs is imposed, the competent authority must compensate the public service operators for the net financial effect on the costs and revenues that they incurred in complying with the established tariff obligations. The parameters on the basis of which the compensation payment, if any, is calculated must be established in advance, in an objective and transparent way. It must take into account the revenue generated by the public service operator and the existence of a 'reasonable profit'. This compensation must be paid by general rules, so

[22] See Protocol 26 of the TFEU on Economic Services of General Interest (http://europa.eu/pol/pdf/qc3209190enc_002.pdf#page=89).

[23] Except in the cases specified in paragraphs 4, 5 and 6, related to the direct award.

as to avoid overcompensation, as otherwise it could be considered that it is State aid, which is prohibited by Article 107 of the TFEU[24].

The fact that the Contracting Authority assumes, in a greater or lesser extent, the losses in SGEI provision of passenger transport by road, could be understood in the sense that the operators are not at risk as such, as in practice the 'risk' that the regulation establishes does not exist. In any case, this question would equally affect undertakings that submit tenders, whether they are public or private.

5. Share of administrative competences in inland transport

Given that the transport of goods is liberalised, tenders will not be generated therein, unless the Administration requests the services, which is why the problem analysed here can only arise in the field of passenger transport[25]. Within this, the two major categories affected would be rail and road transport.

In rail transport, liberalisation is not complete and takes place on an exclusive basis by a single operator, without tenders[26].

In road passenger transport, current regulation makes a distinction between public and private transport, which is understood as that, carried

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[24] All this, unless the conditions are met in the 'Regulation Package on Services of General Economic Interest' composed of the Commission Communication on the application of the European State aid to the compensation offered for the provision of Services of General Economic Interest.(OJ C8, 11/01/2012, p. 4-14), Commission Decision of 20 December on the application of Article 106 (2) TFEU on State aid in the form of compensation for the service provided by certain undertakings for the operation of services of general economic interest (OJ L7, 11/01/2012, p. 3-10), the Communication of the European Framework Commission for State aid in the form of public service compensation (OJ C 8, 11.01.2012, p. 15-22), and Commission Regulations on the application of Articles 107 and 108 of the TFEU on the application of *de minimis* aid criteria to undertakings to provide services of general economic interest (OJ L 114 of 26/4/2012, p. 8).

[25] On the transport of goods, Community legislation aims to create a European transport market. It thus establishes a uniform regime of market access based on the abolition of restrictions associated with service providers as well as a transportation authorisation regime. Council Regulation (EEC) No 881/92 of 26 March 1992 on access to the market in the carriage of goods by road within the Community to or from the territory of a Member State or passing across the territory of one or more Member States. See also Article 21 of Law 16/1987 of 30 July on the regulation of inland transport.

[26] As stated in Law 16/1987 of 30 July on Inland Transport Management, transport by rail is considered as 'that in which vehicles circulate on a fixed rail track, which serves as a support and guidance, constituting the whole road-vehicle operating unit' (Article 1 (3)).

out by third parties for financial rewards[27]. Depending on its scope, public passenger transport by road are urban and intercity[28]. Depending on the frequency of services offered they can be discretionary (outside our field of study) or regular[29]. Regular passenger public transport may be for general use or special use[30].

Taking the transport regulation of each of these types into account, regular general use transportation tenders (urban and intercity) may be verified and, although it is not the most common situation, in regular special use transportation (e.g. when the public authority demands a transport service for varied and specific groups). The competence regime in these kinds of transport is as follows:

Rail transport is the exclusive competence of the Autonomous Community in schedules that are executed entirely within its territory[31].

If we look at the Basque Autonomous Community, Article 4 of the Basque Law on Passenger Transport by Road establishes the competences of the various Basque authorities in road transport[32]:

> 1. It corresponds to the Basque Government to exercise competence over professional training recognition, regulatory implementation of the law, and coordination and senior inspection, which will be carried out through verifications or audits, and

27 See Law 4/2004 on Passenger Transport by Road (Article 2).

28 Urban are those that run within the same municipality, with all other transport being considered as intercity transport.

29 Regular transport is that executed within pre-established itineraries and subject to prefixed calendars and schedules. Regular passenger public transport can be, by its continuity, permanent or temporary. They are permanent when they are carried out continuously to meet stable needs. They are temporary if they are designed to meet exceptional, provisional or durational traffic. Discretionary transport is that carried out without regard to pre-established itineraries, calendars or schedules.

30 General use transport is that intended to meet general demand, used by any interested party. Special use transport is that intended to serve only a specific group of users, such as students, workers and similar groups.

31 See Spanish Constitution on the authority of the Autonomous Communities (Article 148 (1) (5) (a)) and the Statute of Autonomy which states that the Basque Autonomous Community has exclusive competence in the field of railways and inland transport (Article 10 (32)), without prejudice to the provisions of Article 149 (1) (20) of the Spanish Constitution. To carry out the transfer of goods and services corresponding to that subject, Royal Decree 2488/78 of 25 August was issued, on the transfer of authority of the State Authority to the General Council of the Basque Country, and Royal Decree 1446/81 on 19 June on the transfer of government services in inland transport.

32 Law 4/2004 on Passenger Transport by Road.

> the development and coordination of inspection plans. The Basque Government shall also undertake overall planning and shall set intercity transport tariffs.
>
> 2. The Provincial Councils have competence over planning development, the exercise of the powers provided in Chapter IX on passenger stations, and issuing administrative licenses for the exercise of the intercity transport activity that is regulated in this law. In public service administrative concessions, the Provincial Councils shall be responsible for the creation, execution, standardisation, modification, abolition and recovery of services in the following cases:
>
> a) When they are fully carried out within the province.
>
> b) When there is a traffic ban outside the province.
>
> c) When the service is the competence of the Autonomous Community and, not included in the above cases, most of their travel is within the province.
>
> The Provincial Councils shall also grant administrative authorisations for intercity transportation for services in the respective province, when they are mandatory. The Provincial Councils shall carry out direct inspection of the intercity transport and shall process and resolve disciplinary proceedings for offences committed within the province.
>
> 3. Within the field of urban transport, local councils are responsible for the planning, management, inspection and sanctioning of public passenger transport services, granting operating licenses, and setting the tariff regime subject to the provisions of applicable law. Furthermore, they shall hold the powers established in Chapter IX, in relation to passenger stations under the competence of the Provincial Councils and Local Councils.[33]'

6. Determination of the 'affected market' in inland transport tenders

As indicated above, inland transport tenders existing in an autonomous community regards two types of transport: regular general use passenger transport by road (the most common) and special use (if the Administration has a transport necessity that it decides to not to cover itself).

In the first case, the transport provision system is carried out mainly through concession and consequently there is a public tender to award it. The regime that is created in this case is that of exclusive exploitation[34].

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[33] See Articles 25 (2) (II) and 26 (1) (d) of the Basic Law of Local Regime 7/1985 of 2 April, which states that collective passenger transport is the competence of the municipalities and, in the case of a municipality with more of 50,000 inhabitants, that competence becomes a mandatory service.

[34] Article 21 of Law 4/2004 of 18 March on Passenger Transport by Road provides that the public passenger transport service shall be, as a rule, through administrative concession. The public service concessions of road passenger transport shall be granted on an exclusive basis, and while in force, other concessions covering similar transport services may not be established.

This statutory regime prevents competition in the market defined by the concession, to the extent that the bidder's service is unique and its price is conditioned by the administrative concession. For these reasons, the competition that should be set forth is not so much competition 'in the market' but rather competition 'for the market'. This competition is evident when public tenders are held for the award of concessions. It is also called 'controlled or regulated competition' and 'ex-ante or discontinuous competition'[35].

In the second case, the Administration shall become a transport service user, and to meet its needs it will open a tender that will result in the selection of a service provider who it will enter into a contract with.

Based on these premises, market access is only given at the time of the tender. The definition of the specifications allows the various parameters that will generate competition to be established, such as price, capability and quality. In this context, it is essential to ensure maximum efficiency transfer to the end user by reducing the cost and improving service quality without diminishing competition.

7. In house providing which is the justification and legal requirements?

The provision of public services by the Administration may be accomplished through its own bodies or through its own resources. This option is provided in the regulations on public procurement (Revised Text of the Law on Public Procurement (TRLCSP)) within 'contracts and excluded business' in the scope of that Law[36]. In principle, the

[35] National Competition Commission Report on Competition in intercity passenger transport by bus in Spain. *cit.*

[36] The Law on Public Procurement approved by Royal Decree 3/2011 of 14 November states in Article 1 that it is 'aimed at regulating public procurement, in order to ensure that it meets the principles of freedom of access to tenders, publicity and transparency of procedures, and non-discrimination and equal treatment of candidates, and to ensure, in connection with the budgetary stability objective and cost control, efficient use of funds intended for the execution of works, procurement of goods and services by requiring prior definition of the needs to be met, the safeguarding of free competition and the selection of the most economically advantageous bid'. In addition to the numerous provisions of the Law that expressly refer to the conditions of competition, the Twenty-third Additional Provision is of special interest, which recalls the duty to report 'any hint of agreement, decision or recommendation, or concerted practice or consciously parallel among bidders, which is directed, produced or may produce the effect of preventing, restricting or distorting competition in the procurement process.'

Administration's resources are therefore exempt from the application of the procurement law. However, Article 4(n) of that text provides that 'contracts concluded with agencies that are considered as the Administration own resources and technical service for the performance of the services covered shall be subject to that Law, in accordance with the nature of the agency that enters into the procurement and the type and amount thereof, and in any case, when it is a procurement of works, services or supplies for amounts exceeding the thresholds established in Section 2 (a) of Chapter II of this Preliminary Title, the private law agencies shall observe the rules laid down in Articles 137 (1) and 190 in their preparation and award'. A partial limitation of the application of public procurement rules is produced in them, given the nature of the commission.

The Administration's own resource represents a technique to carry out the Public Authority's activity or mission seeking to limit, in the strictest terms possible, the cases in which, for lack of a procurement agreement (given that the Administration uses its own technical services and its own ability to meet an end), the principles of competition that may be limited to some extent with regard to necessary motivation[37]. The Administration –by virtue of an administrative act (unilateral) of awarded management- entrusts the instrumental agency it has created -dependent on it- with the execution of an activity[38]. There is no contract, because a contract requires the presence of at least two persons acting with free will. In the case of the resource and although it has personality, it has no will of its own because it is absolutely subordinate to the Administration that it depends on. However, this capacity for self-provision must be subject to a strict regulatory framework in order to ensure fairness in competition conditions.

Since the resource is an exception to the guarantees that the public procurement law creates, the requirements for being considered a resource are limited to a large extent by community guidelines and set out both by law and jurisprudence.

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[37] See Regulation No 1370/2007, which states that 'Subject to the relevant provisions of national law, any local authority or, in the absence thereof, any national authority, may choose to provide its own public passenger transport in its territory, or to entrust them without tender to an internal operator (recital 18). However, this self-provision option needs to be strictly controlled to ensure a level playing field'.

[38] See Law on the Legal Regime of Public Authorities and Common Administrative Procedure (article 15).

The TRLCSP establishes the material requirements to be met by resources in Article 24 (6):

– The awarded agency (that 'wins' the activity) must exert a control over the resource similar to that exercised over its own services.

– The resource must, in turn, carry out an essential part of its activities with the awarded agency[39].

There are additional formal requirements:

– That the agency in question explicitly describes the resource in its by-laws or statutes (Article 26 (4) of the TRLCSP)[40]

– That the management award is stated in the same way. (Article 26 (4) TRLCSP)

– In the case of public limited companies, the full amount of its equity must be public.

Similarly, the bodies, organisations and public sector agencies considered as resources and technical services of contracting authorities may not participate in calls for public tender by the contracting authorities that they are resources of[41]. It is even possible for the resource to be responsible for forcibly making the awarded provision if the Administration choses to partially open the service to competition through a tender and no tenderer compete[42].

In any case, the contracting authorities have similar control over the body, organisation or agency that they have over their own

[39] Criteria known in EU case law as 'Teckal criterion', which have been endorsed and developed by the European Court of Justice in many other rulings. See European Court Of Justice Ruling of 18 November 1999, Teckal Case C-107/98; Ruling of the Court of Justice of 13 October 2005, Parking Brixen Case C-458/03; Ruling of the Court of Justice of 11 May 2006 Case Carbotermo, C-340/04, or Judgment of the Court of Justice of 13 November 2008, Case Coditel Brabant SA vs. Commune d'Uccle and Région de Bruxelles-Capitale, C-324/07.

[40] The statutes or by-laws in question must determine the agencies that have that condition and specify the regime of award that they may conferred or the conditions under which contracts may be awarded to them, and must further determine the inability to participate in tenders convened by public contracting authorities which are resources, notwithstanding that, if there is no tenderer, they may entrust the delivery of the service described therein. See; inter alia, Ruling No 1285/2010 of 4 May [High Court of Justice of Andalucía].

[41] See in the same regard, Recital 18 of Regulation No 1370/2007.

[42] Ruling No 3/2012 of 16 January [High Court of Justice of Murcia].

services, if they can confer to them mandatory management tasks, in accordance with instructions unilaterally established by the petitioner, the remuneration of which is set by reference to tariffs approved by the public agency on which they depend.

The Administration's decision to use its own resources obviously excludes private companies from the affected market. Therefore, the basic principles of the competition law require a reasoning that justifies that the service cannot be offered in conditions of competition and efficiency by the market. Not surprisingly 'awards must be avoided when the goods or services in question can be provided in the market to the same extent at lower prices as a result of competitive processes'[43].

The requirement of motivation on the part of the Administration in the use of its own resources is also derived from Law 16/2012 on the Support of Entrepreneurs and Small Businesses in the Basque Country, which establishes in its Statement of Reasons the need to develop channels to prevent unfair competition from the Basque authorities, and tries to encourage and promote economic development in the Basque Country[44]. Thus, Article 11 provides that the Public Authority and Public Sector of the Basque Autonomous Community will request from the competition authority (the Basque Competition Authority as it is the Basque Country) an impact report on the competition and free enterprise on several cases, including the following:

> – before the launch of services whose ultimate beneficiaries are the citizens in general and which are likely to be provided by the private sector and their receipt or request are not obligatory for citizens.
>
> – before providing resources to those who provide services in stipulated conditions such as the market, which are likely to be incurred by the private sector, either directly by the Basque public sector or through semi-public undertakings.'

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43 National Competition Commission, *Public Procurement and Competition Guide* (2011) p. 9.

44 See Law 16/2012 of 28 June on Support for Entrepreneurs and Small Businesses in the Basque Country. BOE 172 of 19 July 2012, p. 51776.

According to the same provision, the impact report on competition and free enterprise developed by the Basque Competition Authority will consider whether the Administration's action could seriously distort the conditions of competition in the market and whether this serious distortion could affect the public interest[45].

8. Competition issues in tenders on regular general use road transport

The first issue we need to underline on this field is that the tenders on this kind of transport will be issued by Provincial or Local Councils (Article 4 of the Basque Law on passenger transport by road). With regard to these, along with the general requirement of respect for procurement law mentioned above, public undertakings have another set of conditions that will be analysed below.

8.1. Equality between the public and private sector with respect to the defence of competition rules

Article 106 of the Treaty on the Functioning of the European Union states in its first paragraph that in the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109 (which lay down the basic standards to guarantee fair competition).

The Treaty therefore requires States to respect and ensure compliance with the rules of free competition with regard to their public undertakings, without imposing restrictions on their operation or advantages that may arise from the source of their equity.[46]

[45] In the cases above the impact report on competition and free enterprise 'shall be prior and mandatory for the public authority and the public sector in the Autonomous Community of the Basque Country'.

[46] Ruling 18 December 2007, C-220/056 previously cited [European Court of Justice]: 'Articles 43 EC, 49 EC and 86 EC [now 43, 56 and 106 of the TFEU respectively], *such as the principles of equal treatment, non-discrimination on the grounds of nationality, and transparency must be interpreted in the sense that they preclude the legislation of a Member State that allows public authorities, acting outside the rules for the award of public contracts, the provision of non-reserved postal services under Directive 97/67 to a*

The same naturally applies for Law 15/2007 on the Protection of Competition, which states that, for the purposes of the provisions of this Law, an undertaking is understood as any person or agency engaged in an economic activity, regardless of the legal status of the agency and its method of financing[47]. The competition law therefore applies not only to entrepreneurs but to all agents or operators whose economic activities lead to an impact on the market[48].

Therefore, from a competition law perspective, no general dis tinction can be established between the public or private nature of the undertakings[49].

8.2. Public interest as justification of the Administration's involvement in the business activity

As proposed in Section 3 of this report, if the Administration decides to intervene in the economic activity, it must prove the existence of

public limited company whose equity is fully state-owned and that the universal postal service provider in that State (...)'.

See also the Judgement of 6 April 2006, C-410/04, ANAV: 'Besides the principle of non-discrimination on grounds of nationality, the principle of equal treatment of tenderers is also to be applied to public service concessions even in the absence of discrimination on grounds of nationality (Parking Brixen, cited above, paragraph 48) [European Court of Justice].

Regarding the Community's definition business, some of the most emblematic rulings of the can be analysed, such as 23 April 1991, C-41/90, Höfner and Elser case, paragraph 21 [European Court of Justice]; that of 17 February 1993, C-159/91 and C-160/91 Poucet and Pistre case, paragraph 17, or the Judgment of 17 December 1991, T-6/89, Enichem, paragraph 235, and 10 March 1992, T -11/89, Shell case, paragraph 311). This case law focuses on the ability of a particular agency to infringe competition law, for the purposes of qualifying as a company and as a criterion addresses the economic nature of the activity, adopting a broad definition of a business regardless their particular legal status and method of financing (also covering public administrations) [European Court of Justice].

47 See Law 15/2007 of 3 July on the Protection of Competition [Fourth Additional Provision].

48 The definition of business for the purpose of applying the competition regulation was determined in the rulings of the CNC, and is considered as the decisive criteria of the concept of conducting an 'economic business activity' (CNC ruling of 3 June 1997, File 352/94, Dairy Industries case). The concept is very broad and includes agencies involved in trade, including non-profits, and excluding only bodies whose activities are typically those of a public power and have no economic character (CNC ruling of 24 April 1997, Case R 192/96, Gerona Ambulances case).

Of course, there are more recent decisions, such as the National Competition Commission, which imposes sanctions on public undertakings for violations of competition law. National Competition Commission ruling of 23 August 2011 issued in record SNC/0011/11CORREOS serves as an example. It penalised the State Postal and Telegraph Service with a large fine for breaching competition law.

49 Court Decision of 10 October, *cit.* third statement [Spanish Supreme Court].

a valued and significant public interest. Some factors will be outlined below that should be considered when accrediting ET's cited public interest when submitting bid applications to this type of tender.

8.2.1. Economic factors and public interest

Among the economic factors that can affect the efficient achievement of a public interest, those that are macroeconomic can be distinguished from those that are microeconomic.

Starting with the former, it must be remembered that Article 31 (2) of the Spanish Constitution provides that 'Public expenditure shall make an equitable allocation of public resources, and its programming and execution shall comply with criteria of efficiency and economy.'

For starters, when there is sufficient private initiative to attend to a service, the Administration must at least question the efficiency in the public spending that its action in the market would incur.

Furthermore, the fact that an administration, through its public undertaking, extends its scope of action to the management of public services owned by other administrations, in principle it cannot be considered an efficient use of government resources required by Article 31 of the Spanish Constitution.

It should be noted that in applying EU accounting standards, 'public authorities' are considered all bodies that an administration has 50% or more shares in[50]. Losses of public companies are covered by the general budget and ultimately by taxpaying citizens.

For the sake of the pursuit of macroeconomic efficiency, it would useful to carry out an analysis of the cost-effectiveness to compare the costs of alternative strategies to achieve the public interest objective[51].

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[50] In this regard, see the methodological note presented by Eustat in the document A*ccounts of public authorities in the Basque Autonomous Community,* Vitoria, 2010, in *http://es.eustat.es/document/datos/Nota%20met_ctas_ad_pub10_c.pdf,* as well as the documents 'Calculation of the deficit in business units that apply the general accounting plan or any of its sectorial adaptations' March 2013 by the Ministry of Finance *General Auditing and 'Deficit Calculation Manual in National Accounting Adapted to Autonomous Communities'*, Ministry of Finance. 2006.

[51] Knickman, J., et al 'Conceptual and technical considerations in the analysis of the cost-benefits ratio' in *Management of public agencies and undertakings. Decision, responsibility and control.* Volume III. (1988) 80.

From a microeconomic perspective, there are factors that affect the efficiency of public undertakings that must be analysed in relation to the effects they can produce in the market if they act in it[52].

From the point of view of protection of free market competition principles, it should be considered whether the public limited companies equally compete with private companies in a tender[53].

It cannot be said that an undertaking that is completely owned by an administration acts on equal footing as private undertakings, in which both the risk and investment depend on the private initiative and in which there is a prior entrepreneurial effort that is not comparable with that of a public undertaking. This calls into question the comparable conditions of both market access and the implementation of services within it between public and private companies.

It is common for public undertakings with repeated negative operating results to remain in the market, as the Administration covers the operating deficit through subsidies. Although this is a situation that clearly distinguishes private from public enterprises and renders its comparable nature very difficult, it need not necessarily deserve a negative judgement. If the Administration is covering the public undertaking with the subsidy it has been granted, in an objective, transparent and balanced way, the deficit generated by the clearly defined public service obligations that form part of its jurisdiction fall within the parameters established by Community regulation. If the subsidy does cover the costs directly related to the provision of the SGEI or it is considered excessive to cover the costs of running the public service obligations (taking into

52 With regard to the various motivations for the creation of public undertakings, see Ariño Ortiz, *Public undertakings.., cit*, p. 52. On a comparison of public with private undertakings Vergez, *The comparative efficiency Public Undertaking vs. Private Undertaking: Empirical Evidence*, (2011); Hernandez de Cos, 'Public undertakings, privatisation and efficiency' in *Economic Studies*, (2004), Bank of Spain, 24.

53 In this regard, see 7 December 2000, Case C-94/99 ECJ of in the field of procurement and therefore Directive 92/50, which address the issue of equal treatment of tenderers and which establishes in paragraph 29 that 'While it is not, therefore, contrary to the principle of equal treatment of tenderers for public bodies to take part in a procedure for the award of public procurement contracts, even in circumstances such as those described in the first issue, it is not excluded that, in certain specific circumstances, Directive 92/50 requires, or at the very least allows, contracting authorities to take into account the existence of subsidies, and in particular of aid incompatible with the Treaty, in order, where appropriate, to exclude tenderers in receipt of such aid'.

account a reasonable profit), such compensation could be considered state aid and could be anti-competitive[54].

If a public undertaking unduly interferes in a tender that undertakings may submit bids to, the undertakings would not have options to expand or grow in the service delivery and would be slowed down in options to innovate and improve[55].

Considering all these factors, the accreditation of the existence of a public interest in the performance of public undertakings submitting bids to tenders of other administrations seems difficult to justify from an economic perspective.

8.2.2. Administrative authority and public interest

This element is analysed is based the premise that the public power is not unlimited and therefore neither is its business capacity. This principle implies that business initiative recognised by Article 128 of the Spanish Constitution in the public sector is not unconditional, but it presupposes the action to achieve the public interest. The principle of legality in government actions requires that the act can only exercise the competence that the law has granted it. Therefore, the first condition is that the public authority, with all its instrumental bodies, must operate 'within its competence'.

It is difficult for an administration's public undertaking to justify public interest by acting outside the original authority's scope of powers.

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54 As a reference, see the Judgment of 24 July 2003, Case C-280/00 (European Court of Justice). See Article 95 (2) of the Sustainable Economy Law, which maintains that 'subsidies may be granted only when serving the public interest as compensation for the assumption of public service obligations. Where appropriate, grants are awarded on a competitive basis. The grants must be strictly linked to the provision of services of public interest in the geographical market that lacks, preventing cross-subsidies between markets which may affect the conditions of competition'.

55 Thus, problems may arise if preferences are seen for a public limited company, such as ease in credit rating, preference criteria in the award for having previously provided a transport service by rail, ease in the subrogation of incoming workers, further possibilities for subcontracting competitors, etc. All these issues must be considered on a case by case basis in the tenders that arise.

Another issue is the **'just compensation'** that the administration guarantees of an SGEI provided to the undertaking that has been awarded a concession in order to ensure the provision of the public service and its universal performance. This implies that the Contracting Authority assumes the losses of the service's execution, which could be understood as a reflection that the operators (public or private) are not at risk as such in the sense previously explained.

The law precisely defines the current competence boundaries serving both the territorial dimension and the material and functional. In the case of road passenger transport, as stated in Article 4 of the Basque Road Transport Act, there is no certificate of authority from the Administration of the Autonomous Basque Community for the provision of the road passenger transport service.

From the above it follows that if a public undertaking of one administration decides to address the public service of regular general use passenger transport, it must accredit the public interest in this activity; this justification appears to be complex considering its administrative competence (or rather, its lack thereof)[56].

9. Conclusions

The main conclusion of this analysis is that the gradual liberalization of road transport faces inertias and that the legal system and public administration need to give more effective answers to increase competition, if the intended result is to ensure competitiveness in the economy.

Public companies have historically submitted bids in a road passenger transport tenders, but nowadays the needs of society have changed and new answers are needed. From the point of view of competition, various legal consequences might be brought along.

First, the possible application of Community rules on State aid should be born in mind, as foreseen in Article 107 of the TFEU, in the terms provided for in Regulation No 1370/2007[57].

Moreover, Article 3 of Law 15/2007 states that the National Competition Authority or the competent bodies of the Autonomous Communities shall apply rules of competition to acts of unfair competition which affect public interest by distorting competition.

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[56] In the same regard, see Regulation No 1370/2007, recital 18 which states that 'a competent authority providing its own transport services or an internal operator should be prohibited from taking part in competitive tender procedures outside the territory of that authority.'

[57] On the application of the state aid to public undertakings, see Hancher, Ottervanger, Jan Slot, *EC State Aid*, (2006), 205.

For this provision to be applied, two requirements must be verified: unfair competition and the existence of public interest. Both requirements must be analysed and verified for specific conduct in light of the circumstances of each case under study. However, some general conclusions can be made following our generic analysis.

First, the impact on the public interest can be verified from both a quantitative and qualitative perspective. From a quantitative perspective, the number of tenders in which the conduct under scrutiny arises must be analysed, concluding that if it affects a small number of cases, there would be sufficient public interest involvement. However, from a qualitative perspective, it will be taken into account if the practice affects the provision of a SGEI by an Administration, and if it implies the use of public funding to provide a service in special conditions.

In such cases, it may be concluded that the impact on an isolated tender could involve impact to the public interest.

Second, it should be considered if there is a possible violation of the unfair competition regulation in the case. For there to be such, there must be a specific practice that matches one of the cases of Law 3/1991 on Unfair Competition. This regulation states that conduct referred to therein shall be considered an act of unfair competition 'when carried out in the market with the purposes of competition' (Article 2), which also must be analysed on a case-by-case basis. In any case, the second chapter of the law classifies acts that are deemed as unfair competition and, within them Article 15 describes unfair acts, which it calls 'violation of regulations'.

The cited provision states unfair acts are those in which 'a competitive advantage is gained by violating the laws'. It also includes the provision that 'unfair action will be considered as the mere violation of legal standards aimed at regulating the competitive activity'. For the offense to be established, a violation of rules or breach of law must be verified. Any breach of the TRLCSP, the Sustainable Economy Act, or the Basque Road Passenger Transport Act, could create a situation that would have to be analysed from the perspective of competition.

For all those reasons we can conclude that public companies of one administration can legally present tenders in bids of different

administrations. Nevertheless this can create competition problems and that, therefore, they should have to limit their activity to fields where they can prove protecting and guaranteeing the public service defended by their mother administration, without competing with private operators in the provision of other Administrations' public services, except in the case that the existence of public interest can be accredited.

Part VII

Improving market supervision and market governance

18

Modern Enforcement in the Single European Market

ANABELA CORREIA DE BRITO*

ABSTRACT

Enforcement of and compliance with laws and regulations in the single market of the European Union are not only legally necessary, but also of crucial economic importance for business, consumers and the EU economy at large. This paper provides a comprehensive overview of the current EU enforcement landscape and its functioning. The classical infringement route via the Court of Justice of the European Union remains critical as a last resort, but it is increasingly seen as very slow and costly. The new emphasis relies heavily on a range of pre-infringement as well as preventive initiatives that prevent new technical barriers from arising. They also tend to be far less costly and more rapid, informal and effective in pursuing a properly functioning internal market. These improvements are welcome news for the single market.

KEYWORDS: European Union, enforcement laws, regulations, single market, internal market, Pre-infringement initiatives, Preventive approaches, SOLVIT, EU-Pilot

1. Introduction

Enforcement and compliance with EU law, and in particular in the single market, are not only legally necessary but also of economic importance for business and consumers and the European economy at large. Only with reliable, permanent and effective implementation and enforcement will all the potential gains from the single market be fully reaped. The value-added of the single market has been, right from the beginning of the EU in 1958, precisely its potential to generate economic growth, *in*

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addition to what a single EU country could ever achieve alone, through 'ever-deeper market integration over a large economic space. Nowadays, even more than ever before in 55 years of EU history, companies are keen to exploit the manifold single market opportunities as much as possible as a rare source of growth in times of shrinking demand and an austere fiscal stance by almost all EU governments. Apart from that, it is also important to maximize the effectiveness of free movement in the single market, to encourage establishment in other EU countries and to strengthen enforcement of the Law.

The actual implementation and enforcement of internal market law still faces major challenges. Although in the last year the great majority of the member states has made additional efforts to timely transpose the directives, the number of directives for which transposition is overdue by two years or more has increased and the member states take an average of almost ten extra months to transpose the EU directive after their transposition deadline.[1] Moreover, there is an increasing number of complaints from citizens and enterprises concerning the violation of their rights granted by EU law. Special attention should also be paid to the implementation and enforcement of the EU internal market rules in the key areas identified by the Commission in its Communication on Better Governance for the Single Market:[2] i) services (including retail and wholesale trade, business services and construction); ii) financial (intermediation) services; iii) transport; iv) digital economy (including broadband deployment and e-commerce) and v) energy.

A broader, strategic view of EU enforcement distinguishes five critical aspects: i) good detection of non-implementation, bad implementation and non-application; ii) formal infringement procedures (the classical route); iii) pre-infringement initiatives (ensuring that no infringement procedure will be necessary); iv) preventive initiatives and v) reduction of the transaction and information costs when exploiting the single market rights or laws. In this paper we deal with pre-infringement and preventive initiatives.

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1 European Commission, '*Internal Market Scoreboard No. 26: 15 Years of the Internal Market Scoreboard*' (Brussels February 2013).

2 European Commission, *'Better governance of the Single Market"*, (Communication from the Commission (COM (2012) 259 final).

Central to modern enforcement is the fact that the classical route to the Court of Justice of the European Union (CJEU) is costly and takes a lot of time. It is rarely suitable for European business confronted with suspected enforcement problems, let alone consumers. Of course, formal infringement procedures must always remain available for grave cases, issues of interpretation or, more generally, for the credibility of the system. But they will never yield a properly functioning single market in and by themselves and therefore have to be complemented by a host of other measures and initiatives. For that reason, during the recent decades much effort has been invested in working around it or finding complementary ways of realising greater effectiveness.

Three of the five types of enforcement efforts have been available since the outset of the European Economic Community (EEC): detection (via monitoring and complaints), pre-infringement initiatives and formal infringement procedures. More recently, emphasis has been given to effective prevention. The preventive measures have expanded enormously, closely followed by much greater intensity of pre-infringement efforts with the aim of pre-empting enforcement barriers or nipping them in the bud at low costs when detected. Both the preventive approaches and the pre-infringement mechanisms rely more and more, although not exclusively, on the active cooperation of the member states, as a group, or between the member states and the Commission.

The present paper is based on our CEPS study on 'Enforcement in the EU Single Market'[3] and provides an overview of a range of new EU enforcement methods employed in the single market. Section 2 is dedicated to the pre-infringement procedures. Section 3 gives an overview of some the existing preventive approaches. Section 4 presents briefly the measures for reducing transactions and information costs. Finally, in Section 5 we conclude and present some recommendations.

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[3] Jacques Pelkmans and Anabela Correia de Brito *'Enforcement in the Single Market'* (published by the Centre for European Policy Studies (CEPS), Brussels, 2012). See also Nordic Innovation, '*Deliver a Stronger Single Market* (Nordic Innovation Report, 2012:12 // June 2012) <http://www.nordicinnovation.org/Global/_Publications/Reports/2012/2012_11%20Delivering%20a%20stronger%20Single%20Market.pdf > accessed 05 February 2014.

2. Pre-infringement initiatives

The European Commission, as 'guardian of the treaties', shall oversee the application of the EU law under the control of the CJEU (Article 17 (1) TFEU).

In carrying out this mission and given the slow legal procedures, the Commission continuously developed new 'soft' and flexible pre-infringement instruments, with a less intrusive and often not so legalistic ways to ensure the observance of EU legislation, have a practical influence despite their informal character. These pre-infringement initiatives rely more and more, although not exclusively, on the active cooperation of member states, as a group, or between the member states and the Commission, in sharp contrast to the formal infringement procedures where the EU (via the Commission) *opposes* a member state in a legal proceeding.

The pre-infringement landscape is wide, ranging from the informal and formal steps of the earlier stages of the infringements procedure, to so called 'package meetings' with member states, to setting up specialised networks of national civil servants dealing with specific EU legislation helping with interpretation issues of complex directives (e.g. the Machinery Directive or type-approval questions or of national banking supervision exceptions to EU rules). A new variant of these pre-infringement efforts consists of several informal approaches, which help to reduce the lack of compliance by member states, such as EU-Pilot, the SOLVIT network, the European Consumer Centres Network (ECC-Net) and the regular publication of the European Commission Scoreboards (one on the internal market and one on consumer issues).

Of these many efforts, we shall elaborate on the EU-Pilot, the SOLVIT network and in the Internal Market Scoreboard.

2.1. The EU-Pilot

EU Pilot was launched in April 2008, following the European Commission Communication on 'A Europe of Results – Applying Community Law'.[4] The idea of the system is to provide quicker and better

[4] European Commission, *A Europe of Results – Applying Community Law* (Communication from the Commission, COM (2007) 502 final).

solutions to problems arising in the application of EU law as well as to promote a more informal cooperation between the Commission and the member states. This method would help to correct infringements of EU law at a early stage wherever possible, without the need for recourse to infringement proceedings and in a speedy way, given that cases should, in principle, be dealt with within 20 weeks. Indeed, since March 2010 EU Pilot expanded to cover all cases concerning the correct application and implementation of the EU law and the conformity of the national law with EU law, becoming a substitute of the informal phase of the infringement procedures under Article 258 TFEU. However, where urgency or other overriding interests requires, the Commission can still immediately respond to an alleged infringement by a member state without previous contact through EU Pilot. Furthermore, once the case is submitted to EU Pilot, in the event that the Commission is not satisfied with the solution provided by the member state or if an infringement is detected, the Commission may decide to launch an infringement procedure.

The participation of member states in EU Pilot has been phased in a gradual way. The EU Pilot project started operating with 15 member states.[5] This first phase of the project is known as Pilot I.[6] Following the overall positive evaluation of the first phase of the EU Pilot project the remaining 12 member states were invited to join. Today the project enjoys the participation of 25 member states and the remaining two are preparing their participation. Indeed, since the system was launched in April 2008 until September 2011, a total of 2,121 files were submitted to EU Pilot. Of these, 1,410 files completed the process in EU Pilot.

With regard to the origin of the files submitted to EU Pilot, 44% of the files are opened at the own initiative of the Commission, while 49% of the files are complaints and 7% of the files are requests for information by citizens or businesses.[7] The files related to a broad range issues: 33% concerned

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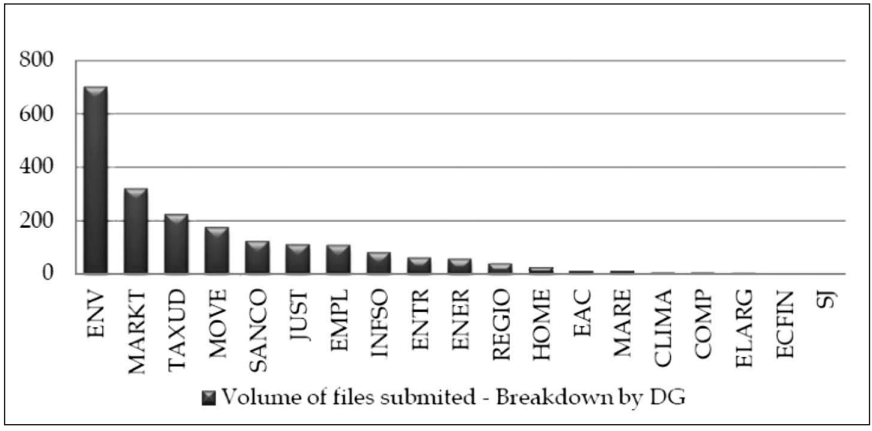
5 Austria, Czech Republic, Denmark, Finland, Hungary, Ireland, Lithuania, the Netherlands, Portugal, Slovenia, Sweden, Spain and the United Kingdom.

6 This initial phase of the EU Pilot project was evaluated by the Commission in its first EU Pilot Evaluation Report published in March 2010, which covers the period of the start-up of the project in April 2008 until March 2010. European Commission, '*EU Pilot Evaluation Report*' (COM (2010) 70 final).

7 Of 4,035 cases entered into CHAP (the Commission's complaint's handling system) in 2010, 686 complaints were sent for further attention to EU Pilot.

environmental issues, 15% internal market, 10.5% taxation, 8% mobility and transport and 6% health and consumer protection (Figure 1).

Figure 1. Volume of files – Breakdown by Commission services, April 2008 to September 2011 (total files = 2,121)[8]



The credibility of the EU Pilot as an pre-infringement procedure depends on the ability of the project to solve the problems concerning to the conformity of national law with EU law or the correct application of EU law, in a effective, efficient and rapid way. For that reason, the cases should, in principle, be dealt with within a 20 weeks benchmark period. Once a complaint or inquiry is received in the EU Pilot database and, subsequently, forwarded to the EU Pilot Central Contact Point of the member state concerned, the member state was 10 weeks to give a reply. Since March 2008, the average time taken by the Commission services to assess the replies proposed by the member states' authorities and to decide the follow-up of the file is 102 days, which exceeds the general benchmark.[9]

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8 European Commission, *Second Evaluation Report on EU Pilot Functioning of the System* (Staff Working Paper, accompanying the document Report from the Commission SEC (2011) 1629/2).

9 It is to be noted that cases exceeding the benchmark are, for the most part, those where Commission services requires additional information from national authorities, especially in the case of more complex files and those where translations were needed.

Of the, 1,410 files processed in the system, nearly 80% (1,107 files) of the responses provided by the member states were assessed as acceptable, enabling the file to be closed without the need to launch an infringement procedure. The remaining 20% of the files (303) in which no acceptable solution in line with EU law could be found, went on to the infringement phase (see Table 1 below). Negative outcomes of the procedure under EU Pilot were most frequent found in dossiers on internal market (62 cases), environment (57 cases), taxation and customs (55 files) and transport (41 refusals).

Since 2010, the Commission has observed a reduction in the volume of the new infringement proceedings (see Table 1 below).[10]

Table 1: Evaluation in the number of infringement procedures launched in 2009, 2010 and 2011 (reference year = 2009)[11]

	2009	2010	2011*
Number of procedures launched	536	296	206
Change in number from 2009	–	-240	-330
Change in % from 2009	–	45%	42%

* Data for first nine months only.

This reduction was greater in the original 15 member states that volunteered to join to EU Pilot project. Furthermore, it should be noted that the areas where more infringement procedures were opened in 2011, similar to the previous years, are precisely those ones where EU Pilot has shown less positive outcomes: Environment (17%), internal market (15%) and transport (15%) and taxation (12%) (See Figure 2 below and Table 1 above).[12] However, this tendency has also been observed in the internal

[10] European Commission, *29th Annual Report on Monitoring the Application of EU Law* (COM (2012) 714 final) and European Commission, *Staff Working Document, accompanying the Report from the Commission 29th Annual Report on monitoring the Application of EU Law* (SWD (2012) O399/0400).

[11] European Commission, *Staff Working Paper, accompanying the document Report from the Commission Second Evaluation Report on EU Pilot: Functioning of the system* (SEC (2011) 1629/2).

[12] European Commission, *Staff Working Document, accompanying the Report from the Commission, '29th Annual Report on monitoring the Application of EU Law (*SWD (2012) O399/0400).

market area, where the number of infringement proceedings for incorrect transposition or application of the single market rules has been decreasing since 2007 and, in a more accentuated way, since 2010 (see Figure 3 below).

Figure 2: Infringement Procedures by area (2011)[13]

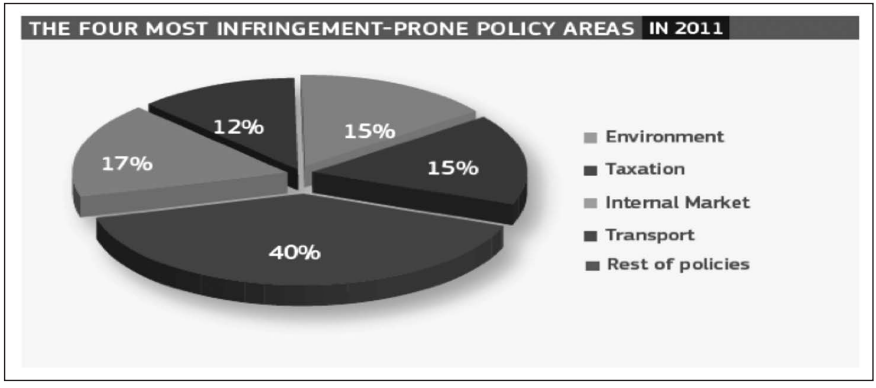
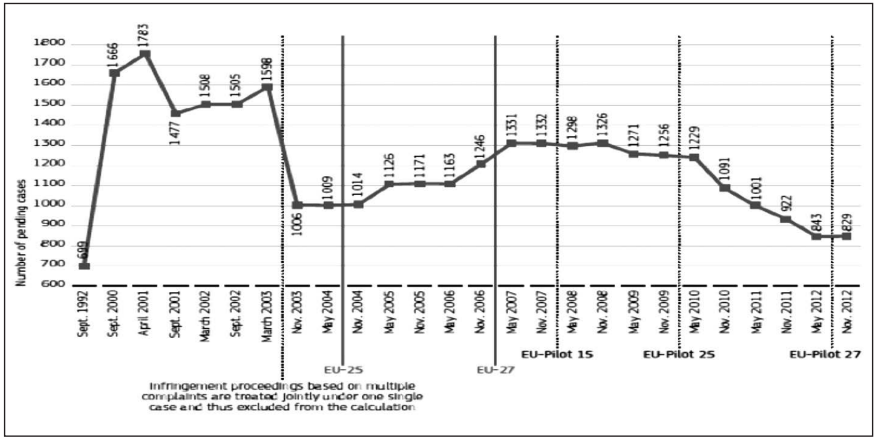


Figure 3: Pending Infringement Procedures for incorrect transposition or application of the EU internal market law since September 1992 to Novembre. 2012[14]



13 European Commission, *Staff Working Document, accompanying the Report from the Commission, '29th Annual Report on monitoring the Application of EU Law* (SWD (2012) O399/0400).

14 European Commission, *Internal Market Scoreboard No. 26: 15 Years of the Internal Market Scoreboard* (February 2013).

Moreover, it should be noted that, since the adoption of the first report, EU Pilot must be used in all cases where additional factual or legal information is required for a full understanding of an issue at stake concerning the correct application, implementation of EU law or the conformity of the national law with EU law. This could explain why the reduction of infringement procedures is even more pronounced when comparing the data of 2009 with the data of 2011 (See Table 1 above). Even if it is not possible to identify all reasons for this trend, one possible explanation is that EU Pilot, as well as the introduction of other working methods concerning complaints and early problem-solving mechanisms as SOLVIT network,[15] help to clarify and solve some issues regarding the application of EU law, without the need for recourse to infringement procedures and providing more rapid results for citizens and businesses. However, we should note that the increase in the cases submitted to EU Pilot has not yet led to a parallel decrease in the number of infringement procedures. Since its beginning until September 2011, 1,410 cases have been entered into the system, although, over 2009-11, the number of infringement procedures declined by only 330 files. This could mean that EU Pilot has contributed to a higher detection rate of non-compliance with EU law, by bringing to the system's attention cases that would otherwise not have often lead to infringement procedures.

In sum, during the three-and-a-half-year period since EU Pilot was launched until September 2011, we conclude that the system has contributed to increased compliance with EU law.

2.2. The SOLVIT network

Set up in 2002, by the European Commission Communication on Effective Problem Solving in the Internal Market (SOLVIT)[16] is a online network for settling cross-border disputes informally over the incorrect and inaccurate application of the single market rules arising between

[15] For the SOLVIT network see section 2.2.

[16] European Commission, *Effective Problem Solving in the Internal Market (SOLVIT)* (Communication to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, COM (2001)702 final), European Commission, *Recommendation on principles for using SOLVIT – The Internal Market Problem Solving Network* (December [2001] OJ L 33) and European Commission, *Recommendation on the Principles governing SOLVIT* (COM (2013)5869 final).

citizens or buinesses and public administrations across EU member states, to the extent that such disputes are not subject to legal proceedings at national or EU level.

The system is based on mutual cooperation and online techniques that allow for a decisional procedure, which is easily accessible, free of charge, and offers a quick solution (the problem must be solved in a targeting deadline of 10 weeks) to the internal market problems.

There is a national SOLVIT centre in every EU member state as well as Iceland, Liechtenstein and Norway, which is part of the member states' national administration and is subject to the law of the member states. SOLVIT centres cooperate directly with each other via an online database.

At the same time, SOLVIT is an online alternative dispute resolution mechanism (ODR) and a cooperation network between national administrations, which contributes to improving the implementation capacity of EU law at national level and hence fosters the correct application of EU law. In fact, evaluation shows that SOLVIT centres contribute to a "cultural change" in their own national civil service, inducing an overall improved compliance with EU law by national authorities.[17]

The Commission is generally not directly involved in this alternative informal dispute settlement system. However, the Commission coordinates and supports the functioning of SOLVIT by being in close contact with SOLVIT centres, offering regular legal training and, in some complex cases, providing informal advice. The Commission also monitors SOLVIT case handling and outcomes via the online database and is responsible for ensuring that the proposed solutions are in full conformity with EU law.[18] Moreover, the Commission always retains its prerogative to start an infringement proceeding, under Article 258 TFEU, whenever this is necessary.

During the SOLVIT network's first eight years of existence (2003-2009), the volume of the cases rose continuously. After 2009, the number

[17] European Commission, *Evaluation of SOLVIT* (Final Report, November 2011) and European Commission, *Recommendation on the Principles Governing SOLVIT* (COM (2013)5869 final).

[18] Idem.

of cases remained stable with only a few fluctuations (Figure 4). Today, SOLVIT handles around 1,300 cases a year (in 2011, SOLVIT received a total of 3,154 cases, of which 1,306 fell within its mandate) and manages to find solutions for over 89% of the cases (Figure 5). In 2011, 67% of the cases were solved within the SOLVIT deadline of ten weeks. However, the average turnaround time was 70 days.[19]

Figure 4: Total number of cases submitted to SOLVIT and to the 'Your Europe Advice' (YEA) portal, 2003-11[20]

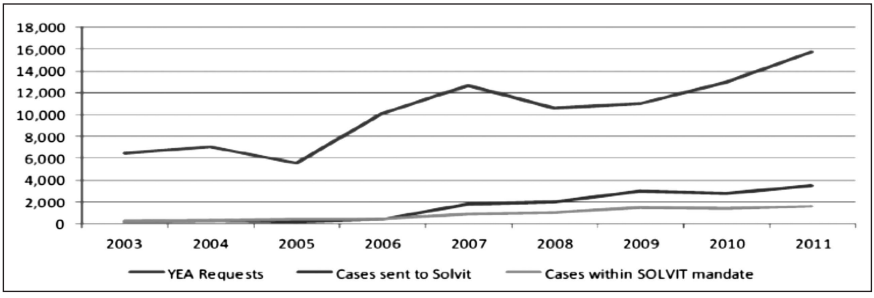
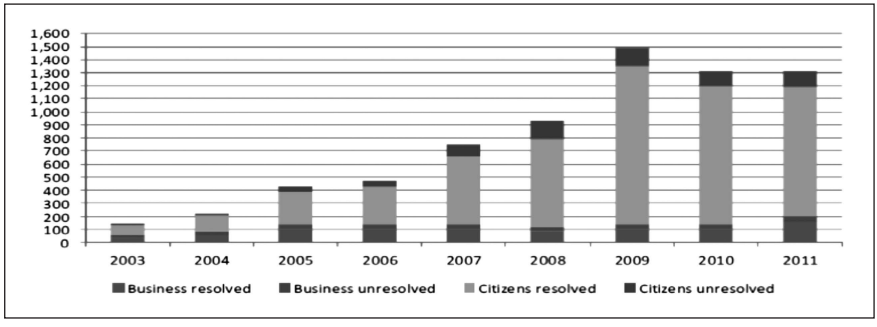


Figure 5: Resolution rates of the SOLVIT cases during SOLVIT's mandate, 2003-11



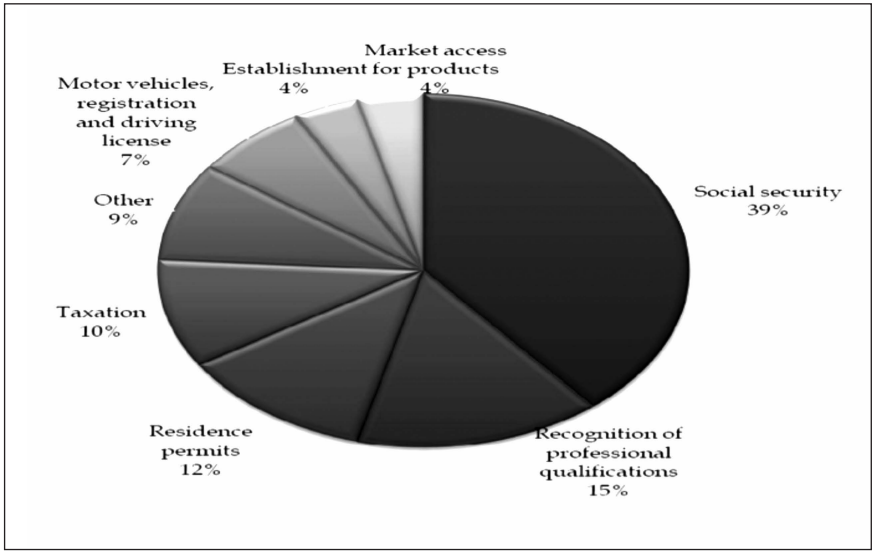
SOLVIT intervention is particularly significant in specific areas of the internal market, where quick and/or cost-effective solutions are needed. In 2011, as in 2010, social security issues related to migrants

19 European Commission, *Making the Single Market deliver, Annual governance check-up 2011* (2012).

20 European Commission, *Making the Single Market deliver, Annual governance check-up 2011* (2012).

generated the largest number of the cases (39% in 2011, 34% in 2010). The proportion of cases concerning the recognition of professional qualifications remained at around 15%. The number of cases concerning residence permits decreased to 12% (from 23% in 2010).[21] Cases involving the free movement of goods and services remained at 8%, while the number of taxation cases increased from 5% to 9% in relation to the last period (Figure 6).

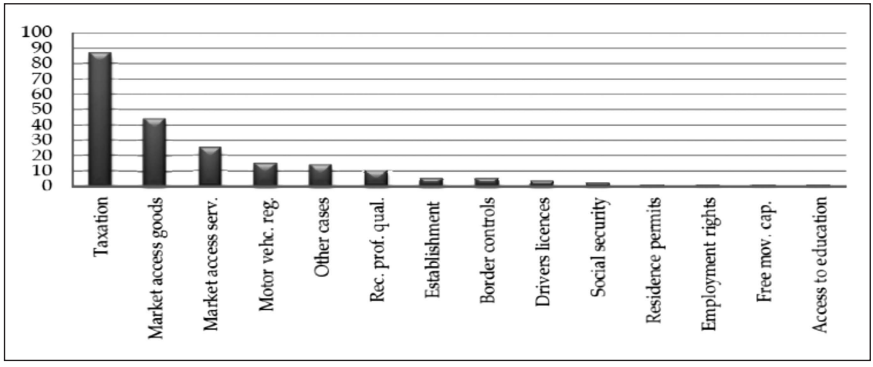
Figure 6: 2011 SOLVIT cases by area



Looking only at the SOLVIT business cases, taxation (47%), followed by problems in the area of free movement of goods (21%) and services (12%) clearly remain the key issues when doing cross-border business in the internal market (Figure 7).

[21] This is mainly because the number of residence permit cases received by the UK SOLVIT centre fell from 419 in 2009, to 185 in 2010 and 37 in 2011.

Figure 7: SOLVIT business cases by area, 2011[22]



SOLVIT has evolved significantly since its inception, handling ten times more cases than it handled ten years ago, in a much diverse variety of fields and, the overwhelming majority of the cases are resolved successfully, within an average of 9 weeks. It definitely has contributed to a better functioning of the Internal Market by fostering and promoting better compliance with EU law. However, SOLVIT network still presents some weaknesses that should be addressed in order to achieve the full potential of this cross-border informal problem-solving dispute mechanism and to deliver fast and effective solutions to problems that individuals and businesses encounter when their EU rights in the internal market are being denied by public authorities.

The European Commission has taken several actions, in recent years, to develop the full potential of the SOLVIT network and to increase its effectiveness, mainly by the new Commission recommendation on the principles governing SOLVIT.[23] One of the biggest problems with the SOLVIT system since it was set up is the amount of cases submitted to the centres that are outside their competences. The overwhelming majority of such cases concern requests for information and advice. It is undeniable that the large number of 'non-SOLVIT' cases dealt with by the network is an obstacle to its effectiveness, especially since centres generally remain understaffed and it adds significantly workload.

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22 Data made available to the authors by the European Commission.

23 European Commission, *Recommendation on the principles governing SOLVIT* (COM (2013) 5869 final).

In order to solve this problem the Commission, in 2008, published an Action Plan to help citizens better understand and make use of their rights in the EU,[24] containing a plan for streamlining a whole range of existing information and assistance services, including SOLVIT, which should bring about better filtering of cases at the point of entry. As a result of the Single Market Assistance Services (SMAS), action plan, the Commission has completely revamped the 'Your Europe' portal. The new 'Your Europe' offers user-friendly information about EU rights and helps people find further advice and help when needed. Moreover, via intelligent on-line forms, 'Your Europe' immediately refers people asking for more advice or help to the right service.[25]

Despite or because of these improvements, the number of visits to the 'Your Europe' website is growing exponentially. In addition, it appears that SOLVIT centres are receiving fewer requests for information and advice, which might well be due to a more effective common intake form. Furthermore, Europe Direct is also further developing its capacity to filter requests, so that they reach the right service, and to facilitate an easy transfer between the systems. On the other hand, the filter system should also lead to an increase in cases where SOLVIT can provide real help, but where citizens and businesses currently have difficulties finding their way to SOLVIT. A positive development in 2011 was precisely the reduced percentage of cases referred to SOLVIT that fell outside its remit (Figure 4). The Commission also has recently rebuilt the SOLVIT online database as a 'stand alone' module in the Internal Market Information System. Consequently, the rules set out in Regulation (EU) No 1024/2012 on administrative cooperation through the Internal the Internal Market Information System on the processing of personal data and of confidential information also apply to SOLVIT procedures.[26]

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[24] European Commission, *Action plan on an integrated approach for providing Single Market Assistance Services to citizens and business* (Staff Working Paper, SEC (2008)188).

[25] European Commission, *Empowering businesses and citizens in Europe's single market: An Action Plan for boosting Your Europe in cooperation with Member States* (Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions (COM (2013) 636 final).

[26] Regulation (EU) No. 1024/2012 of the European Parliament and of the Council on administrative cooperation through the Internal Market Information System (the 'IMI Regulation'), of 25 October 2012 repealing Commission Decision 2008/49/EC [2012] OJ:L:2012:316.

On the other hand, the SOLVIT mandate had given rise to differences in interpretation and led to different approaches among the national SOLVIT centres when it comes to deciding whether a case should be taken up by SOLVIT or not. Aware of this problem and in order to ensure a coherent approach through the EU, the Commission, in its Recommendation on the principles governing SOLVIT,[27] defines the types of cases that should be handled by SOLVIT. SOLVIT cases are now defined as all cross-border problems caused by a potential breach of the EU law governing the internal market by a public authority, where and to the extent such problems are not subject to legal proceedings at either national or EU level. This means, firstly, that SOLVIT's scope is limited to the problems encountered by citizens and business related to the application of internal market rules. Secondly, SOLVIT's centres should only handle cases where breaches of EU law are caused by a public authority,[28] not by a private party. Thirdly, SOLVIT only deals with cross-border problems; pure domestic problems are excluded from its scope of operation. SOLVIT centres have to dismiss cases that do not fit this description.

Among the shortcomings of SOLVIT network are also its scarce resources and limited legal expertise enabling the centres to carry out their tasks in a satisfactory way and to deliver independent legal analysis of the cases. Ensuring an adequate level of staffing and legal expertise is even more pressing if we take into account the increasing variety of cases that SOLVIT is asked to address. In addition, in almost all SOLVIT centres, the staff members have other responsibilities as well, which sometimes take priority over SOLVIT tasks. Currently only 14 SOLVIT centres are adequately staffed. In order to tackle this problem the Commission in its recent recommendation of September 2013 sets out minimum standards SOLVIT centres should comply with in terms of organisation, legal expertise, and relations with other networks. Moreover, since 2009, the Commission also given SOLVIT centres the possibility to request legal advice from lawyers working in 'Your Europe'. In the future, the Commission will also continue

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27 European Commission, *Recommendation on the Principles Governing SOLVIT* (COM (2013)5869 final).

28 The Commission considers that the concept of public authority should be interpreted broadly in order to cover all levels of public administration (national, regional and local authorities) as well as competent authorities (e.g. professional organizations in charge of recognizing professional qualifications) and bodies controlled by the state (e.g. universities). European Commission, *Recommendation on the Principles Governing SOLVIT* (COM (2013)5869 final).

to provide informal legal advice, within a targeted period of two weeks maximum, as well as organise regular legal training sessions and meetings between SOLVIT centres staff and Commission policy officers.[29]

Attracting business cases in SOLVIT remains a key priority for the Commission, as the number of business cases remained relatively stable and low in comparison to the increased number of citizen cases since the system was set up.[30] In 2011, 214 businesses cases were recorded out of a total number of around 1300 cases. In order to promote the use of SOLVIT by business, in 2009 the European Commission produced a Strategy Paper to guide SOLVIT centres on how they could develop activities in a coherent way to increase the awareness of business about SOLVIT.[31] Although a number of effective means have been developed by some SOLVIT centres to promote their activities towards business,[32] many centres have not fully mainstreamed an approach to the extent envisaged by the Strategy Paper. On other hand, we must keep in mind that the SOLVIT network is not always an appropriate or/and attractive problem-solving system to address cross-border business problems arising from the incorrect or inaccurate application of the single market rules by national authorities, for various reasons:

• Given that considerable sums of money or compensation are often sought by companies, they may prefer to employ their own lawyers using formal channels offering more leverage;

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29 Idem.

30 The share of business cases handled by SOLVIT each year in the period 2003 to 2010 in relation to the total number of cases was: 33% (2003), 34% (2004), 29% (2005), 31% (2006), 18% (2007), 14% (2008), 11% (2009) and 12% (2010).

31 European Commission, *Increasing awareness about SOLVIT among business users* (Strategy Paper, (2009). The Strategy Paper was built on the results of the European Businesses Test Panel, which found that 80% of businesses that had not previously heard of SOLVIT would be willing to use it if they required such services. The document seeks a comprehensive approach to delivering awareness-raising activities, developing a more effective web presence, partnership with umbrella business organizations and cooperation with international partners as well as delivering quick and effective services for business.

32 For instance Sweden has been notably successful in targeting advertising at businesses through various means including website links, awareness booklets with examples of successful SOLVIT outcomes and organising seminars with stakeholders. Other SOLVIT centres have been promoting SOLVIT among business by placing advertisements in business newspapers (Germany), developing relations with chambers of commerce (Poland) and promoting public transport advertisement campaigns (Czech Republic).

• Business cases are often seen as complex (often involving harmonised or technical market access issues);

• National administrations may choose to ignore informal legal advice which puts businesses off;

• As SOLVIT is a governmental organisation, businesses may wrongly believe that it is not an independent network and this may lead some companies to feel uncomfortable with SOLVIT if they require support in areas such as taxation.

Indeed, SOLVIT being a network for settling cross-border disputes informally and for free, is more likely to attract citizens and SME's cases. Strengthening relations with the European Enterprise Network should improve the awareness of SOLVIT among SMEs and help to attract more business cases.

Despite, the above mentioned weaknesses, SOLVIT has definitely contributed for a better functioning of the Internal Market, by solving not only the single cases presented to the SOLVIT centres by citizens and business, but also, in some cases, by promoting a change of attitude in national authorities and a better compliance with EU law. However, it is difficult to establish to what extent the SOLVIT network has contributed to a reduction of the number of infringement proceedings for incorrect transposition or application of single market rules occurred, mainly since May 2010.[33]

2.3. The Internal Market Scoreboard

The Commission has maintained the Internal Market Scoreboard for 15 years now, publishing the results twice a year. Although a range of issues concerning the internal market has been dealt with in the Internal Market Scoreboard over the years, the permanent feature is the regular reporting on transposition and application of EU internal market law, including fragmentation records. It is therefore a crucial source for any insight in the proper functioning of the single market. But its significance goes much further.

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[33] European Commission, *Internal Market Scoreboard No. 26, '15 Years of the Internal Market Scoreboard* (February 2013) pp. 19-20.

By carefully and regularly monitoring the application and implementation of internal market EU law by each member state, the Scoreboard creates Commission and inter-member state peer pressure to improve their scores. Poor records of certain member states are easy discerned from the Scoreboard and lead to criticism inside these countries and attract the attention of investors and business more generally. Indeed, the strategies to improve initially poor records of EU member states have been based on the indicators of the Scoreboard. Therefore, the Internal Market Scoreboard, more than just a tool, positively helps to improve the transposition and enforcement of EU internal market rules.

The information given in the Internal Market Scoreboard is based in three indicators: the 'transposition deficit', the 'compliance deficit' and the 'fragmentation factor'.

The 'transposition deficit' is defined as the percentage share of internal market directives not yet notified or implemented by member state of the total number of directives that should have been notified by the deadline. The standard for timely transposition by member state has become stricter over time. In the Stockholm European Council of 2001, the maximum target transposition deficit was set at 1.5% and in the Brussels European Council of 2007 at 1%. The Commission in the Single Market Act[34] proposed to lower the transposition deficit to 0.5%. For transposition overdue by more than two years the Barcelona European Council has set 'zero tolerance'. Since the publication of the first Internal Market Scoreboard in 1997, the EU average 'transposition deficit' has decreased progressively. According to the latest Scoreboard from February 2013 (No. 26) the transposing deficit has fallen to from 0.9% in the previous period to 0.6%, which is the best result since the Internal Market Scoreboard has first been published (Figure 8).[35]

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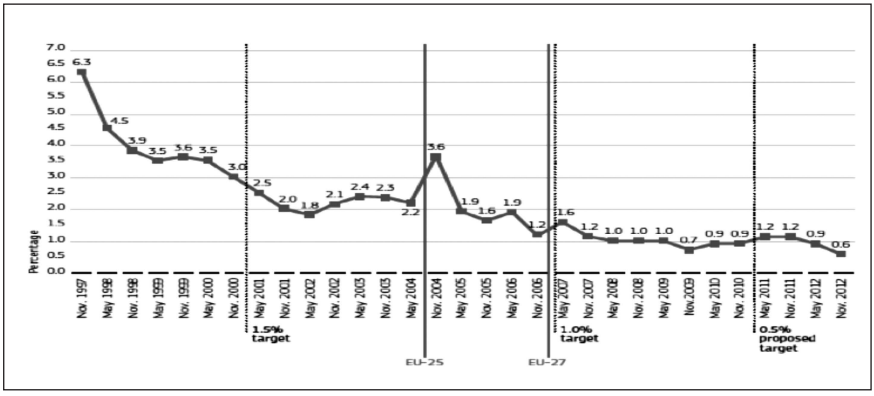
34 European Commission Communication, *Single Market Act: Twelve levers to boost growth and strengthen confidence* (COM (2011) 206 final).

35 European Commission, *Internal Market Scoreboard No.26, '15 Years of the Internal Market Scoreboard* (February 2013) and European Commission, *Internal Market Scoreboard No. 25, Together for new growth – 1992-2012 20 Years of the Single Market* (September 2012).

Figure 8: Average transposition deficit in November 2012[36]



Indeed, only four countries have not attained the standard transposition deficit (Belgium, Austria, Poland and Portugal), with Belgium adding 2 more directives to their existing backlog. These overall good scores may be the result of the introduction by the new Article 260(3) TFEU of the possibility to impose financial sanctions for later transposition of the EU directives.

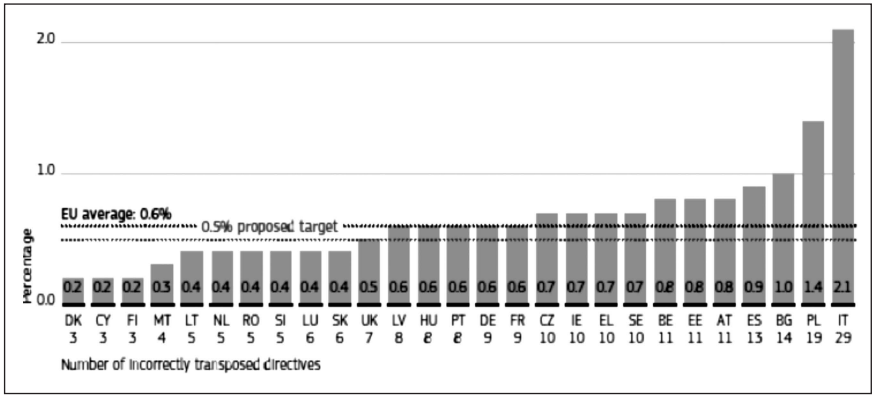
In relation to other challenges highlighted in the Scoreboard the results have worsened. The number of long overdue directives went up from 5 in the previous semester to 8 directives in November 2012 and this refers to five member states, which do not meet the 'zero tolerance' for transposition overdue by more than two years beyond their transposition deadline: Belgium, Germany, Italy, Poland and the United Kingdom. The average transposition delays have also increased from 5.5 months in May 2011 to 9.6% months to transpose the directives after the deadline.

Concerning to the 'compliance deficit', which is percentage share of incorrectly transposed directives from the total number of transposed directives, per member state, the members states have succeeded in further reducing the number of incorrectly transposed directives, by reducing the 'compliance deficit' from 0.7% in the previous period to 0.6%. Also for this indicator, the Commission proposes to have a 0.5%

[36] Idem.

target. What is surely worrying is a combination of a high 'transposition deficit' with a high compliance deficit. This is the case for Poland and Belgium (Figure 9).

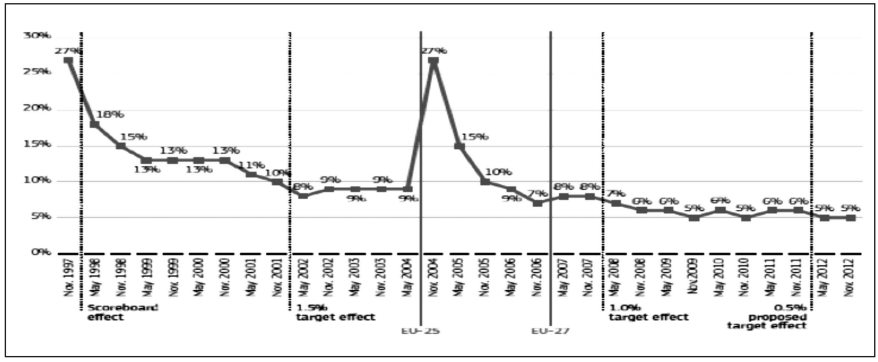
Figure 9: 'Compliance deficit by Member State as of in 1 November 2012[37]



Finally, the Internal Market Scoreboard publishes the 'fragmentation factor', an overall indicator of the 'legal gaps'. This factor is defined as the percentage share of the directives not (yet) transposed in one or more EU member states of the total number of directives that should have been transposed by that date. This is quite different from the 'transposition deficit', because the latter is an average between member states, whereas the former results from adding up all directives that, somewhere in the internal market, are not yet transposed. The fragmentation factor has achieved in November 2012 its lowest level of 0.5% (Figure 10). In absolute terms seventy-three directives have not been transposed on time in at least one Member State. Similar to the previous periods, the areas most affected are transport (20 directives out of 117 directives in force), environment (14 directives out of 151 in force) and financial services (7 directives out of 108 in force).

[37] European Commission, *Internal Market Scoreboard No.26, 15 Years of the Internal Market Scoreboard* (February 2013).

Figure 10: Incompleteness rate from November 1997 to November 2012[38]



For business, especially for European-wide business strategy, the fragmentation factor needs to be as low as possible. Nevertheless, one may wonder whether the Commission does not employ an exaggerated interpretation in the Scoreboard, making the internal market look more fragmented than it really is. Indeed, there are very few EU companies operating in all 27 member states, knowing that the EU comprises many small economies. If one or two member states have not yet transposed a directive, there are still 26 or 25 other EU member states, and a 'European-wide strategy can surely be employed successfully. Furthermore, there are also many other reasons why operating in all 27 member states may be less straightforward than suggested, such as fixed entry costs in terms of marketing and after-sale services, local languages, (costly) regulatory heterogeneity between EU countries in issues under national legislative power, patents, currencies other than the euro, etc.[39]Therefore, to hold that the internal market is operating at 95% of its capacity is an artificial approach not reflecting economic reality for business. This is not to

[38] European Commission, *Internal Market Scoreboard No.26, 15 Years of the Internal Market Scoreboard* (February 2013).

[39] Richard E. Baldwin, 'The euro's trade effect' (ECB Working Paper, No. 594, European Central Bank, Frankfurt, 2006). http://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp594.pdf accessed 5 February 2014. In this work on the economic impact of the euro, the author found that the euro made it possible for European business to enter smaller country markets that otherwise would remained too marginal for them. See also Gianmarco Ottaviano and Paolo Ireo, 'Contract Enforcement, Comparative Advantage and Long-Run Growth' (CEPR Discussion Paper No. 1419, Centre for Economic Policy Research, London, 2007) <http://www.fondazionemasi.it.isiportal.com/UploadDocs/214_Ottaviano.pdf> accessed 5 February 2014.

say that the fragmentation factor is irrelevant, rather, that it better be moderated to what it should mean.

3. Preventive approaches

Another class of enforcement methods is 'preventive' in nature. The philosophy here is to develop methods that reduce the likelihood that infringement to EU law might occur later. The short verdict on this approach is that it is highly beneficial, and in comparison with infringement procedures, less costly, much faster and probably more effective.

This preventive approach has gradually become far more important over time. As is increasingly the case with the 'pre-infringement' approaches, the *member states* have become central to greater effectiveness in this respect.

Ten examples of 'preventive' initiatives or those with a preventive effect (even though the motive for the initiative might be found elsewhere) include:

• Regulatory impact assessments (RIAs);

• Training member states' officials and judges in EU law;

• Regular consultation between member state officials negotiating a directive and those (later) responsible for implementation and enforcement;

• Disciplining member states in respecting 'mutual recognition';

• Joint (Commission/member states) 'ownership' in implementation (services Directive);

• Inter-member states' cooperation via the IMI system on daily implementation issues;

• Council recommendations on member states' implementation and enforcement;

• Selective shift in internal market from directives to (EU) regulations;

• Directive 98/34 on the prevention of new technical barriers in the internal goods market

• The 'rapid alert' mechanism of Regulation 2679/98, regarding the free movement of goods in case of blockages

In this section we briefly discuss six of these ten examples.

3.1. Regulatory impact assessment

Regulatory impact assessment (RIA) is the centrepiece of 'Better Regulation' strategies. The European Commission has conducted RIAs since mid-2003, and altogether over 550 had been completed by early 2012. Every more trivial piece of draft legislation proposed by the Commission to the EU legislator, such as directives and (EU) regulations, has to be presented together with a RIA, published by the Commission on the same date.

The purpose of RIA is to provide evidence-based and systematic analysis of the European public interest rationale of the proposal, alternative options to accomplish the identified objectives via (a combination of) instruments, an analysis of the economic, environmental and social impacts, including societal benefits and costs, and, where possible, a ranking of the options as well as an explicit treatment of the trade-offs between options.

The ultimate aim is to make 'better' EU laws, by avoiding ideological or vested-interest biases and imposing rigorous logic and analysis, to bring in as much empirical evidence as possible (on all options, not just a 'preferred' one), to help MEPs and the Council to think in terms of alternative options (with their expected consequences) and to support public debate in the EU on the basis of solid analysis, data and several alternatives. The idea behind RIAs is not only that the Commission is forced to work within the rigorous and detailed RIA logic, followed by far-reaching transparency, but also that EU-level decision-makers can be held accountable by a much better informed public.

Why do RIAs at EU level form part and parcel of the 'preventive' approaches of better enforcement? There are three reasons. First, RIA

procedures[40] impose a duty of consultation with e.g. business and indeed all stakeholders and imply a spirit of openness to comments and suggestions at all stages of the RIA writing. It is the combination of open consultation and RIA rigour that tends to result in 'better regulation' – at least, as proposed by the Commission –than before by e.g. blocking exemptions or inconsistencies driven by vested interests or unjustified traditions– and by paying careful attention to solid reasons "why regulate" (the benefits for the EU) and the costs and on whom these fall.

This point extends to the instruments and their 'enforceability' in actual practice. Other things being equal, better regulation tends to be more easily enforceable. Of course, this argument may sometimes be undermined by the actual EU laws enacted finally by the Council and the EP together, for whatever political reasons. However, the EP has recently announced that it has established a new unit in its services checking the impact of (nontrivial) amendments to Commission proposals.

Second, the much greater care taken in formulating Commission proposals based on RIAs often has the effect of removing or pre-empting all kinds of technical or legal 'bugs' in legislation that, later, lead to difficulties in implementation and enforcement by member states.

Third, every RIA has six stages, the sixth one being monitoring and evaluation of a directive once it is in force. In case implementation or enforcement difficulties can be attributed to a bad, inconsistent or excessively complex directive, the often incorporated review after (say) five years can prompt redrafting, reducing such problems.

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[40] Over the years since 2002, the Commission's Guidelines for RIAs have improved enormously. For the January 2009 version, see http://ec.europa.eu/governance/impact/docs/key_docs/iag_2009_en.pdf, plus many annexes and several handbooks. For literature, Andrea Renda, *Law on Economics in the RIA World: Improving the use of economic analyses in public policy and legislation (published by* Intersentia, European Studies in Law and Economics, 2011) and EU Court of Auditors, *Impact assessment in the EU institutions: Do they support decision-making?* (Special Report No. 3/2010, Brussels). For quality assessment of EU RIAs over the last few years, see Olivier Fritsch, Claudio M. Radaelli, Lorna Schrefler and Andrea Renda, 'Regulatory quality in the European Commission and the U.K.: Old questions and new findings' (CEPS Policy Brief No. 362, Brussels, January 2012) <www.ceps.eu/ceps/dld/6589/pdf> accessed 5 February 2014.

3.2. Regular consultation between those member states' officials negotiating a directive and those (later) responsible for implementation and enforcement

In the early phases of an RIA, there should be consultations between those who draft a directive/regulation (i.e. Commission officials) and those who will later have the responsibility to execute it nationally. Once negotiations start in Council committees, it is even more important for every member state to consult practitioners or officials in the relevant ministries in order to promote a final version of the directive that is relatively easy to implement and enforce, and in any event avoids unnecessary complications that might cause enforcement issues later on, if not 'barriers'.[41]

3.3. Joint EU and member state ownership of implementation

The 2006/123 horizontal services Directive[42] has been implemented in a unique fashion. In a major effort of profound cooperation between the member states as well as between the member states and the Commission, this complex and ill-drafted Directive[43] has been implemented as much as possible in similar ways, notwithstanding the

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41 In a classic study of 17 directives as applied in all 12 member states at the time the lack of contact between negotiators and practitioners proved to be a significant cause for differences in enforcement between member states (hence, 'distortions' in the single market) or occasionally for 'barriers'.

That this is just as much an issue today is clear from the very detailed study made by the Davidson Review. Lord Davidson recommends that "there should be an effective transfer of knowledge between teams negotiating and teams implementing European legislation" in order to minimise implementation problems. Admittedly, this is not always easy since, with truly new legislation, there may be few, if any, practitioners available yet. This 'time inconsistency' can be reduced if after the negotiations the negotiating experts are not immediately shifted around to other functions elsewhere inside the public administration. This can avoid the loss of institutional memory and tacit information. See Bernard Siedentopf and J. Ziller, *Making European Policies Work: The Implementation of Community Legislation in the Member States*, (eds, 1998, London: Sage and Davidson) and Lord Neil, 'Implementation of EU Legislation' in Davidson Review (November London HMS. 2006) pp. 8.

42 Directive 2006/123/EC of the European Parliament and of the Council on services in the internal market (Services Directive) [2006] OJ:L:2006:376.

43 Catherine Barnard *The Substantive Law of the EU: The Four Freedoms* (3rd edn, Oxford, University Press 2008).

wide and possibly disruptive variety between EU countries. Such extreme efforts can only be expected in special cases: the services Directive surely is a special case as its scope is broad (applying to services generating more than 40% of EU GNP) and the barriers were numerous and deep-seated, even at several layers of government all the way to provincial and local governments.

The implementation of Directive 2006/123 was guided by four committees (chaired by the Commission, with all member states), a detailed Guide, an obligatory 'screening' of all domestic legislation potentially relevant (literally thousands of laws and decrees at more than one government level), direct monitoring of and support for each and every national implementation by the Commission for years and finally a 'mutual evaluation' (in 2010) amongst the member states. The result is impressive.[44] There can be no doubt that, following such major and cooperative efforts, numerous enforcement problems in this area have been prevented.[45]

This prominent example shows that proper implementation of complex EU directives is possible in a two-level government system like the EU, only if: a) member states are prepared to work together and with the Commission and, b) there is a political and administrative conviction of responsible 'ownership' in national capitals. It should be realised that the services Directive is largely based on prior CJEU case law and comprises relatively little 'harmonisation'. Therefore, apart from a number of explicitly banned restrictive practices, which represent great progress for the services market, the Directive's impact hinges mainly on effective domestic screening, the Points of Single Contact (key for business) and effective inter-member states' cooperation in daily matters of administration. In future, some such special cases should utilise similarly intrusive methods in order to accomplish proper implementation and thereby pre-empt many difficulties of later enforcement. That the lessons

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[44] European Commission, *Implementation of the Services Directive, 'A partnership for new growth in Services 2012-2015* (Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions (COM (2012) 261 final) and the European Commission Staff Working Paper accompanying the communication **(SWD (2012) 0189).**

[45] European Commission, *The economic impact of the services directive: a first assessment following implementation* (European Economy, Economic Papers, No. 456, June 2012).

of the cooperative approach towards the implementation of the services Directive have been learned is clear from two recent initiatives, the IMI system of inter-member state cooperation (see section 3.4.) and the new 'partnership' approach between the Commission and the member states with respect to detections of possible misapplication of EU law, signaled via enquiries and complaints.

3.4. Developing the IMI system of inter-member-states' administrative cooperation

In September 2009, the Commission and the member states agreed to establish closer 'partnerships' between the member states (and the Commission as well), with a view to making the single market work better.[46]

In many instances this can be important, if not crucial, for business and citizens alike. A breakthrough was accomplished with the start of IMI, the Internal Market Information mechanism, an IT-based information network linking authorities in all 30 EEA countries, with a multilingual search function helping competent authorities find their counterpart in other EU countries, prepared questions and answers in 23 languages as well as automatic translation for other queries. In February 2012, no less than 11,000 authorities were registered in IMI. Its use is rapidly increasing. The 2005 Directive on recognition of professional qualifications,[47] whereas it may now also used for public procurement questions (and possibly, posted workers).

For a long time in the EU, inter-member state administrative cooperation was a serious weakness: slow, ineffective or even failing hopelessly, leading to business frustration and loss of opportunities. IMI is very different. In numerous trivial instances, like the verification of addresses or registrations or licenses or diplomas, it works rapidly (often

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[46] Commission Decision 2008/49/EC of 12 December 2007 concerning the implementation of the Internal Market Information System (IMI) as regards the protection of personal data, [2008] *OJ:L:2008:013*. The Commission Decision it was recently replying by Regulation (EU) No. 1024/2012 of the European Parliament and of the Council of 25 October 2012, on administrative cooperation through the Internal Market Information System, [2012] OJ:*L:2012:316*

[47] Directive 2005/36/EC of the European Parliament and of the Council of 7 September 2005 on the recognition of professional qualifications, [2005] *OJ:L:2005:255*

requiring only days, 43% processed in a week). IMI has the additional advantage that it has now become routine for national or regional administrations to work together with counterparts in other member states. Although it is exceedingly difficult to foresee all the benefits flowing from a successful and widespread utilisation of IMI in more fields, it is bound to be advantageous for cross-border business and has the potential to pre-empt high information and transaction costs. In case of administrative issues, the key business problem of the past – losing time-to-market – may be drastically reduced as well.

The successful IMI experience had lead the Commission to propose a firm legal basis for the system, in the recent approved Regulation (EU) No. 1024/2012 on administrative cooperation through the Internal Market Information System.[48]

3.5. Selective shift from internal market directives to EU regulations

According to the Internal Market Scoreboard (No. 23, September 2011),[49] on 30 April 2011, the internal market *acquis* consisted of 1,525 directives and 1,347 EU regulations.[50] These seemingly plain data masks a silent revolution in the EU internal market regulatory regime. Over the last decade or so, the total number of internal market directives has hardly changed whereas the number of EU regulations has increased enormously, indeed, has more than quadrupled! Thus, in Scoreboard No. 10 (May 2002), the total number of directives was the same as ten years later (1,497, as against 1,525 in the spring of 2011) but the total number of EU regulations amounted to no more than 299 (as against 1,347 in 2011).

For the enforcement in the internal market, this major shift can be regarded as another instance of a 'preventive' approach. After all, regulations have direct effect and need no transposition into member

48 Regulation (EU) No. 1024/2012 of the European Parliament and of the Council of 25 October 2012, on administrative cooperation through the Internal Market Information System, repealing Commission Decision 2008/49/EC, [2012] *OJ:L:2012:316*.

49 European Commission, *Internal Market Scoreboard No. 23, 'Together for new growth'* (September 2011).

50 Not counting decisions, recommendations and other softer EU law, and CJEU rulings.

states' domestic law; there is, by definition, no implementation problem. Although, there is no broad proof have no hard proof, it is likely that EU regulations also lead to fewer problems of wrong or misguided problems of application of EU law. In other words, enforcement in the internal market is expected to improve significantly, if and to the extent that regulations rather than directives are employed. And, as noted, since 2002, the extent of the shift has been very large indeed. This means that, irrespective of the transposition deficit and also irrespective of the compliance deficit (see section 2.3), enforcement in the internal market must have improved solely on account of having far more EU regulations. Curiously, this shift has remained largely unnoticed and is never explicitly related to 'better enforcement' efforts. The shift to regulations, with the clear and explicit approval of member states, can be considered as a highly significant contribution to better enforcement in the internal market.

3.6. EU prevention of new technical barriers (Directive 98/34/EC)[51] [52]

Under Directive 98/34/EC the European Commission receives compulsory notifications from the member states of all national draft laws containing technical regulations (on goods and, a minor part, on information society services). The notified national draft laws are verified so as to enable the Commission as well as the member states to detect potential (new) technical barriers or other (new) regulatory barriers to intra-EU cross-border trade. Subsequently, the Commission requests the relevant member states to amend the draft so as to *prevent* such (potential) barriers.

The 98/34/EC mechanism is remarkable for at least two reasons. First, member states temporarily renounce their sovereign right and freedom to legislate as and when they want. A notification automatically postpones the conclusion of domestic pre-legislative procedures for three months, i.e. the draft cannot be adopted before the end of this standstill

[51] Directive 98/34/EC of the European Parliament and of the Council of 22 June 1998, laying down a procedure for the provision of information in the field of technical standards and regulations and of rules on Information Society services, [1998] *OJ:L:1998:204*.

[52] For further details see Anabela Correia de Brito and Jacques Pelkmans, 'Pre-empting Technical Barriers in the Single Market (CEPS Policy Brief No 277, 11 July 2012) <http://www.ceps.eu/book/pre-empting-technical-barriers-single-market> accessed 5 February 2014.

period. However, such standstill period may be prolonged to four or six months. In case of a blockage (i.e. when the Commission announces that the proposal concerns a matter that is covered by a proposal for an EU directive, regulation or decision), it may reach twelve months. If the Council adopts a common position, the national legislative procedure is blocked for 18 months. This is an effective way to prevent new technical barriers from arising. Second, notification is not only compulsory but the Court of Justice of the European Union (CJEU) has explicitly ruled (in CIA Security International, 1996)[53] that non-notification renders the national law, adopted subsequently, inapplicable and, consequently, 'unenforceable' against individuals. Again, such a ruling provides strong incentives to notify, thereby raising the credibility of 98/34 even more.

What is typically notified? Basically, all national technical regulations together with an explanation of the necessity to make such regulations, if this is not clear in the draft, unless the regulations are a simple transposition of international requirements or European directives. It is hard to 'guesstimate' what the economic significance of its scope is, but minimum proxy would be nearly 20% of intra-EU trade in goods. The regular Commission reports on Directive 98/34/EC3 speak of goods in the non-harmonized field as well as in the harmonized field. The latter refer to secondary national legislation that elaborates principles and specifications in EU directives. Depending on the situation, member states may exercise considerable discretion in this area, and 98/34 procedure verifies whether that discretion is used in ways that create unnecessary divergences or incompatibilities with the relevant directive(s). In other words, it disciplines at EU level the national regulatory autonomy first allowed in the directive, such that no new barriers to the internal goods market emerge.

National notifications, sent to the Commission, are automatically transferred to the national representatives in the 98/34 Committee (which is chaired by the Commission). It is expected that both the Commission and the member states carefully screen the notifications and, if they see a reason, make observations of two kinds:

• 'Comments' are advisory in nature and/or ask for clarification so as to ensure that no new barrier might arise from the draft law at stake

[53] Case C-194/94 '*CIA Security*' [1996] ECR I-2201.

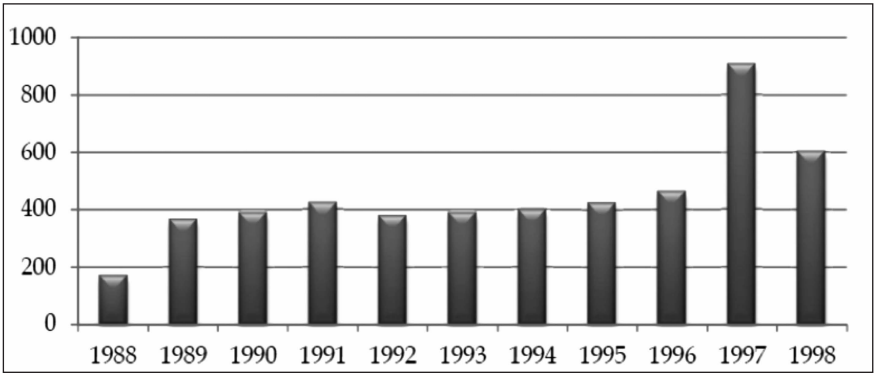
and should be taken into account by the notifying EU country 'as far as possible';

• 'Detailed opinions' argue why the draft law risks erecting one or more new technical barriers, which is the basis for automatically suspending national legislative procedures for another 3 months, and the notifying member state must report to the Commission the action it intends to take to remedy the problem.

A Commission website called TRIS[54] reports all notifications in summary form (usually in English), with links to the full text. In principle, therefore, business and all interested associations and individuals have the possibility to track the process and identify cases of interest to them.

How critical the 98/34 mechanism has been for the protection of the internal goods market can be seen from Figures 11 and 12, which show the number of the notifications over the period 1988–2010.

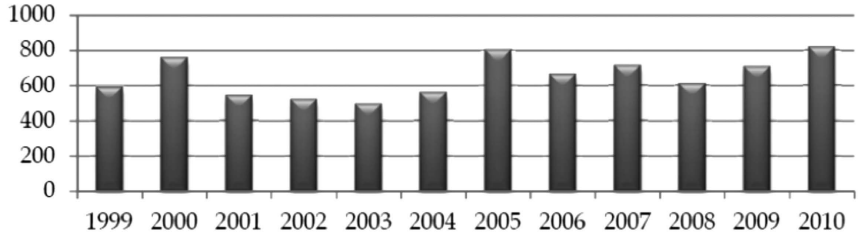
Figure 11: Total number of notifications of national draft laws under 98/34, 1988-98[55]



[54] TRIS stands for a Technical Regulations Information System and is a database which facilitates the notification system under Directive 98/34/EC. On the publicly available website, one can find all the relevant information on the procedure, including notified draft laws and subscription to a regular alert system on the latest notifications. <http://ec.europa.eu/enterprise/tris/default.htm?CFID=8438170&CFTOKEN=340b9653def3dee1-044F37E7-B193-40BA-E6D33D2B8300CC78> accessed 5 February 2014.

[55] Jacques Pelkmans and al., 'Reforming Product Regulation in the EU: A Painstaking, Iterative Two-Level Game', in Giampaolo Galli and Jacques Pelkmans (eds.), *Regulatory Reform and Competiveness in Europe*, Vol. I, Horizontal issues, Cheltenham: Elgar (2000).

Figure 12: Total number of notifications draft laws under 98/34, 1999-2010[56]



The regulatory activity of member states in this narrow field of goods legislation is considerable. In the period of the EU-12 (1988–94), annual notifications hovered between 300 and 400 and many of these prompted observations from the Commission and/or member states, suspecting potential barriers. During the period of the EU-15 (1995–2003), notifications start to rise to (sometimes far) beyond 500 a year.

A further structural increase can be observed after the first and second Eastern enlargement (2004–10), approaching an annual average of around 700 a year. This shows that member states remain very eager regulators. Yet, this eagerness creates serious risks of newly emerging technical or other regulatory barriers, which might be difficult, slow and costly to remove again. Hence, the justification of the intrusive 98/34 mechanism which does not reduce national regulatory autonomy but disciplines it for the sake of the internal goods market.

As noted, member states and the European Commission can make two types of observations on notified draft laws: "*comments*" and "*detailed opinions*".[57] Figure 13 provides empirical evidence for the period 2004–10 inclusive.

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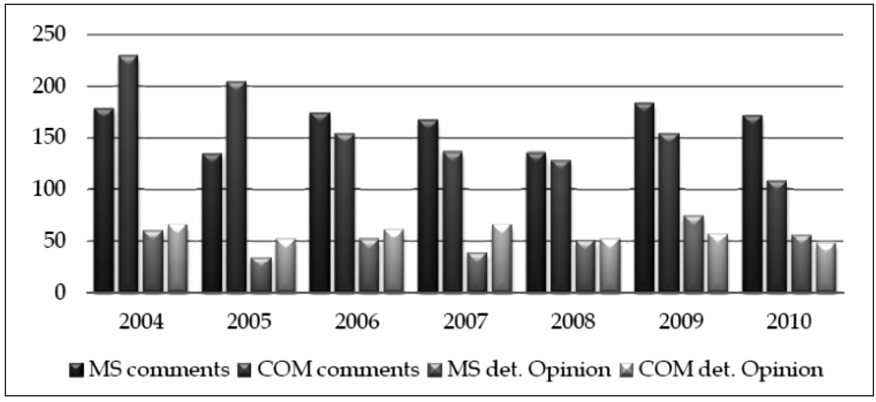
[56] Jacques Pelkmans, 'Mutual Recognition in goods: On promises and disillusions' in Journal of European Public Policy [2007] No. 5, Vol. 14, August; European Commission working document accompanying the Report from the Commission to the Council, the European Parliament and the European Economic and Social Committee *on the operation of Directive 98/34/EC from 2006 to 2008* (SEC (2009) 1704) and European Commission working document accompanying the Report from the Commission to the Council, the European Parliament and the European Economic and Social Committee *on the operation of Directive 98/34/EC in 2009 and 2010* (SEC (2011) 1509 final).

[57] The Commission can also block a draft law in case relevant harmonization work is already under way or due to be undertaken. This leads to a suspension of 12 months, giving time for the preparation of a draft directive.

Figure 13: Detection under 98/34 of potential regulatory barriers, 2004-10[58]



The comments over these 7 years amount to 1,142 for the member states and 1,113 for the Commission. The 'detailed opinions' identify potential future barriers. The member states identified over the seven years no less than 366 such instances, and the Commission 402. One cannot add these totals because many detailed opinions of member states may well be on the same draft laws and are likely to overlap with detailed opinions from the Commission; usually, the Commission list is larger than the number of draft laws identified as problematic by member states. On this basis, one can conclude that no less than 400 national draft laws were temporarily stopped by 'detailed opinions', indicating a serious risk of emerging technical barriers in the internal goods market. Moreover, the experience shows that a significant chunk of identified potential problems can be solved in a dialogue between the notifying member state and the Commission or another member state that issued a comment or a detailed opinion. This amazing record shows how crucial 98/34 is for keeping the internal market from deteriorating by preventing a groundswell of new technical barriers.

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[58] European Commission working document accompanying the Report from the Commission to the Council, the European Parliament and the European Economic and Social Committee *on the operation of Directive 98/34/EC from 2002 to 2005* (SEC (2007) 350; European Commission working document accompanying the Report from the Commission to the Council, the European Parliament and the European Economic and Social Committee *on the operation of Directive 98/34/EC from 2006 to 2008* (SEC (2009) 1704) and European Commission working document accompanying the Report from the Commission to the Council, the European Parliament and the European Economic and Social Committee *on the operation of Directive 98/34/EC in 2009 and 2010* (SEC (2011) 1509 final).

4. Reducing transaction and information costs

The third challenge in enforcing the EU market arises from the need to reduce the transaction and information costs of actual or potential market access, including legal uncertainty. Whether intentional or not, these costs can be regarded as barriers or border effects for business and there is every reason to lower them in a single market. Among the Commission's initiatives/mechanisms that could contribute to reducing transactions and information costs, we can mention the following:

- Commission guidelines, interpretative notes, handbooks, etc.;
- Points of single contact (e.g. services Directive and the new legislative framework);
- Commission information flow (websites, EU Info Centres, etc.);
- Cheaper/easier cross-border dispute settlements (FIN-NET, ADR) and,
- 28th regime for contract law.

A new twist to this cost reduction approach (which also has a 'preventive' element to it) are recent attempts to develop EU instruments that lower the costs and risks of EU-wide transactions. One set of attempts is about cheaper/easier cross-border dispute settlements, e.g. FIN-NET, the network for financial services, the Directive on consumer Alternative Dispute Resolution (ADR)[59] and the Regulation on consumer online dispute resolution (ODR).[60] Alternative dispute settlement mechanisms may also complement the traditional judicial system by facilitating the resolution of conflicts and avoiding costly procedures.

The new Directive on consumer ADR covers all kinds of consumer disputes and aims to provide consumers and businesses, particular small ones, with a out-of-court, low-cost (ADR procedures must be free

[59] Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes (Directive on consumer ADR), amending Regulation (EC) No. 2006/2004 and Directive 2009/22/EC [2013] OJ:L:2013:165.

[60] Regulation (EU) 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No. 2006/2004 and Directive 2009/22/EC (Regulation on consumer ODR) [2013] OJ:L:2013:165.

of charge for consumers or have a cost below ⁋50), fast (most disputes submitted to ARD are decided within 90 days) and alternative way to improve redress in the internal market. The directive covers contractual disputes between consumers and traders of services or goods. Business-to-business (B2B) disputes are excluded from the scope of the directive.

The Regulation on consumer ODR aims to fill the existing gap of ADR for shopping online and creates an EU-wide online platform, providing consumers and businesses with a single point of entry to resolve their disputes concerning purchases made online. This single European point of entry automatically sends the consumer's complaint to the national ADR entity.

Another set of attempts seeks to enact at EU level a 28th regime for contract law, meant to promote legal certainty for business in the single market. A proposal has been made for sales law.[61] If the 28th regime is attractive enough, it reduces 'regulatory heterogeneity' among member states. In fact, contracts are essential for running a business and the existence of a legal certainty and the uniform implementation of EU law. The proposed regulation would create a 28th optional European contract law for the sale of goods, with contracts for the sale of goods applying both to B2B and B2C transactions (previous agreement of both parts is necessary).

5. Conclusion

There can be no doubt about the firmer resolve, evident for around a decade or so, and about the widening and strengthening of efforts with respect to implementation and proper application of EU internal market law by both the European Commission and the member states. While of course retaining the ultimate legal option of going to the Court of Justice of the European Union (CJEU) for infringement cases, it is –rightly– considered to be (much) faster and mostly cheaper to employ a range of other approaches in order to avoid the route all the way to the Luxembourg court, or, to prevent bad implementation and/or application in the first place.

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61 European Commission, Proposal for a Regulation of the European Parliament and of the Council on a Common European Sale Law (COM (2011) 635 final).

This approach not only proved to be more effective on enforcing EU law, but also increases the confidence of the European businesses and citizens in the opportunities offered by the single market.

However, now that the resolve is greater and several new methods have been introduced with some measure of success, the last thing one should do is to consider the enforcement in the internal market as a problem solved. It is not. There are still lots of enforcement problems, big and small, and almost every new method would seem to attract new notifications or complaints.

The positive experiences in SOLVIT, EU Pilot and the 98/34 Committee have already helped a lot to improve enforcement.

SOLVIT is a success story since it has proven to be a resolution mechanism with easy access, a high success rate and considerable speed, while costing very little. A closer study of business cases in SOLVIT and of business attitudes towards this free mechanism with limited and voluntary solutions suggests that SOLVIT should focus on SMEs in the first place.

The partnership approach between the Commission and the member states, manifest in the pre-litigation stage (before a formal infringement procedure starts), is a success, as shown by EU Pilot.

EU Pilot and the SOLVIT network,[62] helps to clarify and solve some issues regarding the application of EU law, without the need for recourse to infringement procedures and providing more rapid results for citizens and businesses. Moreover, they also has contributed to a higher detection rate of non-compliance with EU law, by bringing to the systems attention cases that would not often lead to infringement procedures.

The Commission's Scoreboards have also proven their utility over the last 15 years.

In the wider landscape of EU enforcement, 'preventive' approaches aiming to reduce the likelihood that infringement might occur later, we witness the increasingly active and positive involvement of member

[62] For the SOLVIT network see section 2.2.

states in such approaches (in eight out of ten mechanisms). Major achievements include the mutual recognition Regulation 764/2008, the pro-active joint 'ownership' of the difficult implementation of the 2006/123 services Directive, the rapidly intensified and ever-more effective IMI (Internal Market Information) system of day-to-day inter-member states' administrative cooperation and the crucial cooperation of all member states in the 98/34 Committee preventing new technical barriers from arising in the internal market.

These impressive examples underline, without any doubt, that preventive and cooperative approaches can be of great help in preventing enforcement problems. The EU should extend this form of cooperation wherever meaningful. The marvel of preventive approaches was and remains the 98/34 procedure, which aims at pre-empting the emergence of new technical barriers caused by new draft laws and decrees in member states.

19

Compliance Mechanisms Compared: An Analysis of the EU Infringement Procedures, SOLVIT, EU Pilot and IMS

CATHARINA E. KOOPS*

ABSTRACT

Full completion of the Internal Market is essential for realizing the growth potential of the European economy. Completion of the Internal Market and the four freedoms of the Union can only be achieved through better implementation of EU legislation. This paper provides a comparative analysis of the existing basic enforcement mechanisms of the EU: the infringement procedures and three alternative mechanisms – SOLVIT, EU Pilot and the Internal Market Scoreboard. By integrating management and enforcement theories of compliance, it is shown how the complementarity of and interaction between the different mechanisms provide a model to effectively induce compliance. At the core of the model lies the concept of effectiveness: the degree to which objectives are achieved.

The paper concludes that the three alternative mechanisms have similar actors, aims and scope as the infringement procedures, and are complementary to those procedures. It is the path to compliance that makes the difference. It is shown how the complementary mechanisms interact with the infringement procedures, and how they influence and reinforce their respective effective functioning. When designing new compliance mechanisms, be it a dispute resolution mechanism such as Solvit, a peer review mechanism such as the Internal Market Scoreboard, or an interactive information and enquiry system such as EU Pilot, such possible interaction with and influence on the infringement procedures needs to be taken into account.

KEYWORDS: Compliance, Infringement Procedures, SOLVIT, EU Pilot, Internal Market Scoreboard, Effectiveness.

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1. Introduction

"I now see a willingness of governments to accept stronger monitoring, backed up by incentives for compliance and earlier sanctions. The Commission will strengthen its role as independent referee and enforcer of the new rules."

The above statement was made by mr. Barroso, President of the European Commission, as part of the first State of the Union address of the European Union in 2010. By that time it had become clear that economic governance in the European Union needed to be modified, in order to be able to face the challenges put before the Member States by the 2008 economic crisis. Reforms were proposed, not only increasing the role of the European Commission as Guardian of the Treaties, but also introducing new and strengthening existing options for supervision and enforcement including stronger surveillance mechanisms and the application of sanctions to non-compliant Member States.[1]

In the area of EU Internal Market law, on the other hand, the role of the European Commission as enforcer of the Treaties has since long been established.[2] The infringement procedures under Articles 258 – 260 TFEU make several options available to the Commission to induce compliance by the Member States, including court procedures and the ultimate option of imposing sanctions. Over the years, however, new systems have been introduced with the aim of increasing adherence to Internal Market rules. These newer compliance mechanisms rely on the power of soft methods such as increased transparency, dialogue, peer review, naming-and-shaming and the like, to induce compliance without recourse to the harder option of enforcement and sanctions.

This introduction of soft mechanisms for an area where an established hard compliance mechanism already existed, alongside a gradual switch in the opposite direction in the area of economic governance, shows the intricacies of choosing the appropriate mechanism to induce compliance. The extent to which the compliance system can induce adherence to the underlying obligations, in short: its

1 European Commission (2012) *Commission Communication: A Blueprint for a deep and genuine economic and monetary union. Launching a European Debate COM(2012) 777 final.*

2 Article 17(1) TEU.

effectiveness, is an essential element to take into account when choosing between different types of mechanisms.

This paper offers a comparative analysis of the effectiveness of the EU infringement procedures and three alternative compliance mechanisms: the Internal Market Scoreboard, SOLVIT and EU Pilot. Section 2 sets out the theoretical assumptions underlying the model for effectiveness used in the paper. Section 3 and 4 explain the set-up and functioning of the four compliance mechanisms, while section 5 analyzes the interaction between them. Section 6 then applies the effectiveness model to the mechanisms, while section 7 concludes.

2. To comply or not to comply

This study sets out to determine the effectiveness of compliance mechanisms in the EU. The current section explains the theoretical model underlying that analysis.

2.1. Compliance theories

Compliance with international law is a complex and much debated subject. Scholars from the fields of international law, international relations, social science and in particular political science, have examined how international law can affect the conduct of states. A traditional way of classifying theories on compliance with international law, is to distinguish between realist and normative theories. On the one hand, according to realists, non-compliance can be intentional, rational, or based on cost-benefit analysis, while on the other hand according to normative theory, this may be unintended, unknown to the actor or based on informational, communicational or capacity issues. [3]

A relatively more recent take on the compliance debate focuses on regime characteristics that are most able to invoke compliance by the Member States.[4] The two most important perspectives in this debate

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[3] See e.g. Keohane, R.O., *After Hegemony: Cooperation and discord in the world political economy* (2nd edn Princeton University Press, Princeton, NJ, 2005).

[4] Tallberg, J., 'Paths to Compliance: Enforcement, Management and the European Union' (2002) 56 (3) *International Organization*, p. 611.

are referred to as the enforcement approach and the management approach. These two models incorporate most elements of realist and normative theories, without discerning between the different variations on those theories. The management model is one of cooperation, where justification, discourse and persuasion are used to make states comply.[5] The premise is that non-compliance by states is not necessarily due to deliberate defiance. The enforcement model on the other hand, is based on cooperation, enforcement, and "the endogenous quality of rules".[6] In contrast to the management theory, states, as rational actors that weigh the benefits and costs of their actions against each other, might willfully choose not to comply when this suits them. In this model therefore, compliance is structured around state incentives in order to induce compliance, with the use of sanctions in the case of non-compliance.

When the management and enforcement theories are applied to instances of non-compliance, it is seen that two elements need to be taken into account: the sources of non-compliant behavior, and the character of the underlying obligations. The table below shows what happens when we combine these two elements.

Table 1: Compliance Variables & Corresponding Models

Source / Character	*Intentional non-compliance*	*Unintentional non-compliance*
Soft underlying obligations	Management	Management
Hard underlying obligations	Enforcement	Management or Enforcement

When non-compliance is intentional, theory predicts that an enforcement model is most effective in inducing compliance. An enforcement approach increases the cost of non-compliance, thereby tipping the outcome of a cost-benefit analysis toward compliance. A similar result is found when the underlying obligations are of a hard

5 Chayes, A. and A. Handler Chayes, 'On Compliance' (1993) 47 (2) *International Organization.*

6 Downs, G.W. *et al.*, 'Is the good news about compliance good news about cooperation?' (1996) 50 (3) *International Organization*.

(binding) nature, and can be enforced through courts, coercion or other compliance mechanisms. When the underlying obligations are of a soft nature, however, the enforcement model would not work. Soft obligations are not binding in court and cannot be enforced. A management model would then be better at predicting compliance outcomes.

The same holds true, and even more so, in case the underlying obligations are of a soft nature *and* non-compliance was unintentional. Not only would an enforcement approach be inappropriate,[7] it would also not be effective. Since the non-compliance was not caused by cost-benefit analysis but rather by other factors, merely increasing the costs of non-compliance cannot induce adherence to the rules. However, when non-compliance was unintentional but the underlying obligations are hard, it is unclear which model would work best. Hard underlying obligations are enforceable in court, and an enforcement approach would thus theoretically be more appropriate. On the other hand, when non-compliance is unintentional, management theory predicts that an enforcement model will not work well since the non-compliant behavior is not based on the outcome of a cost-benefit analysis. A combination of the two systems could be an option – first try to induce compliance through managerial efforts and when the results remain unsatisfactory, back it up with an enforcement approach.

Drawing on the management and enforcement approaches, Tallberg posits the idea of a "management-enforcement ladder": a twinning of cooperative and coercive instruments.[8] This ladder has four steps: *Prevention* - preventive capacity building and rule clarification that reduce the risk of violations due to incapacity or inadvertence; *Monitoring* - forms of monitoring that enhance the transparency of state behavior and expose violators; *Legal framework* - a legal system that permits cases to be brought against non-compliant states and that further clarifies existing rules; and *Sanctions* - deterrent sanctions as a final measure if states refuse to accept the rulings of the legal system.[9]

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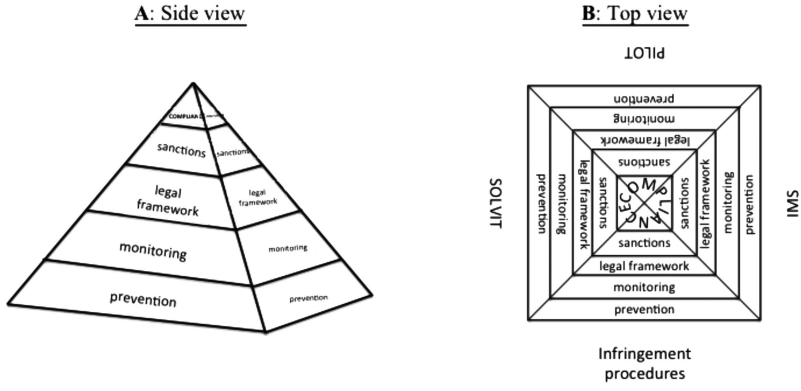
7 Since a Member State would be punished for not adhering to non-legally binding rules.

8 Tallberg (2002), p. 610.

9 Ibid., pp 632-633.

This current paper proposes to expand Tallberg's ladder to analyze the multiple different but interacting mechanisms within the EU. Rather than a two-dimensional ladder, a new perspective is needed on the inner workings and external interactions of compliance mechanism. Therefore a three-dimensional pyramidal representation enables a comparison of the way the different compliance mechanisms function as well as their effectiveness.[10] Each side of the pyramid representing a compliance mechanism, the steps on all sides will eventually lead up to the ultimate goal of compliance. The figure below shows what the model would look like in this pyramidal shape.

Figure 1: Routes to Compliance



This pyramidal compliance model can be applied to the compliance mechanisms used in the EU to determine their comparative effective functioning. Before this can be done, however, the terms compliance and effectiveness now need to be defined.

[10] The idea of a pyramid to illustrate the increasing hardness of enforcement measures has been introduced before, but was applied to the infringement procedures only in a more abstract, limited manner, not including any specific steps toward compliance. (See e.g. Andersen, S., *The Enforcement of EU Law: The Role of the European Commission* (Oxford University Press, Oxford 2012), pp. 128).

2.2. Defining Compliance

In general it can be said that compliance occurs where an actor's *prescribed* or *expected behavior* is set against his *actual behavior*.[11] However, in international law two additional elements need to be taken into account. First: in practice, non-compliance refers to not only *actual behavior*, but also possible *future behavior* as set out in national legislation.[12] Infringement or other enforcement action, therefore, focuses on past, actual as well as possible future non-compliant behavior, while in theoretical definitions, the prevention of future behavior (deterrence) is not specifically incorporated.[13]

A second important element is that in practice no objective standard can be found against which compliance can be measured. The determination of the existence of non-compliant behavior, or the decision to take enforcement action, is left to the discretion of either the Member States or an independent body. If these entities decide that there is no occurrence of non-compliance, no action will be taken. This means that non-compliance can be allowed to occur, even when it is known to exist.[14] Whereas in theory compliance is implicitly assumed to be objectively observable, in practice there is room for discretion in the determination of cases of non-compliance.

When these two elements of deterrence and discretion are added to the general definition, the concept of non-compliance can now be redefined as follows:

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11 See e.g. Raustiala, K. and A.M. Slaughter, 'International Law, International Relations and Compliance' in W. Carlsnaes *et al.* (eds), *Handbook of International Relations* (Sage Publications, New York, 2002); Young, O.R., *Compliance and Public Authority: A Theory with International Applications* (Johns Hopkins University Press, Baltimore and London 1979); or Zürn, M., 'Introduction: Law and Compliance at Different Levels' in M. Zürn and C. Joerges (eds), *Law and Governance in Postnational Europe: Compliance Beyond the Nation-State* (Cambridge University Press, New York 2005).

12 This is found when examining the provisions in international treaties, e.g. the TFEU, the WTO Agreement, the IMF Articles of Agreement or the OECD Convention.

13 In the EU for example, the introduction of the possibility of sanctions in Article 260 TFEU, has had a significant deterrent effect.

14 In practice, a certain degree of non-compliance can be deemed acceptable. Optimal compliance, therefore, is not necessarily equal to perfect compliance.

Non-compliance occurs when a Member State's actual or expected future behavior conforms to the expected behavior as outlined in the organization's rules, while the determination of the existence of non-compliant behavior is left to the discretion of the organization's other Member States or an independent body. Enforcement or other compliance-inducing action might then occur after such a determination of non-compliance, a determination which is in some cases confirmed by judicial or arbitral bodies.

Given this definition of compliance, in combination with the management-enforcement theories discussed above, the following four questions need to be asked when examining compliance-inducing mechanisms in international organizations:

1 Which obligations should Member States adhere to?
2. What is the character of these obligations?
3. When is a Member State non-compliant? Who determines when a Member State is not in compliance, and what role is played by the element of discretion?
4. What caused the alleged non-compliant behavior?

A combination of the answers to these four questions will theoretically predict when a certain type of compliance mechanism or combination of compliance mechanisms may be effective in inducing compliance by the Member States. In order to test these theoretical assumptions, effectiveness is defined as the degree to which objectives are achieved. When a system does not achieve the goals it was created to accomplish, the usefulness of the system should be reassessed. If it only partly achieves its goals, one could adapt the system to make it more effective, design complementary systems that can improve effectiveness, or find alternative systems that are more effective.

3. The infringement procedures

Articles 258 and 260 TFEU comprise the infringement procedures.[15] They describe how the Commission can act when it considers a Member State has failed to fulfill an obligation under the Treaties. The procedure consists of two phases: the administrative phase, and the judicial phase.

3.1. Administrative phase

There are three modes of detection available to the Commission. First: cases can be based on complaints. Anyone may lodge a complaint with the Commission for any practice or measure attributable to that Member State which they consider incompatible with a provision or principle of EU law. Second, so-called "own-initiative" cases are started by the Commission based on parliamentary questions or petitions, through the press or other sources. Third, the non-communication of measures taken by Member States to transpose a directive automatically leads to the start of an infringement procedure.

Once an alleged infringement has been detected the Commission will start the *pre-258* phase, where the circumstances of the suspected infringement are investigated through fact-finding and discussions with the Member State. Second, the Commission can decide to send a so-called *letter of formal notice*, which starts the formal phase of the procedures. Here the Member State is officially offered the possibility to submit its observations. If again no satisfactory reply is received from the Member State, the Commission can decide to send a *reasoned opinion*, in which it sets out its detailed reasoning for its suspicion of an infringement. When the Commission is then still not satisfied, it can decide to start the third, *judicial phase* and take the non-compliant Member State to the Court of Justice. The figure below shows the percentage of cases is closed (cumulatively) during each stage.[16]

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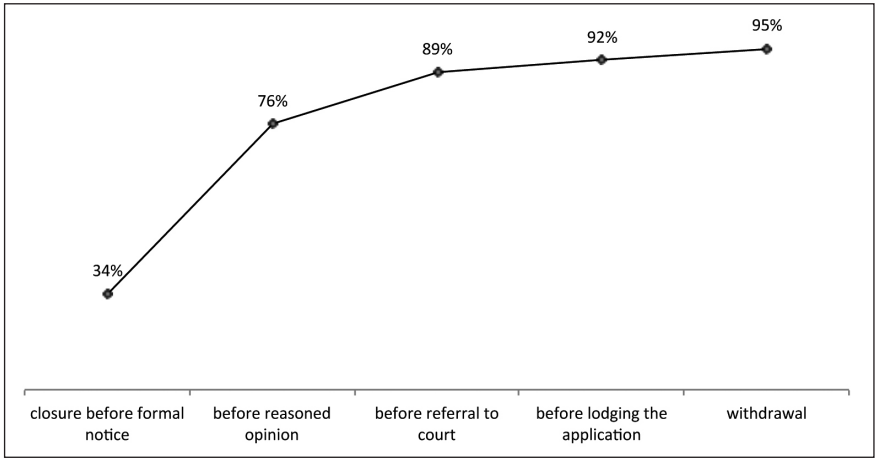
[15] We leave Article 259 TFEU out of the analysis. That article applies to cases where a Member State believes another Member State has not fulfilled its obligations under the Treaties, and may therefore bring the case to the Court of Justice itself (if the Commission has decided not to do so). However, the application of this provision is extremely rare (only five times in the half century that the possibility exists), and will not be discussed in this paper.

[16] Figure based on statistics taken from the EU infringement reports 1998 through 2010.

Figure 3: Closures per Stage
(in cumulative percentages of total closures - average 2004-2010)



As is shown in the figure, 95% of all cases are closed before the start of the judicial phase. This so-called "early closure" can in part be explained by the diplomatic or political[17] nature of the preliminary stage, which is characterized by the discretionary power of the Commission and a certain lack of transparency. The fact that a case is closed in an earlier stage, does therefore not necessarily mean that the infringement has actually been resolved. A Member State can be non-compliant, but the Commission has discretion in deciding whether or not to pursue the case.[18]

Two other reasons for early closure can be mentioned. First, the fact that Member States were often simply not aware of the existence of

[17] The decision of the Commission to bring or not bring a case against an alleged non-compliant state will often be influenced by political considerations. By political is meant here the fact that it is unclear what elements, other than a state's non-compliant behavior, will bring the Commission to open a case or not. If these considerations are not purely legal considerations, the term "political" is applied.

[18] This follows from the wording of Article 258 TFEU ('*If the Commission considers* that a MS has failed to fulfill an obligation under the Treaties, it shall deliver a reasoned opinion […]. If the State concerned does not comply with the opinion within the period laid down by the Commission, the latter *may* bring the matter before the Court of Justice.' (emphasis added)), also acknowledged in e.g. Case C-247/87, *France v Commission,* [1989] ECR 291 where the court stated the Commission is not obliged to commence proceedings but has a discretionary power in this regard.

a possible infringement situation before contacts with the Commission. Moreover, 30 to 50% of all newly detected infringement cases are caused by the non-communication of national measures transposing EU directives.[19] In most of these cases, the Member State is simply late in transposing the directive.[20] Second, Member States try to avoid the legal proceedings because they are costly and time-consuming, but also because of the possible negative reputational impact for the Member State involved.

3.2. Judicial phase

If the Member State has not complied after the time limit in the reasoned opinion has passed, the Commission has the discretionary power to take it before the CJEU. The judgment of the CJEU in infringement procedures has a declaratory character, merely pronouncing on the compatibility of a Member State's actions with EU law. In determining whether a breach of obligations exists, the reasons for non-compliance are not taken into account.[21] Notwithstanding the declaratory character of the judgment by the Court under Article 258, a Member State is obliged to comply with the binding judgment. [22] If the state does not comply, the Commission can take recourse to Article 260 TFEU to request the imposition of sanctions on the Member State concerned.[23] The Court of Justice may then impose a lump sum or penalty payment on the non-compliant Member State. Although the Commission has not often asked for it, the availability of the option has shown to be highly effective in inducing compliance. In most cases, Member States complied before the Commission had actually requested the CJEU for a judgment under Article 260.

The payments under Article 260 are not meant as punishment, but

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19 Ibid.

20 European Commission *SOLVIT 2009 Report. Development and Performance of the SOLVIT network in 2009 (2010) Luxembourg: Office for Official Publications of the European Commission.*

21 De Búrca, G. and P. Craig, *EU Law: Text, Cases and Materials.* (4 edn Oxford University Press, Oxford 2008), pp. 443 – 451; Lenaerts, K. *et al.*, *Procedural Law of the European Union* (2 edn Sweet & Maxwell, London 2006), pp. 128 – 129.

22 Article 260(1) EC.

23 The possibility for sanctions was introduced by the Treaty on European Union in the nineties.

as an incentive for the Member State concerned to comply as soon as possible. Nevertheless, they have given a sharper edge to the enforcement capabilities of the Commission under the infringement procedures. Moreover, it might have diminished the influence of diplomacy and negotiation, which is such an important part of the Article 258 stages.

4. Alternative compliance mechanisms

The infringement procedures constitute the main compliance mechanism available to the Commission and Member States to increase adherence to EU rules. However, over the past decades, several newer mechanisms have been set up as additional ways of inducing compliance. The fact that 95% of all infringement cases are closed in the pre-judicial stage does not mean that cases are solved quickly. On average, an internal market infringement procedure takes two years in the informal stage.[24] The judicial stage is not much quicker; the average time for a Member State to comply with the Court ruling is over one and a half years. For citizens, businesses and other complainants this timeline is often too long, if an infringement procedure was even started at all following their complaint.

To avoid these situations, as well as for time- and budgetary reasons, the Commission has established several alternative compliance mechanisms. Three of these are discussed in this paper: the Internal Market Scoreboard (IMS), SOLVIT and EU Pilot.

4.1. Internal Marketreboard

The origins of the IMS can be found in the Commission's Communication on the Single Market Action Plan, where it stated that it would "regularly publish and draw to the attention of each Internal Market Council a "Single Market Scoreboard" containing detailed indicators of the state of the Single Market and of Member States' levels of commitment to implementing the Action Plan".[25] One of the cornerstones

[24] See the EU Infringement Reports, available at http://ec.europa.eu/eu_law/infringements/infringements_annual_report_en.htm

[25] European Commission (1997) *Commission Communication: Action Plan for the Single Market CSE(97)1 final* , p. 2.

of the European Union is the internal market and the free movement of goods, persons, services and capital. To keep a check on progress made by the Commission, the Council and the Member State with regard to the internal market, the IMS has provided the public and the Member States with twice-yearly reports since 1997.

The information in these IMS reports covers for example statistics on the implementation of directives (per directive and per MS) and the amount of infringement procedures. The aim of these reports is not only to provide information, but also to induce a certain amount of peer-pressure and naming-and-shaming. The scoreboard (or *scareboard* as it has also been called)[26] provides much detailed information and rankings of Member States on most fronts. A component that was recently added to the IMS is Member States' success stories. This sharing of "best practices", originally applied in firms and businesses, has since long been used successfully in international organizations to inspire and instruct Member States as to how one can most effectively tackle a certain problem.[27]

4.2. Solvit

One of the ways in which the Commission has tried to solve problems that arise for individuals and businesses from the misapplication of internal market law is SOLVIT. This project was set up in 2002 "to help citizens and businesses when they run into a problem resulting from possible misapplication of Internal Market rules by public administrations in another Member State".[28] SOLVIT is officially an alternative informal dispute settlement system, where the Commission is generally not involved. However, the Commission coordinates the

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[26] Monti, Mario, *EMU, Taxation and Competitiveness*, Speech given on 27 November 1998, London.

[27] One example of an organization which has institutionalized the idea of best practices is the Organization for Economic Cooperation and Development (OECD).

[28] In fact, an earlier version of SOLVIT existed since 1997, but was deemed ineffective by all concerned. The Commission therefore proposed a newer, enhanced version of this network, effective as of 2002 (European Commission *Commission Communication on Effective Problem Solving in the Internal Market ("SOLVIT") COM(2001) 702 final*), and confirmed by a Commission Recommendation setting out the principles for the system (European Commission (2001) *Commission recommendation of 7 December 2001 on principles for using 'SOLVIT' - the Internal Market Problem Solving Network C(2001)3901 final*).

network, provides the database facilities and if needed helps speed up the resolution of problems. Moreover, the Commission always retains its prerogative to start an Article 258 procedure if it considers this necessary.[29]

Briefly, the system is set up as follows: when an individual has a complaint concerning the application of internal market rules, she can lodge this complaint at the SOLVIT center of the country of which she is a national.[30] This Home Center will check whether the problem does indeed concern internal market rules and if all necessary background information is complete. The case will then be automatically forwarded through an online database to the SOLVIT center in the country where the problem had occurred: the Lead SOLVIT Center. The two Centers will work together in solving the problem within a target deadline of 10 weeks. Given this short deadline, the SOLVIT centers are allowed to refuse cases that require a change in national law or other implementing provisions (the so-called SOLVIT+ cases). These cases would be too difficult to handle with informal means within ten weeks.

SOLVIT can be seen as a complement to the official system, since it can filter out cases that can be solved quicker and easier than through the official procedures, and those cases that would probably have never gone beyond the administrative phase of Article 258. Moreover, even though most centers do accept SOLVIT+ cases, cases that require more structural solutions and could thus possibly better be dealt with under the infringement procedures, the total number of these cases is insignificant in comparison with the regular SOLVIT cases.

It is unclear, however, what the exact influence of this system is on the effectiveness of the infringement procedures. It is unknown what amount of cases now solved by SOLVIT would have gone on to become infringement procedures based on complaints, and it is also unclear which part of these SOLVIT cases concern a similar problem as under existing infringement procedures, which could thus have been solved simultaneously in one case under the Article 258 procedure.

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29 Commission recommendation of 7 December 2001 on principles for using 'SOLVIT' - the Internal Market Problem Solving Network, II(G)(1).

30 The SOLVIT Centers are usually part of the Ministries of Economic or Foreign Affairs (with some exceptions, see http://ec.europa.eu/solvit/site/centres/addresses/index.htm for the locations of the Centers.

SOLVIT officials themselves believe the system to be effective. On the SOLVIT website for example, they are proud of their "effective problem solving in Europe". The system is probably quite effective in what it aims to do: solving individual complaints, given SOLVIT's solution ration of over 80%.[31] Also, the users of the system (individuals, businesses as well as the Member States) perceive the system as functioning effectively. This feeling of effectiveness is strongly linked to the success rate of the system, as well as its ability to on average solve problems within the deadlines.[32]

4.3. EU Pilot

EU Member States and Commission authorities are meant to work together to ensure understanding and application of EU law.[33] However, in case of the infringement procedures, this cooperation was never officially structured. The Commission nevertheless felt that, just as the SOLVIT system had shown in case of Internal Market rules, many of the implementation problems that citizens face regarding other areas of EU law could and should be solved quickly through increased initial information exchange and cooperative problem-solving.[34] This is why in April 2008 the Commission launched EU Pilot "to test increased commitment, co-operation and partnership between the Commission and Member States".[35] The idea of the system is to provide solutions to problems arising in the application of EU laws, to obtain quicker and better responses to enquiries for information, as well as to work more closely and less formally with the Member States. This method would help correct infringements of EU law at an early stage wherever possible,

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31 European Commission *SOLVIT 2010 Report. Development and Performance of the SOLVIT network in 2010 (2011) Luxembourg: Office for Official Publications of the European Commission*.

32 The European Commission undertook a comprehensive analysis of the functioning of the SOLVIT system, where interviews were held with, and surveys sent to the users and stakeholders of SOLVIT. For statistics from this evaluation of the SOLVIT system, see European Commission (2011) *Evaluation of SOLVIT, Final Report*.

33 As follows from e.g. Article 4(3) TEU: "Pursuant to the principle of sincere cooperation, the EU and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties."

34 European Commission *Commission Communication on A Europe of Results - Applying Community Law COM(2007) 502 final*.

35 European Commission *EU Pilot Evaluation Report COM(2010) 70 final*, p. 2. The idea was based on *Commission Communication 2007*.

without the need for recourse to infringement proceedings. In fact, EU Pilot has evolved into a replacement of the first preliminary phase of the Article 258 procedures. In 2008, 15 Member States volunteered to participate in the test-project,[36] and has meanwhile expanded to include all Member States.[37] The way the system works is as follows.

Upon receiving a complaint or of its own accord, the Commission may decide that contact with a Member State could help in resolving the problem, or might provide useful information concerning the implementation or application of EU law. The Commission will then enter the issue and all other information it has received in the EU Pilot database.[38] The complaint or enquiry will subsequently be examined by the Commission and forwarded to the EU Pilot Central Contact Point of the Member State concerned.[39] Once entered in the EU Pilot database, the Member State has ten weeks to send a reply, preferably providing a solution to identified problems. The Commission will be informed of the proposed solution, and will evaluate whether this solution is in conformity with EU law. If the Commission decides to accept the position expressed by the Member State it will inform the complainant on the action taken, and if the complainant does not respond within four weeks with new information, the case will be closed. If the Commission is not satisfied, it can ask for more information, reject the answer and inform the Member State that further action needs to be taken, or –in case an infringement is detected– decide to launch an infringement procedure.[40] The success rate of the system is high, with 68% closures – more than double the amount closed during the first stage of the infringement procedure before the introduction of EU Pilot.[41]

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36 Austria, Czech Republic, Denmark, Germany, Finland, Hungary, Ireland, Italy, Lithuania, the Netherlands, Portugal, Slovenia, Sweden, Spain and the United Kingdom.

37 European Commission *29th Report on monitoring the application of EU law (2011) COM(2012) 714*.

38 In fact, EU Pilot can be seen as an interactive database, where two parties (the Commission and the Member State) can exchange information on identified issues with EU law.

39 The Member State's EU Pilot Central Contact Point is usually part of the State's Ministry of Foreign Affairs, or another government office that occupies itself with European affairs (EU Pilot Evaluation Report 2010, p. 2-4).

40 If urgency is required, the Commission may decide to launch an infringement procedure right away, without going through the steps in EU Pilot.

41 European Commission *30th Report on monitoring the application of EU law (2012) COM(2013) 726 final*.

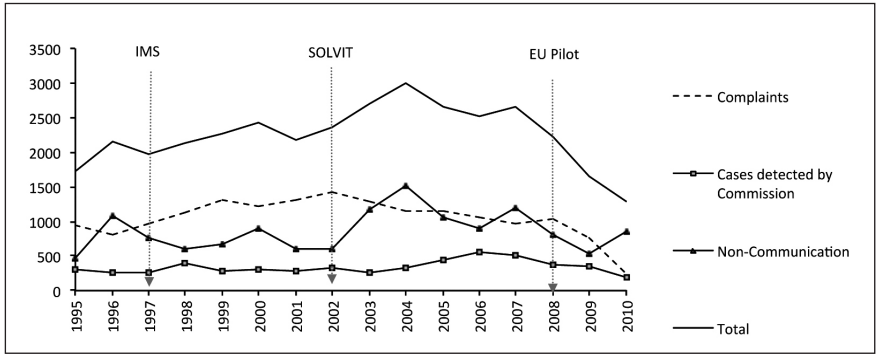
5. The interaction with the infringement procedure

The previous sections have shown how the different systems work and what place they occupy in the EU legal system. It is now important to determine how these mechanisms interact. A brief analysis of some of the statistics available on the four systems will be examined in this section.

5.1. Data on the Infringement Procedures and Alternatives

To ascertain what influence the alternative systems have had on the infringement procedures, a start is made by taking a look at the historical data regarding the infringement procedures. The figure below shows the effects of the introduction of the three alternative mechanisms.[42] The effects are not obvious. However, without wanting to conclude anything about causality, one can observe the following in this figure.

Figure 4: EU Compliance 1995-2010
(number of infringement procedures)



Internal Market Scoreboard – After the introduction of IMS (1997), the number of infringement procedures due to non-communication by Member States went down slightly. The IMS provides information

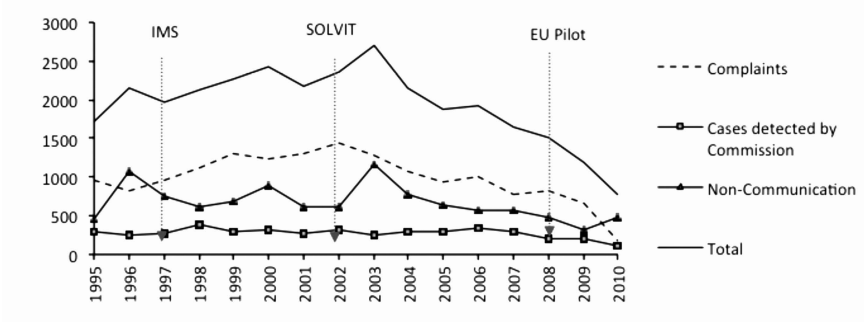
[42] In making these remarks any changes such as the enlargement of the Union in 1994, 2004, and 2007 have not yet taken into account.

on implementation of directives and the amount of infringement procedures. It could be that the peer pressure induced by this system has led Member States to address late implementation of directives and thereby prevented the start of infringement procedures.

SOLVIT – After the introduction of SOLVIT in 2002, the number of cases started based on complaints by EU citizens went down. This downward trend is continued until 2010, the latest data available. Since SOLVIT is meant for individuals and companies to solve their complaints through use of the SOLVIT system, this could be explained by the fact that the introduction of the SOLVIT system has led to fewer complaints by individuals to the Commission directly.

EU Pilot – Given the short period of existence of EU Pilot, no conclusions can be drawn on its influence. Moreover, during the first year of the project, only 15 Member States were involved in the pilot project. From the little data that is available, it can be learned that the amount of cases based on complaint as well as non-communication cases have gone down drastically, while cases on the Commission's own initiative show almost no change. The reduction of the amount of infringement procedures based on complaints is what would be expected to happen, given the purpose of the EU Pilot system. Why non-communication cases have gone down, cannot be explained by the introduction of the new system. This effect can possibly be explained by the EU enlargement in 2007 from 25 to 27 Member States, causing a rise in non-communication cases in that year, and a subsequent decline after the new Member States had time to adapt to the new legislation. A similar effect is seen with the previous enlargement in 2004. The figure below eliminates this effect by looking at the data for the original EU-15 only.

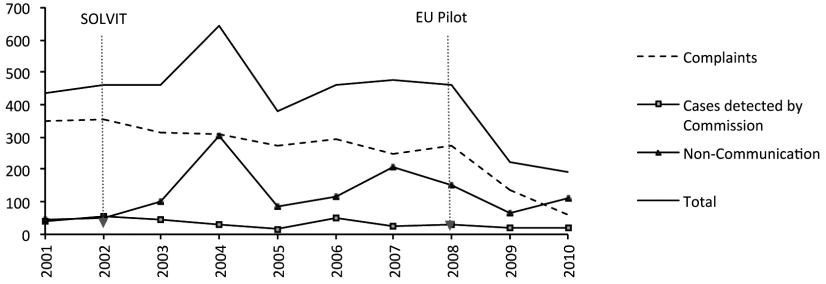
Figure 5: EU-15 Compliance 1995-2010
(number of infringement procedures)



A temporary decrease in the number of non-communication cases after the introduction of IMS is still observed, as well as a large, continued decrease in the number of cases based on complaints after the introduction of SOLVIT and EU Pilot. The large peaks in 2004 and 2007 have now disappeared. Instead, three new peaks in procedures can be observed: 1996, 2000 and 2003, corresponding to three peaks in the same years in cases based on non-communication. These types of cases therefore, seem to be most volatile of the three. Cases detected by the Commission remain more or less stable, while cases based on complaints do fluctuate, but not nearly as much as non-communication.

Given the lack of data on the EU Pilot system due to its recent existence, it would be interesting to look especially at IMS and SOLVIT in more detail. These are both systems that are targeted for legislation in the internal market area, so any effects of these mechanisms should be magnified when internal market data alone is looked at. The figure below shows the results for that analysis.

Figure 6: EU Internal Market Compliance 1995-2010 (number of infringement procedures)



Unfortunately, the data needed to make an accurate figure for IMS and SOLVIT together is not available. It was only from 2001 onwards, that the Commission has provided data on the infringement procedures by sector as well as by origin of the procedure. Previous data does not provide this information by sector, only on an aggregate basis. From this figure only the conclusion can be drawn that in 2004 there was a notable increase in the number of non-communication cases, which can well be explained by the EU enlargement in the same year. It is also seen that the amount of cases based on complaints from individuals has gone down steadily since 2002, the time of the introduction of the SOLVIT system. This occurs, however, not in such a distinct manner as was expected, given the system's aim and scope. Still, given the fact that the amount of cases based on own-initiative or on non-communication has remained relatively stable or even gone up (when the spike in 2004 is left out) between 2001 and 2009, while the cases based on complaints have diminished, this is an interesting result.

Also, a sharp decline can be observed in the number of cases based on complaints after 2008. An explanation for this may be found in the introduction of EU Pilot. Although the system is not meant to target all Internal Market issues, it does serve as a signposting service. In the first year of EU Pilot's existence, 21% of all cases concerned Internal Market cases. If cases concerning bad application are submitted to EU Pilot, these are forwarded to the relevant SOLVIT center. The amount of cases

forwarded to SOLVIT, however is almost negligible.[43] Moreover, if these complaints concern e.g. non-conformity of national legislation with EU legislation they do fall within the scope of EU Pilot, hence explaining the 21%. Possibly, the handling of these types of complaints through EU Pilot explains the decline in Internal Market infringement cases based on complaints.

The difficulty with basing any conclusions on the figures above lies with the fact that other elements apart from the introduction of the compliance mechanisms may cause any and all of the changes that were observed. There is no counterfactual. The distortion caused by the two EU enlargements during the course of the observations was already mentioned and accounted for. Another problem is, however, the amount of directives that need to be implemented in the Member States. The larger the amount of directives, the larger the amount of possible infringement procedures, especially around the time of the transposition dates. This might be the explanation for the peak that was observed in year 2003. In all three figures above a significant increase in the amount of cases based on non-communication by the Member States could be seen - the amount more than doubled in all three figures. When figures 4 and 6 are examined, this could be interpreted as caused by the upcoming enlargement of the EU, since the upward trend continues in 2004 as well. However, figure 5 shows that it is in fact a single occurrence in 2003 only for EU-15.

When a closer look is taken at the underlying data, the cause of this anomaly can still not be determined: While the relative number of instances of non-communication went down from year 2002 to 2003, the absolute amount of non-communication cases also went down, but only marginally. The fact that in percentages the Member States performed much better than in absolute numbers is explained by the total number of directives that were to be implemented in the respective years by the Member States. This number had gone up from a total of 1585 in 2002 to 2553 in 2003.

[43] SOLVIT Evaluation 2011.

5.2. Discussion

It is clear that no obvious answers can be found by casual observation of the available data. Nevertheless, some observations can be made based on the aggregate data. First of all, there is no obvious statistical link between the two types of mechanisms. This means that the alternative mechanisms probably should be seen as complementary systems next to the infringement procedures. SOLVIT, for example, is frequently used and has more respondents each year. The yearly amount of SOLVIT cases is now almost equal to the amount of infringement procedures based on complaints. Moreover the amount of infringement procedures based on complaints has gone down over the years since the introduction of SOLVIT, indicating the possibility of SOLVIT influencing the functioning of the infringement procedures.

If SOLVIT were an alternative for the infringement procedures, this could mean that it would be equally successful without the existence of the infringement procedures. It is probable, however, that the remaining possibility of an infringement procedure serves as an incentive for the Member States to deal with complaints through SOLVIT, to prevent an infringement procedure (which would be time-consuming, costly and cause reputational issued). On the other hand, the Commission established the SOLVIT network because it does not have the time or budget to solve individual complaints through the application of infringement procedures. The Commission therefore also has an incentive to have complaints solved through cost-reducing SOLVIT-type mechanisms. This trade-off obviously also plays a role in the interaction between the systems, but does not show as such in the data.

On the other hand, if the alternative mechanisms did not exist, more complaints would be made to the Commission. The Commission has only limited resources, and would thus have to prioritize even more than it already does. This would leave a greater opportunity for non-compliance with EU law by the Member States, since the probability of getting caught diminishes.

Second, even if a firm link between the mechanisms could be established, the use of the systems and the number of procedures are no indication of absolute compliance with EU law. Due to the outlined

inconsistencies in the reported data and given Commission discretion, not to mention the fact that not all actual infringements are detected, the reported number of infringement procedures is no reliable indicator for compliance. However, it can say something about relative compliance (sectoral, over time, or between countries). Since any effect of the alternative mechanisms on the infringement procedures is necessarily relative - the effectiveness of the infringement procedures before and after the introduction of an alternative, for example - this is not a real problem for this paper.

6. The effectiveness of the compliance mechanisms

The previous sections have explained the workings of the infringement procedures and three specific alternative compliance mechanisms. This current section will now analyze the effectiveness of all four mechanisms by applying the theoretical model elaborated in section 2.

6.1. The goal of the procedures

According to Article 258 TFEU, the primary aim of the infringement procedures is to make Member States comply with and fulfill their obligations under the Treaties. The aim of the procedures is not to punish Member States for their non-compliant behavior, but to ensure that the behavior is ended as quickly and effectively as possible. Moreover, the procedures are intended to remedy current and prevent future non-compliant behavior.

The wording of Articles 258 and 260 already show that the target is not perfect compliance in the Member States, but rather a state of compliance that is deemed acceptable by the Commission as Guardian of the Treaties. At all steps of the procedure it is left to the Commission's discretion to decide whether or not to take action. Despite the changes made to the procedures over the past decades, as for example the greater involvement of complainants, a greater divulging of information to the parties as well as the public in general, the involvement of the European Ombudsman or even the European Parliament, the Commission's discretion is still an important element in the procedures, as the Commission as well as

the Court of Justice (and the European Ombudsman and the European Parliament for that matter) regularly remind us.

The goals of the compliance mechanisms differ for all three. The aim of the IMS is to offer an overview of the state of the Single Market and the degree to which Member States have implemented measures targeting the Single Market. It intends to, through naming-and-shaming and peer pressure, induce compliance with Internal Market rules. SOLVIT then, aims to help citizens and businesses when they run into problems resulting from possible misapplication of Internal Market rules by public administrations in another Member State. EU Pilot in its turn is aimed at providing solutions to problems arising from the application of EU laws and to obtain quicker and better responses to enquiries for information. It can be seen as a replacement of the first, informal step of the infringement procedures, targeting all areas of EU law, except those covered by SOLVIT – unless SOLVIT was unable to solve the problem and referred the case (back) to the Commission.

The goals of the different procedures are therefore not the same. The IMS shows the rate of transposition of Internal Market directives, as well as the progress concerning infringement procedures in the same area. By showing detailed information on these topics, it aims to induce compliance with Internal Market rules through naming-and-shaming and peer pressure. Its goal is to increase compliance by Member States with EU law in this area. SOLVIT targets the same area (the Internal Market), but its aim is not to increase compliance as such, but rather to help citizens and businesses when they encounter problems. The goal is thus not to reach general compliance (except in some exceptional cases in SOLVIT+), but rather compliance vis-à-vis individuals and businesses. Reaching compliance in general is rather a collateral gain than a target *an sich*. EU Pilot, then is aimed at everything not covered by SOLVIT, and, as a preliminary step in the infringement procedures is primarily targeted at inducing compliance by Member States.

6.2. Compliance

Since the aim of the procedures is to induce compliance by Member States with EU law, the four compliance questions from section 2 need to be answered regarding Member State obligations, the character

of these obligations, the definition of non-compliance and the causes of non-compliant behavior.

6.2.1. Expected behavior

The first question asks which obligations Member States are expected to adhere to. An infringement is defined in Article 258 TFEU as the "failure to fulfill an obligation under the Treaties". An obligation under the Treaties refers to any obligation under European Union Law, covering all rules of EU law: primary legislation, secondary legislation and supplementary legislation. This includes both binding as well as non-binding acts (such as opinions or recommendations), and equally covers both acts and omissions.

The three alternative procedures target the obligations under the Treaties, although they are narrowed to those obligations falling under the Internal Market only for IMS and SOLVIT, and specifically everything except the internal market (for the most part, excepting non-communication and some other cases) for EU Pilot.

6.2.2. Hard or soft obligations

The second question pertains to the character of these underlying obligations. As was mentioned before, an "obligation under the Treaties" encompasses both binding as well as non-binding acts, meaning that these obligations can be of a hard or a softer character. All procedures under analysis in this paper, however, can only be started when there is alleged non-compliant behavior with respect to hard legal obligations, since non-binding or soft law can never be subject to judicial proceedings. The obligations that are relevant for the application of the infringement procedures are therefore necessarily of a hard character.

6.2.3. Actual behavior given the element of discretion

The third question then, concerns the determination of non-compliant behavior – when is a EU Member State non-compliant? In this respect, the element of discretion plays an important role. As was explained, the Commission has discretion at all steps of the procedure to decide whether and when it will proceed with the next step or close

the case. This means, practically speaking, that it is the Commission that decides whether or not there has been a breach of obligations under the Treaty that should be remedied. Ultimately, if and when the Commission has decided to lodge an application with the Court of Justice, it is the Court of Justice that makes an objective determination of the existence of non-compliant behavior.

In EU Pilot and IMS discretionary action is important as well. Under SOLVIT non-compliant behavior exists when an individual or business encounters problems due to the misapplication of internal market rules, and this misapplication is recognized by the SOLVIT Centers. There are thus two steps here: 1. An individual or business encounters problems; and 2. These problems are seen as caused by the misapplication of internal market rules. Only then, under the remit of SOLVIT, is a Member State non-compliant. A very narrow scope therefore, but which still leaves room for discretion, especially in the way the problem is solved. Perfect compliance is not demanded: SOLVIT is aimed at solving problems – if a problem can be solved in a particular case, a Member State can still be in non-compliance with EU law. However, since the Commission always remains part of the system, it can still weed out those cases where non-compliant behavior remains a problem, either by referring it back to EU Pilot or through other channels.

6.2.4. Intentional or non-intentional non-compliance

The last compliance question refers to the underlying reasons for non-compliant behavior. These reasons will first be examined for the infringement procedures, followed by a similar analysis for the alternative compliance mechanisms.

Infringement procedures. As stated before, the decision by the Court of Justice under Article 260 is objective in nature, meaning the Court does not take into account the underlying reasons for the non-compliant behavior, intentional or unintentional. However, the procedures themselves implicitly do take this into account by means of gradually increasing the level of hardness of the steps leading up to the top of the pyramid. As described in section 2, the pyramid shows there are four basic steps to compliance: prevention, monitoring, a legal framework and sanctions.

Prevention in terms of preventive capacity building and rule clarification that reduce the risk of violations due to incapacity or inadvertence[44] is as such not a part of the infringement procedures. The procedures come into play at the time when non-compliant behavior has already occurred. Nevertheless, the procedures do have a preventive aspect, in that their existence alone will to a certain degree prevent states from showing non-compliant behavior. When states know that non-compliance may invoke judicial procedures that take years, takes up resources and may end in the imposition of sanctions, they might think twice before intentionally breaching their obligations. Moreover, the infringement procedures started against one Member State, when publicized, may alert another Member State of their possible (unintentional) non-compliant behavior as well and in that way induce compliance.

Monitoring in order to enhance the transparency of state behavior and expose violators is quite difficult under the infringement procedures. The Commission relies heavily on complainants and other external channels to ensure non-compliant behavior is caught. Then again, once non-compliant behavior is detected, Commission monitoring is possible since it will monitor the compliance progress of the allegedly non-compliant Member State.

In the early, pre-judicial stages of the infringement procedures this monitoring step plays an important role. With a view to solving breaches of obligations under the Treaties in an amicable and non-adversarial manner, the early stages entail the exchange of information between the Commission and the Member States. These informal consultations make it possible to weed out those cases that arose due to legal uncertainty or misunderstandings. The cases to which the formal part of the proceedings apply, are usually those where non-compliant behavior is either intentional, or where the Member State does not agree with the Commission as to whether its behavior is in fact non-compliant. In the prejudicial part of the procedures, the Commission uses both soft measures, such as naming-and-shaming through press releases, and hard measures, such as official reasoned opinions and the threat of imposing sanctions if necessary, to induce compliance. The fact that the

44 Tallberg (2002).

Commission can in fact back up its pressure with judicial proceedings and sanctions opens the possibility for Member States to negotiate solutions with the Commission.

A legal system, permitting cases to be brought against non-compliant states and further clarifying existing rules, is the hallmark of the infringement procedures. This is where the Court renders its objective judgment of whether or not a state of non-compliance exists. As was said, this objective declaratory statement does not take reasons for non-compliance into account.

Sanctions, the last step to compliance, is a step that was added to the infringement procedures at quite a late stage, but is currently used more and more often by the Commission. The application of lump-sum as well as penalty payments, including the more direct route of asking for these sanctions in case of non-communication of transposition measures, have led to a sanctioning as well as deterrent function of these sanctions.

From these four elements it is seen that managerial type efforts are used to solve most non-compliance cases which were unintentional in the early stages of the procedure, while enforcement type mechanisms are increasingly applied in the later stages to remedy intentional non-compliance, or otherwise unsolvable unintentional non-compliance.

Alternative Mechanisms. For IMS and SOLVIT, it does not really matter what the underlying reasons are. For IMS only the state of play at the time of printing of the scoreboard is interesting. It is often pointed out what the underlying reasons may be for Member States lagging behind concerning the transposition deficit for example, but this has no influence on where the Member State is placed on the Scoreboard. For SOLVIT, theoretically all that matters is that the problem is solved for the individual or business concerned within the set deadline. Knowing the underlying reasons may sometimes help in solving the problem, but has no influence on the application of the system. However, the entire purpose of SOLVIT is to solve problems through managerial type efforts, without recourse to enforcement. It is thus a very effective way to efficiently remedy unintentional non-compliance. Sometimes it is not possible to solve the problem under SOLVIT exactly due to the underlying reasons, and the case needs to be referred to the Commission in that case.

For EU Pilot on the other hand, this is quite different. EU Pilot has become the first, informal step in the infringement procedures – meaning the part of the procedures that is the most managerial in character. Here discussions, negotiations, consultations, dialogue, information-sharing etcetera are very important, and do take into account the underlying reasons for non-compliance in so far as to help the Member States in reaching compliance without recourse to the harder steps of the procedures.

When the four basic steps towards compliance are examined (prevention, monitoring, legal framework and sanctions), a picture is drawn that is very different from the complete front side of the pyramid for the infringement procedures. The last two steps do not appear on these sides of the pyramid, except maybe through referring cases to the infringement procedures themselves. On the other hand, the steps of prevention and monitoring do play an important role. Prevention is especially visible for the IMS, where through naming-and-shaming and peer pressure the aim is to induce compliance with EU law without recourse to the infringement procedures. EU Pilot, as the first, informal step of the infringement procedures, also aims to prevent the formal steps of the procedure by trying to remedy non-compliance in this first stage. Monitoring is also visible with these procedures, but, as with the infringement procedures, the reliance on citizens, businesses and other players from outside the EU institutions is great. SOLVIT acts only in response to problems brought to it by citizens and businesses, while EU PILOT in its turn relies in great part on the same sources. The IMS then, is aimed at the monitoring of states, showing who lags behind and who are the front-runners, showing to all actors which are the Member States with the largest problems in this area.

7. Conclusions

This paper has described and analyzed the set-up and functioning of the EU infringement procedures and three alternative EU compliance mechanisms. First, it was found that the infringement procedures are quite effective in inducing compliance with EU law, with a 95% closure rate before judicial procedures. Especially the early phases of the procedure play an important role, as most cases are closed during that time. This confirms the importance of managerial type efforts, such as take place in the administrative phase. The introduction of sanctions is

thought to have added to the effectiveness of the procedures. Not only may they have a deterrent effect on the earlier stages, they also could shorten the duration of non-compliant behavior.

Over the years, the infringement procedures have gradually developed into a harder system, with more transparency, less room for Commission discretion and the added element of sanctions. This broadening of the enforcement side of the system has had a positive effect on compliance with EU law over the years. On the other hand, the hardening of the system has gone hand in hand with an increased focus on the managerial phases of the mechanism. Member States, not wanting to be "punished" by the application of hard enforcement elements will try and solve issues concerning alleged non-compliance in an earlier phase. The deterrent effect of the enforcement side of the system increases the need for the management side. In terms of the compliance pyramid, the two bottom steps of the pyramid of prevention and monitoring have been expanded so as to provide a broader base for the upper two steps of a legal system and sanctions.

The importance of the managerial elements is even more obvious from the introduction of alternative compliance mechanisms. Although not all systems have the same direct aim of increasing compliance with EU law, the eventual outcome of the procedures must be in conformity with EU law. These systems, although not meant as replacements of the infringement procedures, partly function as an alternative mechanism and partly as a complementary.

Given the fact that all three procedures have the same ultimate effect of inducing compliance, as well as a similar scope and participating actors as the infringement procedures, it is clear that there will be some interaction between the four mechanisms. It was found that, although there is no obvious statistical link between the infringement and alternative mechanisms, and the underlying data for statistical analysis are not unambiguous, the tentative conclusion can be drawn that the introduction of the newer systems have indeed influenced the functioning of the infringement procedures.

When all four systems are examined together, some differences are found when analyzing the compliance elements. Although the expected

behavior and the character of the obligations and the element of discretion is the same for all four, the IMS is the only system not really taking unintentional behavior into account. This means that managerial type efforts should play a larger role in EU Pilot, SOLVIT and the infringement procedures than in and the IMS. This explains why the effect of IMS on the functioning of the infringement procedures is quite small, as it depends almost fully on management elements such as peer pressure and transparency. *Almost* fully, since the possibility of the application of an infringement procedure always looms in the background. Since the IMS targets non-implementation of directives, where a semi-automatic procedure including a fast-track sanction option exists for non-communication cases, quite a strong enforcement element looms in the background. If IMS does not have the intended effect, therefore, recourse can and will be taken to the infringement procedures.

The interaction that was shown to exist between the functioning of the infringement and the alternative procedures is an important factor in inducing compliance with EU law. The effectiveness of the infringement procedures is increased since the total amount of possible infringement cases is reduced by the application of the alternative systems. This releases Commission resources to focus on those cases that fall outside the alternatives' remit or which beg special attention. Moreover, the alternative procedures have increased the detection rate of non-compliant behavior by appealing to a different audience than under the infringement procedures. *Vice versa*, the effectiveness of the alternative procedures is influenced to a great extent by the existence of the enforcement possibility of the infringement procedures. It is precisely the interaction between the managerial type systems and the enforcement procedures, which explains the effective functioning of all four. In terms of the compliance pyramid, not only the managerial bottom steps of the front side of the pyramid have been expanded, but of the other sides as well. The alternative mechanisms, on the other hand, may not include the enforcement type upper two steps of the pyramid, but can rely on the existence of the legal system and sanctions contained in the infringement procedures. If needed, a switch from the alternative side to the front side can thus always be made.

The interaction between the infringement procedures and the alternative mechanisms has a mutually reinforcing effect on the

functioning of the respective systems. The newer mechanisms provide an alternative route for inducing compliance especially for complainants, while also attracting users that would not have played a role under the infringement procedures. This makes it possible for the Commission to devote its resources and attention more to the prioritized areas of EU law or cases of persisting non-compliance. The existence of the hard infringement procedures, on the other hand, provides an enforcement element crucial for inducing compliance with the hard underlying obligations of the EU internal market.

We end this paper with a caveat and a recommendation. Although this paper has shown the positive aspects of including alternative routes twoards compliance in the EU supervisory system, introducing new mechanisms can also lead to fragmentation of problem-solving and compliance mechanisms. It is essential that complainants know where they can go and how their problems can be addressed most effectively. A final point of interest concerns the publicly available documents. It is to be preferred that the Commission's data and statistics are presented in a consistent manner, especially in the yearly infringement reports. Given the changes in the way the data is presented over the years, it is challenging to make a thorough comparison. In the interest of transparency, it is recommendable to publish consistent reports with comparable data.

20

The SOLVIT network and unlawful decisions of national administrations: 'governing' the new challenges and problems of the internal market

MICAELA LOTTINI*

ABSTRACT

The first part of this paper discusses the particular threat that national administrations pose to the integration of the internal market, when they infringe EU law in individual decisions. In the second part, attention is paid to the SOLVIT network's role in this respect, in particular, by focusing on its background, its activity, and its structure based on the 'mutual cooperation' between different levels of administrations. Finally, some conclusions are drawn as to the effectiveness of the SOLVIT mechanism, having regard to the protection of the individuals and to the more general contribution that the network has been given to the integration and to the better functioning of the internal market.

KEYWORDS: SOLVIT, Internal Market, Correct Application Of European Union Law, National Administrations, Administrative Cooperation, Effective Protection, ADR – Alternative Dispute Resolution Mechanism, European Commission, Internal Market Information System, European Ombudsman

1. Introduction

Over the last ten years, the correct application of European Union (EU) law by national public administrations (PAs) has been acknowledged as a key issue for the integration and the correct functioning of the internal market. The role that the individual decisions of PAs play in the

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European integration process has become a matter of increased interest to both European institutions and member States. Consequently, different mechanisms have been put forward at a national and European level, aimed at preventing PAs from making unlawful decisions (under European Union law) and at resolving the actual problems when they occur. Among the various mechanisms (which all revolve around the principle of 'cooperation' between administrations), particularly significant is the SOLVIT network[1]. SOLVIT was set up in the year 2002, to provide an informal, quick and cost-effective resolution of disputes between citizens (or undertakings) and national administrations, in relation to the correct application of EU law. SOLVIT is designed to provide an alternative to the national Courts and it is made up of a network of national Centres, which are linked up by a data-base managed by the Commission. SOLVIT's operation is based on the 'mutual cooperation' between different levels of administrations: the national Centres participating in the network, the national administration which allegedly infringed EU law, and ultimately the European Commission.

This unique mechanism provides a new way of 'governing' the ongoing challenges and problems of the internal market, posed, in particular, by the material application of EU law by national administrations and due to the increasing complexity of their activity at a European level and to the emerging forms of administrative 'cross-border cooperation'[2].

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1 Following the SOLVIT experience, a similar network was set up in the public procurement field: the Public Procurement Network (PPN). More information on PPN is available at ‹www.publicprocurementnetwork.org›. Moreover, within the European Network of Ombudsmen, cooperation between the European and the national Ombudsmen has been strengthened, in order to foster a better and uniform application of EU law by national authorities throughout Europe. In other words, the European Ombudsman has been cooperating with its national counterparts when they are called upon to decide cases involving EU law. This approach of the network, oriented on the correct application of EU law, was highlighted in a Statement adopted at the Sixth Seminar of National Ombudsmen, held in Strasbourg in October 2007. The statement makes it clear that: 'national and regional ombudsmen may ask the European Ombudsman for written answers to queries about EU law and its interpretation, including queries that arise in their handling of specific cases. The European Ombudsman either provides the answer directly or, if more appropriate, channels the query to another EU institution or body for response'. See, in this respect, Micaela Lottini, 'From 'Administrative Cooperation' in the Application of European Union Law to 'Administrative Cooperation' in the Protection of European Right and Liberties' [2012] EPL 127.

2 See, Lafarge F, 'Administrative Cooperation between Member States and Implementation of EU Law' (2010) 16 European Public Law 597.

Since its inception, despite the non-binding nature of it solutions, SOLVIT has been providing an effective protection of the European citizens (and undertakings) against the unlawful decisions of national administrations; at the same time, it has been fostering the correct application of EU law by PAs, and it has been promoting amendments in the national regulatory framework that is often the very cause of the unlawful administrative behaviour.

2. The correct application of European Union law by national administrations and the integration of the internal market

When European citizens and undertakings want to take up their free movement opportunities, normally they have to address themselves to national public administrations. For example, an Italian optician who wants to exercise his economic activity in France, needs to have his professional qualification recognised by the French authorities and then he has to be issued an authorization. Likewise, an English company seeking to market a product in Greece needs to be granted permission by the Greek supervisory authorities. And so on.

These regulatory powers conferred upon public administrations are normally a restriction on the free movement of economic operators within the EU market and they can only be considered lawful (justified) provided that certain conditions are met. In accordance with the case law of the Court of Justice of the European Union (CJEU)[3], the administrative mechanism has to be aimed at protecting a specific public (national) interest (recognised as legitimate by the Treaty or by the case law of the CJEU); also, it has to be 'necessary' to effectively protect that public (national) interest (in the sense that a measure which is less restrictive of free movement would be ineffective) and it has to be 'proportionate' (in the sense that it must not go beyond what is needed for that protection).

All in all, a balance has to be found between the rights of free movement and the rights of member States to protect national public interests by regulating the exercise of economic activities on their markets.

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[3] See, just as examples, the decisions of the Court of Justice of the European Union: Case C-120/78 *Rewe-Zentral*, [1979] ECR 649; Case C-567/07 *Woningstichting* [2009] ECR I-9021.

The extent to which national measures can lawfully provide for administrative control over the market and the role that national public administrations play in the integration of the internal market has been of particular interest to the European institutions. A clear example of this interest is the services Directive (Bolkestein Directive)[4], which is aimed at simplifying the procedures and formalities that services providers need to comply with (to carry their activity) and it requires member States to remove unjustified and disproportionate legal and administrative barriers to trade in the services sector.

Having said that, we have to point out that national public administrations can affect the EU market and ultimately raise an obstacle to its integration also from a different perspective.

The administration (vested with a lawful regulatory power) might make an individual decision which is not in compliance with the EU rules. The French authorities, for example, (in disregard of the 2005/36 Directive on the recognition of professional qualifications[5]) might deny the recognition of the Italian optician's professional qualification, because it does not comply with specific French regulations. The Greek authorities might infringe the free movement of goods provisions, by per se (i.e. without taking the mutual recognition principle into consideration) deny market access to the English product because it contains a particular ingredient.

In practice, the unlawful (negative) decision is a measure having an equivalent effect to a regulatory restriction on free movement and it raises an obstacle to the European integration that we refer to as a 'decisional' obstacle. 'Decisional' obstacles 'work' at a micro-level, namely that of the individual citizen or undertaking, which is in practice prevented from freely moving and conducting its business throughout Europe.

For the purpose of this article a further clarification is required.

A public administration's decision conflicting with the EU law can be regarded as a 'decisional' obstacle even when the national regulatory framework is not in compliance with EU law and the administration

4 Directive (EC) 2006/123 on services in the internal market [2006] OJ L 376.

5 Directive (EC) 2005/36 [2004] OJ L255.

concerned is then applying an unlawful national regulation. Although in this case the internal market problem is primarily structural and it is caused by a national regulatory barrier, nevertheless, it must be remembered that public administrations are under the obligation to ensure observance of EU law and they have to disapply national regulations which conflict with it[6].

3. The correct application of EU law and the principle of 'administrative cooperation'

The importance of the correct application of EU law by national public administrations, for the enhancement of a more integrated and well-functioning internal market, was stressed by the European Commission in various Documents[7], where it also pointed out that the strengthening of administrative capacity at a national level is a key part of its strategy for a new 'European governance'[8].

Following this line, article 197 of the Treaty on the Functioning of the European Union (TFEU), under the heading of 'administrative cooperation', makes it clear that 'the effective implementation of Union law by the member States, which is essential for the proper functioning of the Union, is to be regarded as a matter of common interest. In this sense, the Union may support the efforts of member States to improve their administrative capacity to implement Union law.

As it is apparent from the Documentation[9] of the European Commission and from article 197 TFEU, because of its importance in the context of the internal market, European institutions and member States have to promote the correct application of EU law in individual cases, and have to prevent 'decisional' obstacles from being raised. In order to

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6 See, the decisions of Court of Justice of the European Union: Case C-103/88 *Fratelli Costanzo* [1989] ECR 1839; Case C-198/01 *CIF* [2003] ECR I-8055.

7 Commission Recommendation (EC) 2009/524 on measures to improve the functioning of the single market, [2009] OJ L 176, passim.

8 Commission of the European Communities, White Paper on European governance COM(2001) 428 final, 25 and ff.

9 Commission Recommendation (EC) 2009/524 on measures to improve the functioning of the single market, cit., passim.

do so, they have to foster administrative cooperation[10], which ultimately has become a key feature of the system of European governance[11].

Cooperation between national administrations (and between national and European administrations) should promote the adoption of administrative decisions that are lawful and consistent throughout Europe and should facilitate the action of the administrations when they deal with 'cross-border issues'. The extension and the importance of the phenomenon is well demonstrated by the Commission Staff Working Document, Administrative cooperation in the single market[12] (adopted on 29 June 2009), which provides a non-exaustive list of regulations that impose administrative cooperation and exchange of information obligations between national and European administrations. Moreover, it is demonstrated by the fact that the vast majority of internal market regulations provide mutual cooperation obligations. Just as examples, this is the case of the services Directive[13], of the Directive on the recognition of professional qualifications[14], but also of the Directive on patients rights[15] and of Regulation n. 178/2002[16], which lays down the general principles and requirements of food law.

Public administrations at a national and European level, more and more often, have to cooperate for the application of European regulations, and they are faced with the new problems raised by the different languages and working techniques of their counterparts. In order to overcome these difficulties and to improve communication and exchange of information

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10 Commission Recommendation (EC) 2009/524 on measures to improve the functioning of the single market, cit., passim.

11 Türk A and Hofmann HCH, 'An Introduction to EU Administrative Governance', *EU Administrative Governance* (Edward Elgar Publishing 2006). See, also, Commission of the European Communities, White Paper on European governance, COM(2001) 428 final, 25 and f.f.; Commission Staff working document, The single market: review of achievements accompanying document to the Communication from the Commission, A single market for 21st century Europe, COM(2007) 724 final, para 5.3.

12 SEC(2009) 882 final.

13 Cit.

14 Cit.

15 Directive (EC) 2011/24 on the application of patients' rights in cross-border healthcare [2011] OJ L 88/45.

16 Laying down the general principles and requirements of food law, establishing the European Food Safety Authority and laying down procedures in matters of food safety [2002] O J L 31.

between member States' administrations, the Commission launched the Internal Market Information System (IMI)[17] initiative. IMI provides a secure on-line application (run by the Commission itself) that allows national, regional and local authorities to communicate quickly and easily with their counterparts abroad. Its legal background is now provided by Regulation n. 1024/2012, on administrative cooperation through the Internal Market Information System (adopted on 25 October 2012)[18].

As mentioned above, member States should try to prevent 'decisional' obstacles from being raised. However, if a problem occurs and the administration does make an unlawful decision, the correct application of EU law requires that the affected citizen (or undertaking) is given an effective and adequate redress mechanism.

The 'European effectiveness' of national judicial systems has been of primary concern to the CJEU[19] over the years and it has now been 'constitutionalised' in article 19[20] of the Treaty.

Ultimately, an effective legal protection requires 'the conferral of rights by Community law to be meaningful in practice'[21], this is why the remedies provided for have to be equivalent, non-discriminatory and effective. Nevertheless, in order for the individual to be effectively protected, these remedies must also be 'adequate'. This is to say that, under specific circumstances, a long and costly Court process might not offer a satisfactory protection. This might occur especially in cases such as where the decision of a foreign national administration has to be challenged and a cross-border litigation has to be initiated; or in cases where a quick and law-cost solution is needed.

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17 All the relevant information on ‹http://ec.europa.eu/internal_market/imi-net/index_it.html›

18 OJ L 316/1.

19 See, Case C-526/04 *Boiron* [2006] ECR I- 7529; Cases C-317/08, C-318/08, C-319/08 and C-320/08 *Alassini* [2010] ECR I-2213. National procedural rules governing actions for safeguarding the rights that individuals derive from EU law 'must not render practically impossible or excessively difficult the exercise of these rights and the same rules are not to be less favourable than those governing similar domestic actions'.

20 'Member States shall provide remedies sufficient to ensure effective legal protection in the fields covered by Union law'.

21 Biondi A, 'How Effective a Right Should the EU "Effective Judicial Remedy" Be?', *Institute of European Public Law Lecture 2008* (University of Hull 2008)

All in all, an effective protection requires, among other things, that citizens and undertakings are provided with alternatives to the Courts; in other words, with mechanisms for the informal (even though non-binding) resolution of disputes (out-of-court problem-solving mechanisms).

4. The SOLVIT network

In the Communication Action plan for the single market[22] (of 4 June 1997), the Commission proposed that each member State, within its administration, should designate a national Centre responsible for helping citizens and undertakings that faced problems resulting from alleged misapplication of EU law by public administrations in a member State other than their own. In other words, a 'problem solving network' was to be set up, which subsequently should be bound by telematic links. During the following years, a network of national Centres (one for each member State) was set up, in accordance with the provisions of the Action Plan.

In the year 2001, the Commission adopted the Communication Effective Problem Solving in the Internal Market: 'SOLVIT' [23], whose aim was to improve the efficiency of the 'problem solving network'. In practice, the Commission drafted a system made up of three 'pillars': the pre-existing cooperation network; principles for the Centres to follow when dealing with the cases (which are now set out in the Recommendations on principles for using SOLVIT of September 2013)[24]; and an on-line database to connect the Centres in a unified system (SOLVIT).

SOLVIT is designed to provide a quick and cost-effective, even though not binding, mechanism for the settlement of cross-border disputes, regarding the application of EU law between citizens (or undertakings) and public authorities.

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22 Communication from the Commission, Action plan for the single market [1997] CSE (97) 1 final.

23 Communication from the Commission, Effective Problem Solving in the Internal Market ("SOLVIT") [2001] COM(2001) 702 final.

24 Recommendation of the Commission on principles for using SOLVIT – the Internal Market Problem Solving [2013] C(2013) 5869 final.

In accordance with the recent Recommendations on principles for using SOLVIT, public authorities are to be considered as: 'any part of the public administration of a Member State, at national, regional or local level, or any body, whatever its legal form, which has been made responsible, pursuant to a measure adopted by the State, for providing a public service under the control of the State and that has for that purpose special powers beyond those which result from the normal rules applicable in relations between individuals'[25].

SOLVIT's operation[26] is based on the principle of 'administrative cooperation', which works at three different levels: at a cross-border level (between the two Centres involved in the decision procedure); at a national level (between the Centre and the national administration) and at a supranational level (between the Centres and the European Commission).

In the first form of cooperation, the Centre in the member State of the applicant (Home Centre - HC) receives the complaint and makes a preliminary assessment. If the claim is, prima facie, well founded the HC forwards the case to the Lead Centre (i.e. the Centre of the member State in which the cross-border problem occurred) which has to assess whether there has actually been an infringement of EU law and subsequently has to accept or to dismiss the case.

Having regard to the second form, if the Lead Centre (LC) has accepted the case, it is responsible for resolving the problem by cooperating with the public administration concerned. In other words, the Lead Centre proposes a solution to the national administration which is free either to accept or to disregard it and to which the actual solution of the problem is due.

Cooperation between administrations is the very principle that governs the overall system and it is significantly facilitated by the shared data-base. The on-line tool makes the recourse to SOLVIT easier for the

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25 Recommendation of the Commission on principles for using SOLVIT – the Internal Market Problem Solving [2013] C(2013) 5869 final, 5.

26 The principles for Centres to follow when dealing with the cases are set out in the Recommendation of the Commission on principles for using SOLVIT - the Internal Market Problem Solving Network, cit.

individual, who can readily submit a complaint and interact with the national Centre.

It has been pointed out[27] that the level of cooperation between the national Centres is generally good and successful, nonetheless, at times, more difficulties are encountered which inhibit the emergence a mutually agreeable outcomes. This may be as a result of diverging legal interpretations, or it may also reflect different views of the national Centres.

SOLVIT Centres cooperate among themselves and with national public administrations. Also, the Centres work in strict interaction with the European Commission.

The role of the Commission in relation to the system involves the management of the data-base[28] and of the web-site (through which citizens are informed and can submit their complaints). Also, the Commission monitors the quality and performance of SOLVIT Centres and the cases they handle and conducts regular overall quality checks of all cases and signal possible problems to the SOLVIT Centres concerned (which should take appropriate action to redress the shortcomings identified).

Furthermore, the Commission works in cooperation with the Centres to facilitate their activity. It provides advice and assistance or any relevant information. In this respect, it has been pointed out that: 'the informal advice provided by the Commission experts is appreciated. However, occasionally, it fails to meet quite demanding SOLVIT deadlines and is sometimes not designed to compellingly address the circumstances surrounding a particular case'[29].

Cooperation in resolving individual internal market problems goes both ways. All in all, when a complaint addressed to the European Commission involves the misapplication of internal market rules by a

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27 DG internal market and services, Framework Contract for projects relating to evaluation and impact Assessment activities of Directorate General for Internal Market and Services evaluation of SOLVIT, Final Report, [2011], para 2.4.

28 The SOLVIT Support Team maintains the database in good working order and provides training and explanatory material.

29 DG internal market and services Framework Contract for projects relating to evaluation and impact assessment activities of Directorate General for Internal Market and Services Evaluation of SOLVIT, Final Report, cit., para 2.4.

PA, the competent official can decide to sent it to SOLVIT (subject to the complainant's approval).

Alongside with the resolution of individual problems, SOLVIT cooperates with the Commission in order to tackle cases of non-compliance of national regulations with EU law.

SOLVIT Centres not only decide cases which involve the misconduct of an administration when the national regulatory framework does conform to EU law, but also cases where the 'internal market problem' is caused by a national barrier raised either by a specific regulation or by an unlawful administrative practice.

In cases such as these (referred to as SOLVIT PLUS cases)[30], the SOLVIT Centres resolved the individual problem by getting the administration to disapply the concerned unlawful regulation or to move away from an unlawful practice. Moreover, the Centre reported the issue to the relevant national authorities to have the specific regulation amended or to have the practice changed by the issuing of specific guidelines.

Overall, with SOLVIT PLUS cases the Centres have been playing an important role for the integration of the internal market by helping to resolve structural problems and to remove regulatory barriers. In practice, they have been playing a role complementary to that of the Commission under article 226 TEC (now 258 TFUE)[31].

The importance of this role has been acknowledged by the Commission itself. One of the key features of the new internal market governance is the search for a more efficient management of infringements**;** the recourse to infringement proceedings should be reduced, inter alia, by fostering the use 'of alternative problem solving mechanisms and preventive measures'[32]. In the 2002 Communication on Better monitoring of the application of Community law[33], the Commission indicates SOLVIT

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30 A list of SOLVIT PLUS cases is available on the SOLVIT web-site and also on the Annual Reports.

31 See in this respect par. 5 of this article.

32 Communication from the Commission, A Europe of results: applying community law COM(2007) 502 final, 8.

33 [2002] COM(*2002*)*725* final.

as one of those mechanisms, whose use should be increased when the case at issue does not qualify as a priority one.

In this respect, it is worth noting that, in 2008, the Commission launched a Pilot Project (PP)[34], aimed at fostering a more efficient and effective dialogue between member States and the Commission, when dealing with inquiries and complaints in relation to national breaches of EU law. In other words, it is aimed at fostering the collaboration between the Commission and the member States at a pre-infringement stage, by way of a newly developed IT system (The EU Pilot IT application).

SOLVIT is expressly taken into consideration by the PP when the case at issue involves a cross-border problem, faced by an individual, and due to the misapplication of an internal market rule by a national PA. In this respect, the Pilot reads as follows: 'should such issue be submitted to the Commission, and should the Commission wish for some clarification of the issue to be obtained from the member State the relevant service will submit the issue to SOLVIT[35]. In other words, all contacts taken with member States before a letter or a formal notice stage of an infringement proceeding concerning individual cross-border Community law issues (i.e. involving two or more member States) encountered by a citizen or organization in relation to the functioning of the internal market should be put into SOLVIT'[36].

It has been pointed out that these criteria provide general guidance on whether cases should be referred to EU PILOT or SOLVIT, in practice, they are difficult to apply, especially before the details and context of the case have been understood and assessed[37].

In conclusion, SOLVIT is helping to reduce and facilitate the Commission's activity in relation to article 226 EC (now 258 FEU)[38],

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34 EU pilot on Community law: Guidelines, 1, available at ‹www http://ec.europa.eu/index_it.htm›.

35 EU pilot on Community law: Guidelines, cit., 1.

36 Ibid.

37 DG internal market and services, Framework Contract for projects relating to evaluation and impact assessment activities of Directorate General for Internal Market and Services Evaluation of SOLVIT, Final Report, cit., para 2.4.

38 In this respect, see, Anabela Correia de Brito, 'Modern enforcement in the single market', in this volume; and Catharina E. Koop, 'Compliance Mechanisms Compared. An Analysis of the EU Infringement Procedures, SOLVIT, Pilot and IMS', in this volume.

by dealing with non-priority cases that are referred to it, either by the Commission or by the individual concerned.

5. The cases handled by the SOLVIT network

SOLVIT was established in 2002 with the remit of providing an out-of-Court response to cross border complaints brought forward by consumers and businesses, regarding the incorrect application of EU law by national public authorities[39].

SOLVIT's action covers a wide range of policy areas, but its intervention is particularly significant in cases where quick and/or cost effective solutions are needed. Commission statistics[40] show that 34% of the cases handled by SOLVIT are social security cases, 23% involve residence rights, 16% the recognition of professional qualifications, 4% market access to products, and 3% are in the areas of services and establishment.

A closer look at the cases indicates that many of them involve 'cross-border problems' related to the recognition of pension rights acquired in a different member State from that of origin or involve the coverage of medical treatment outside the patient's home Country[41]. Other cases involve discrimination against migrant workers in the access to schools (workers who are required to pay school fees that nationals do not have to pay). SOLVIT Centres also facilitate the recognition of permanent residence rights of citizens residing in a member State for more then five years, when the national authorities unlawfully request that they prove they possess sufficient financial resources or that they produce a contract of employment, and so on.

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39 Recommendation on principles for using SOLVIT - the Internal Market Problem Solving Network, cit., 2.

40 2010 Report, Development and performance of the SOLVIT network on ‹http://ec.europa.eu/solvit/›.

41 A British national resident in Bulgaria was charged for a medical consultation (which was free of charge for citizens insured in Bulgaria) despite presenting a specific EU documentation entitling her to free healthcare at the point of delivery. The doctor in question refused to accept the documentation on the basis that he had not received any guidance about treating nationals of other EU Countries. SOLVIT convinced the Bulgarian authorities to send to the patient a letter confirming her right (letter which was then accepted by the doctor) and to provide a contact person in case further problems occurred. An Italian and an Austrian citizen were on holiday in the Netherlands when they had to undergo an urgent medical treatment. Upon return home, they received invoices from the Netherlands and they were expected to pay for the medical services. SOLVIT contacted the hospitals and the invoices were redirected to the national heath authorities.

Interestingly, SOLVIT Centres can also act as 'national Ombudsmen', by tackling problems caused to applicants by their own public administrations, after having exercised their free movement rights or when trying to do so (Recommendation – 2013).

One general point to make is that the number of businesses lodging a complaint to SOLVIT is still relatively low[42]. This is because they might have other established channels for addressing their problems (such as the Chambers of commerce) or they are more likely to have the means to bring the case in front of a Court. Businesses are also sometimes reluctant to file complaints against national authorities, as they fear that this may have repercussions on their relations with the authority concerned[43].

Hence, attracting business cases remains a key priority for the SOLVIT Network. In this respect, in 2009, the European Commission produced a Strategy Paper to guide SOLVIT Centres on how they could develop activities to increase the awareness of businesses about SOLVIT[44].

As it has been argued above, SOLVIT was in principle aimed at resolving individual problems caused by 'decisional' obstacles raised by public administrations' incorrect application of European rules and principles in a cross-border dimension, when**,** because of the particular nature of the situation, the recourse to a national Court would (or could) be ineffective.

However, Centres have decided cases even when the situation was not strictly 'cross-border' and, as already mentioned, they have been tackling structural problems due to an unlawful national regulatory framework or by an unlawful administrative practice.

The Latvian authorities introduced a rule that the EU regional funds used to purchase agricultural machinery, would be granted only for purchases of new machinery. This rule had the effect of barring access to funding for companies that imported and leased such machinery. After the intervention of SOLVIT the rule was revoked.

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42 167 business cases were recorded in 2010 out of a total number of 1363 cases.

43 2008 SOLVIT Annual Report, 12.

44 European Commission, Strategy Paper: Increasing awareness about SOLVIT among business users (2009).

A Swedish importer of fireplaces manufactured in Hungary had to meet a number of requirements on the testing and conformity assessment procedure for these products. In practice, these requirements forced it to re-test and re-label some Hungarian fireplaces which had already been tested in line with the European standard. SOLVIT contacted the Swedish local authority that had asked for the conformity assessments. The authority changed its requirements so that the Swedish importer could freely market and install Hungarian fireplaces. In addition, as a result of this case, SOLVIT Sweden promoted changes to the rules of at least other twenty local authorities.

6. Solvit: cooperation with other networks and institutions

As above mentioned, SOLVIT works in strict cooperation with the European Commission. However cooperation takes place also with the European Ombudsman (EO) and, to some limited extent, with the members European Network of Ombudsmen[45] (ENO).

As a matter of fact, according to the Annual Reports of the EO, cases refereed to the EO have been transferred to SOLVIT as they involved a cross-border dispute between a national administration and a European citizen (or undertaking).

In case (644/2012/MF), a French national complained against the German public authorities in relation to her pension. She claimed that the pension she received was not commensurate with the number of years she had worked, and that the German public authorities had failed to properly calculate the amount. The Ombudsman transferred the case to SOLVIT France, which later informed him of its intention to open an investigation and to contact the relevant German authorities to resolve the problem.

In another case (case 1944/2012/HK), a Spanish national complained against a decision of the Employment and Support

[45] In this respect, the outgoing European Ombudsman (Prof. Nikiforos Diamandouros) stressed the importance and the need to foster cooperation between its institution and SOLVIT, but also between the former and all the members of the European Network of Ombudsmen. Presentation delivered at the joint session of ENO liaison officers and SOLVIT (June 2010), available at ‹http://www.ombudsman.europa.eu›.

Allowance Office at the Department of Work and Pensions (DWP) in the United Kingdom. She had moved from Spain to the United Kingdom and had worked part-time for two years before she was diagnosed with cancer. The DWP decided that she was not to be considered habitually resident in the Country and thereby she was not entitled to employment and support allowance. The Ombudsman transferred the case to SOLVIT Spain.

Having regard to SOLVIT's cooperation with the National Ombudsmen, it is worth noting that it is still in the early stage of development, although there are some examples where relations have been developing satisfactorily. In particular, cooperation has taken place between SOLVIT and the Spanish Ombudsman (in the migration and equal rights field); moreover, the Slovakian SOLVIT Centre has recently provided training to the Ombudsman regarding SOLVIT, and the Finnish SOLVIT Centre exchanged views with the Ombudsman on EU legislation.

SOLVIT Centres also cooperate with other European and national information and help networks, such as Your Europe, Europe Direct, Your Europe Advice, the Enterprise Europe Network, European Consumer Centres, EURES, Fin-net. SOLVIT Furthermore, Centres cooperate with the respective national members of the Administrative Commission for the Coordination of Social Security[46], when they are dealing with social security cases and they need in-depth expertise.

7. The effectiveness of the SOLVIT mechanism in contributing to the better functioning of the internal market and to the protection of the EU citizens

After more then ten years from its inception, it is possible to contend that the SOLVIT system has lived up to its expectations. The 2010 Annual

[46] The Administrative Commission for the coordination of social security systems comprises a representative of the Government of each EU Country and a representative of the Commission. It is responsible for dealing with administrative matters, questions of interpretation arising from the provisions of regulations on social security coordination, and for promoting and developing collaboration between EU Countries. The composition, operation and tasks of the Administrative Commission are laid down by Articles 71 and 72 of Regulation (EU) 883/2004 on the coordination of social security systems [2004] OL 166/01, and by the Rules of the Administrative Commission for the Coordination of Social Security Systems attached to the European Commission adopted on 16 June 2010 by the Administrative Commission (2010/C 213/11).

Report (Development and performance of the SOLVIT network)[47] shows that the current resolution rate of the cases investigated by SOLVIT is 91%.

Hence, although national public administrations are not bound to follow SOLVIT's advice**,** internal market problems referred to the Centres do find a solution in a very high percentage of cases and national administrations tend to act in accordance with the solutions proposed. This is most likely due to the 'pressure' that administrations receive from Centres that are part of the same national administrative structure and that are normally at a governmental level.

Still, according to the Documentation of the Commission, evident problems remain. Over half of the Centres are understaffed in relation to their caseload, the level of public awareness of SOLVIT's activities is relatively low[48], and its cooperation with national administrations is not always effective.

Moreover, it has to be recalled that the Home Centre cannot enter the case in the database if it is already the subject of legal proceedings. If an applicant decides, at any stage, to initiate legal proceedings the case must be removed from the database. It remains confirmed, of course, that if the applicant is not satisfied with the proposed solution he/she can bring the case before a Court of law afterwards. In practice, however, this is not always feasible. The period of time that is necessary for a decision to be taken by SOLVIT often exceeds the time limit laid down by national legislations to successfully submit a case to the competent Courts[49], and this deadline is not in any way affected by the entering of the case into the SOLVIT's database.

Hence, the individual who chooses to refer a case to SOLVIT is, often, de facto prevented from receiving Court protection. This is probably one

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47 Available at ‹http://ec.europa.eu/solvit/site/index_it.htm›.

48 In this respect, it is worth noting that SOLVIT Italy is currently endorsing the pilot project 'SOLVIT nel Comune', in cooperation with the Associazione Nazionale dei Comuni Italiani e la Scuola Superiore della Pubblica Amministrazione Locale. The aim of the project is to raise public awareness of SOLVIT at a local level and also to reduce the opening of formal infringement proceedings against Italy. Moreover, the project aims to establish a territorial network which can assist the work of the national Centres.

49 In Italy, for example, the deadline for starting proceedings before the Administrative Court is 60 days.

of the reasons why the Annual Reports[50] show that businesses are less likely than individual citizens to submit a case.

As it is shown by the relevant Documentation of the Commission and by the 2010 Resolution of the European Parliament [51], SOLVIT is, nonetheless, an effective initiative.

All in all, SOLVIT was designed to reach individuals and small businesses that could not bear the time and costs necessary to bring a cross-border action in front of a national Court. SOLVIT is helping those that would otherwise be unlikely to obtain any legal protection and it is designed to find a solution to internal market problems that require a quick response.

It is a fact (as many critics of the system point out) that the network deals with a low number of cases, compared to the number dealt with by national Courts. As already mentioned, according to the Commission's statistics, the number of cases submitted to the system, within a year, is around 1300.

We have to bear in mind, however, that the network was only set up in 2002. Individuals and undertakings are not yet aware on a large scale of the possibility of referring their problems to a SOLVIT Centre. In addition, just one Centre[52] is set up per member State. Nevertheless, the system is developing; more and more people are being informed of the existence of SOLVIT by national and European advertising campaigns and conferences. Furthermore, SOLVIT's case flow has been increasing over the years and resolution rates have been improving.

Despite the still low number of cases handled[53], SOLVIT provides an effective remedy to a specific kind of internal market problems, offering individuals an alternative to Courts and a mechanism, which adequately meets their needs.

Furthermore, SOLVIT has been promoting changes of national administrative practices and legislations. As an example, the 2010 Annual

50 2004-2010.

51 Of 9 March 2010 on SOLVIT, 2009/2138 (INI).

52 Which normally employs two or three people.

53 In 2010, SOLVIT handled almost 3800 cases, out of which 1363 were within its competence.

Report, points out that, in absolute figures, the number of SOLVIT cases of 2009 was higher that in 2010. This was because, in 2009, SOLVIT handled numerous similar cases lodged by non-EU family members of EU nationals suffering delays in obtaining a residence permit in the UK. The number of these cases dropped in 2010 because the UK authorities took structural measures to resolve the problem.

In conclusion, it is worth stressing that SOLVIT can play another role the importance and the effects of which are still to be seen. SOLVIT can deeply affect national administrative law and can foster the correct application of EU law by PAs in a way which is uniform throughout Europe. This is due, in particular, to the shared database that allows SOLVIT Centres to record information on individual cases, to exchange them quickly among themselves, and to develop a common set of principles and standards which are likely to affect national public authorities' activity and national regulations.

8. Conclusions

When national administrations infringe EU law in individual decisions, they pose an evident threat to the integration of the internal market. This has been a major concern of European institutions and member States, over the last ten-fifteen years. Among the various initiatives put forward to foster the correct application of EU law at a national level, the SOLVIT network is particularly significant and has made a substantial contribution to the better functioning of the internal market and to the protection of the EU citizens.

Still, some changes are deemed necessary to improve the performance of the network. In particular, SOLVIT's activities should be more actively promoted, the number of staff allocated to its Centres should be raised, Centres should foster more regular contacts with national authorities in order to make the SOLVIT method better known and trusted. Also, it has been pointed out[54] that the current SOLVIT IT tool has reached its limits and technical problems often occur; hence, the

[54] Commission Working Document, Reinforcing effective problem-solving in the Single Market Unlocking SOLVIT's full potential at the occasion of its 10th anniversary, available at ‹http://ec.europa.eu/solvit/site/index_it.htm›.

SOLVIT IT system is being rebuilt as a stand-alone module into the wider Internal Market Information System (IMI) IT tool[55].

[55] Given this technical integration, the rules set out in Regulation (EU) 1024/2012 of the European Parliament and of the Council on administrative cooperation through the Internal Market Information System and repealing Commission Decision (EC) 2008/49 (the 'IMI Regulation') [2012] OJ L 316/1, also apply to SOLVIT's procedures.

21

Improving market supervision and market governance: "Prevention of new obstacles and standardization"

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ABSTRACT

The Internal Market of the European Union is based fundamentally on four freedoms: the free movement of goods, services, people and capital. Among the different regulations adopted by the Community legislature aimed at preventing obstacles to free movement, one that stands out is Directive 98/34/EC of the European Parliament and of the Council of 22 June 1998 laying down a procedure for the provision of information in the field of technical standards and regulations. This key reference point is the basis for analysing how and whether a degree of convergence of preventive measures in relation to the other freedoms might be established and/or strengthened.

KEYWORDS: European Union, Internal Market, Free Movement Of People, Free Movement of Goods, Free Movement of Services, Free Movement of Capital, Directive 98/34/EC, Technical Specification, Standards

1. Introduction

This paper aims to both summarise and complete the presentation I gave at the International Conference "Fostering growth: reinforcing the internal market", held in Madrid at the end of October 2013.

During my presentation I discussed the prevention of obstacles to the four freedoms[1] which are the cornerstones of the Single Market: the

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1 The 'four freedoms' once referred to certain essential human freedoms, when used by President Franklin D. Roosevelt in his State of the Union speech in 1941 (however, European legal scholars have since transformed the term into a reference to the transnational economic freedoms essential to European integration).

free movement of people, goods, services and capital. I also argued about standardisation, which in principle ought to help enable free movement in the European Union (EU). In this paper however I shall focus on the free movement of goods, and in particular Directive 98/34/EC of the European Parliament and of the Council of 22 June 1998 laying down a procedure for the provision of information in the field of technical standards and regulations[2]. This is not only because as the Spanish saying goes, «el que mucho abarca, poco aprieta»[3], but also because said Directive is the key reference point for EU regulations aimed at preventing obstacles to free movement. As such it has proven invaluable in setting up the Internal Market and ensuring it functions properly.

By looking then in some detail at the origins of Directive 98/34/EC and its procedures I will outline how obstacles to the other three freedoms might be prevented, and whether it is possible or desirable to work towards convergence in this field.

2. Directive 98/34/EC

2.1. From 1980 to 2013…

In 1980 the European Commission presented the Proposal for a Council Decision laying down a procedure for the provision of information in the field of technical standards and regulations[4], which ended up becoming Council Directive 83/189/EEC of 28 March 1983 laying down a procedure for the provision of information in the field of technical standards and regulations[5]. From the outset this Directive was seen as a groundbreaking, almost revolutionary means by which the Community legislature could help to make major improvements to the performance of the internal market.

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2 [1998] OJ L204/37 (consolidated versión < http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:1998L0034:20130101:EN:PDF > accessed 4 November 2013).

3 Something like «Do not bite off more that you can chew», although the translation of phrases and expressions is always a minefield.

4 [1980] OJ C253/2.

5 [1983] OJ L109/8.

With this purpose in mind the Commission emphasized in its 1980 proposal that:

> • "… the prohibition of quantitative restrictions on the movement of goods and of measures having an equivalent effect is one of the basic principles of the Community";

and likewise that:

> • "… technical regulations relating to products, where they impede the free movement of goods legally manufactured and sold in a Member State, are *lawful*[6] only if they are necessary in order to meet essential requirements and have an objective in the public interest of which they constitute the main guarantee".

Indeed, one of the hardest and most important tasks when achieving the Internal Market is to avoid the adoption of national technical standards and regulations which then present new obstacles to the internal market. Thirty years after coming into force, Directive 83/189/EEC (consolidated by Directive 98/34/EC) has proven to be an instrument of fundamental importance in this area.

In this vein the Directive states that the prohibition of quantitative restrictions on the movement of goods and of measures having an equivalent effect is one of the basic principles of the Community, and that the barriers to trade resulting from technical regulations relating to products may be allowed *only* where they are necessary in order to meet essential requirements and have an objective in the public interest of which they constitute the main guarantee. It also states that:

> • "… it is essential for the Commission to have the necessary information at its disposal before the adoption of technical provisions"[7];
>
> • "… all the Member States must also be informed of the technical regulations contemplated by any one Member State"[8];
>
> • "… the Commission and the Member States must also be allowed sufficient time in which to propose amendments to a contemplated measure, in order to remove or reduce any barriers which it might create to the free movement of goods"[9]; and
>
> • "… the Commission must also have the option of proposing or adopting a Community directive governing the subject of the national measure contemplated"[10].

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6 Emphasis added by the author.

7 Directive 83/189/EEC, first recital.

8 *Ibidem*, second recital.

9 *Ibidem*, third recital.

10 *Ibidem*, fourth recital.

Given its inclusion in Directive 98/34/EC I do not need to discuss in great depth the means of notification established by Directive 83/189/EEC, which is based on the agreement of the Member States to inform and consult each other and the Commission *before* they adopt technical regulations and to modify their drafts if necessary.

In effect, the first recital of the latter Directive confirms that "… for reasons of clarity and rationality the […] Directive [83/189/EEC] should be *consolidated*[11]". This *continuity* becomes clear upon reading the recitals that follow:

> "2) Whereas the internal market comprises an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured; whereas, therefore, the prohibition of quantitative restrictions on the movement of goods and of measures having an equivalent effect is one of the basic principles of the Community;
>
> (3) Whereas in order to promote the smooth functioning of the internal market, as much transparency as possible should be ensured as regards national initiatives for the establishment of technical standards or regulations;
>
> (4) Whereas barriers to trade resulting from technical regulations relating to products may be allowed only where they are necessary in order to meet essential requirements and have an objective in the public interest of which they constitute the main guarantee;
>
> (5) Whereas it is essential for the Commission to have the necessary information at its disposal before the adoption of technical provisions; whereas, consequently, the Member States which are required to facilitate the achievement of its task pursuant to Article 5 of the Treaty must notify it of their projects in the field of technical regulations;
>
> (6) Whereas all the Member States must also be informed of the technical regulations contemplated by any one Member State;
>
> (7) Whereas the aim of the internal market is to create an environment that is conducive to the competitiveness of undertakings; whereas increased provision of information is one way of helping undertakings to make more of the advantages inherent in this market; whereas it is therefore necessary to enable economic operators to give their assessment of the impact of the national technical regulations proposed by other Member States, by providing for the regular publication of the titles of notified drafts and by means of the provisions relating to the confidentiality of such drafts;
>
> (8) Whereas it is appropriate, in the interests of legal certainty, that Member States publicly announce that a national technical regulation has been adopted in accordance with the formalities laid down in this Directive".

[11] Emphasis added by the author.

In our opinion, the transparency and exchange of information in the draft stage of regulations or legislation, as introduced by Directive 83/189/EEC and confirmed and ratified by Directive 98/34/EC, has proved effective in preventing the creation of new obstacles to the Internal Market.

2.2. The scope of the Directive 98/34/EC

Article 1 defines the meaning given to certain key terms used in the different provisions of Directive 98/34/EC. This clarification of terminology and semantics is vital to ensuring a proper understanding of the text and the scope of its application:

> "For the purposes of this Directive, the following meanings shall apply:
>
> 1. 'product', any industrially manufactured product and any agricultural product, including fish products;
>
> 2. 'service', 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.
>
> […]
>
> 3. 'technical specification', a specification contained in a document which lays down the characteristics required of a product such as levels of quality, performance, safety or dimensions, including the requirements applicable to the product as regards the name under which the product is sold, terminology, symbols, testing and test methods, packaging, marking or labelling and conformity assessment procedures.
>
> […][12]
>
> This Directive shall not apply to rules relating to matters which are covered by Community legislation in the field of telecommunications services, as defined by Directive 90/387/EEC [replaced by Directive 2002/21/EC[13]]".

In regard to the first article I would highlight the following:

Cosmetic products, medicines, products destined for human and animal consumption and agricultural products were all excluded from the scope of the first version of the Directive (i.e. Directive 83/89/EEC).

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12 *Brevitatis causae* I have not included the definitions of 'other requirements', 'rule on services', etc.

13 [2002] OJ L108/33.

In effect the scope of the *new* Directive has been extended, since the operation of the information procedure revealed that numerous national regulations and standards involving barriers to intra-Community trade had not been monitored by the Commission and the Member States because certain products were not covered;

It is worth noting here that the services covered by Directive 98/34/EC are general online information services (newspapers, databases etc.), telemonitoring, interactive home shopping, e-mail, online flight reservations, professional services online (access to databases, diagnoses, etc.);

'Technical specification' is defined as a generic term which covers standards as well as technical regulations [article 1 stipulates that the document containing the technical specification should define 'the characteristics required of a product' (the examples given are not exhaustive because the composition of the product, along with its shape, weight, presentation, performance, life span, energy consumption, etc., could have been added)].

2.3. The procedure applicable to technical regulations

Article 8 covers the obligations on Member States and the Commission respectively in relation to the information procedure applicable to technical regulations. It also covers the possible actions available to them, with the exception of those reactions which trigger a standstill period, to be observed before notified drafts are adopted. This is mentioned in article 9 of Directive 98/34/EC. The procedure in question can be summarised as follows:

First stage: the obligation to inform

a) The Member States' obligations

- General rules

In order to guarantee the transparency of national initiatives, Article 8 requires the Member States to communicate immediately to the Commission any draft technical regulation which they plan to adopt.

- Specific cases

–One notification valid for more than one act: According to Directive 98/34/CE, Member States are not obliged to communicate again a draft technical regulation that has already been communicated by means of another Community act. In such cases the Member State should advise that the communication in question remains applicable pursuant to Directive 98/34/CE. This provision of the Directive (see article 8.5), reflects the Commission's wish to reduce the extra administrative work caused when notification procedures are repeated because more than one Community Directive requires the Member State to inform the Commission of its intention to legislate in a particular area. Or in other words, when the Member State has to notify the Commission again of the same text during the draft stage.

However this does not exempt member States from meeting the specific obligations stipulated in each Community instrument. Once an official communication has confirmed that a national draft is valid for more than one Community procedure, then said draft should be examined in the light of each Community act which it refers to. The Commission may then give a different opinion on the draft in the case of each procedure.

–Basic legislation already sent: With the same concern for efficiency, Member States are exempt from the obligation to send the Commission the text of the basic legislative and regulatory provisions concerning a draft technical regulation, if this text has already been sent with a prior communication.

–Additional documentation: Conversely, Directive 98/34/EC introduces an obligation for Member States with regard to draft technical regulations designed to limit the marketing or use of a substance, a preparation or a chemical product for reasons of public health, the protection of consumers or the environment [c.f. the fourth subparagraph of Article 8(1)].

–New notification: Member States should notify again if major changes have been made to the text of any draft already examined in the light of Directive 98/34/CE.

b) The obligations of the Commission

When the Commission has been notified of a new draft national technical regulation, it must transmit all the information communicated

by the notifying Member State to all the other Member States (the draft will simultaneously be sent to all the Commission departments which may be concerned by the notified regulation as a result of their specific or horizontal responsibilities).

Second stage: possible reactions open to the Commission and the Member States

During the three months following the notification of a draft [this period corresponds to the standstill period referred to in Article 9(1)], the Commission and the Member States examine the notified text in order to ascertain its compatibility with Community law and also with the sectorial Directives involved, and to reach a decision, where necessary, on its consistency with the concerned provisions.

This examination can produce one of two reactions from the Commission and the Member States (in addition the Commission may also react by "blocking" the draft if harmonization of content in question appears necessary).

- The Commission and/or Member States can decide that the draft technical regulation risks creating obstacles to the free circulation of goods and services and the freedom of establishment[14];
- the Commission and the Member States can send comments or a detailed opinion to the Member State which notified the draft technical regulation; or
- the Commission can announce a Community initiative on the subject of the proposed national measure or announces its finding that such initiative exists (this is known as 'blockage').

In the latter case detailed opinions are sent by the Commission or Member States if they consider that upon being adopted the draft measure might create obstacles to the free circulation of goods, the freedom to provide services or service operators` freedom of establishment within

[14] Nevertheless the resulting *right* of the notified Member State to adopt its legislative or regulatory draft does not prevent the Commission from intervening at a later stage above and beyond the procedure provided for by Directive 98/34/CE, if the provision in the version finally adopted can be shown to be in conflict with the Treaty or secondary legislation.

the Internal Market. The purpose of these detailed opinions is to change the proposed measure eliminating at source any obstacle it may present to these freedoms.

2.4. The procedure for the provision of information with regard to standards

Given the limits of this paper I shall only deal briefly with this aspect.

Without going into the source material in detail, I should note that *standardisation* is the voluntary process of developing technical specifications based on a consensus reached by all interested parties (industry including Small and Medium-sized Enterprises (SMEs), consumers, trade unions, environmental Non Governmental Organisations (NGOs), public authorities, etc.). It is carried out by independent standards bodies acting at a national, European and international level.

In this context, article 2 of Directive 98/34/CE provides that information procedures with regards to standards is limited to new projects which national standardization bodies intend to begin. They should apply at the point at which such projects are included in the normalization programme, and at a stage early enough to allow interested parties in other States to take part and have any comments taken into consideration.

Clearly the community legislator was right to create the above provision as it is only the 'purely' national standards that are likely to act as barriers to the proper functioning of the internal market. An international or European standard should not, in principle, jeopardise the free movement of goods within the European Community, since its technical specifications have been the subject of consensus on a much wider geographical scale.

2.5. Access to information by private individuals and industry

Although the implementation of Directive 98/34/EC is above all a matter for the parties involved in the procedure for the provision of information in the field of technical standards and regulations –the Commission, Member States, the European and national standardisation

bodies– information on draft national standards and technical regulations is of considerable interest to all the citizens of the EU.

Hence I believe it is very important for economic operators –the real beneficiaries of the notification procedure and who include all categories of service recipients in the information society (companies, professionals, consumers, etc.)– to inform themselves of both the initiatives planned by national standardisation bodies and of all the draft legislation and regulations being prepared by Member States at a sufficiently early stage. This will allow them should they so wish to:

• take part in the work of preparing standards relating to their field of activity in the standardisation committee of the national body which has initiated this work;

• anticipate the adoption of future national standards or technical regulations in other Member states, by adapting their production in order to comply with the precise content of these texts. In this way, manufacturers can, when the time comes, immediately export products which comply fully with the requirements of these standards or regulations; and

• suggest changes to be made where proposed technical regulations might create obstacles to trade, the purpose of such changes being to enable transnational access to information society products and services[15].

On this last point I note that economic operators can submit comments on potential problems arising from the application of texts in their sector even after said texts have been adopted. My own experience of having spent over 20 years putting Directive 83/189/EEC and later Directive 98/34/EC into practice tells me that this information is invaluable to the different departments of the Commission, as the latter do not have equivalent practical experience of the relevant fields.

In order to take full advantage of the possibilities opened up by Directive 98/34/CE, EU citizens and companies can consult the sources

[15] These comments may be sent directly to the relevant Commission departments or to the national authorities responsible for administering Directive 98/34/EC in the field of technical regulations. The Commission and Member States may then, on this basis, send comments or detailed opinions to the notifying Member State with a view to the removal of protectionist elements identified in the draft.

of information provided by the Commission. One source I would recommend in particular is the TRIS Database[16]

2.6. The inapplicability of the 'non notified' technical regulations

The sources of information referred to above enable private individuals and other interested parties to stay informed of the notifications and ensure that any technical regulations which they are bound to comply with have indeed been notified.

If a technical regulation has not been properly notified then a case for its inapplicability may be made on the basis of European Court of Justice case law.

The 'CIA Security' judgment and the 'Unilever' judgment, delivered under the preliminary ruling procedure by the Court of Justice, are key elements in the protection of private individuals against failure on the part of Member States to fulfil their obligations under Directive 98/34/EC[17].

These sentences detail the consequences when a technical regulation is adopted without having complied with the requirements of Directive 98/34/CE. Namely, private individuals may invoke articles 8 and 9 of the Directive before their national courts, which should prohibit the application of any national technical regulation which has not been notified in accordance with said Community law, or which has been notified during rather than after the pre-established standstill period.

Private individuals and enterprises have the possibility to ensure that any technical regulation adopted by a Member State is monitored

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16 Available at: < http://ec.europa.eu/enterprise/tris/pisa/app/search/index.cfm?lang=en>.

17 Judgment of 30th April 1996 'Interpretation of Article 30 of the EC Treaty and of Directive 83/189/EEC laying down a procedure for the provision of information in the field of technical standards and regulations – National legislation on the marketing of alarm systems and networks – Prior administrative approval', delivered in Case C-194/94 'CIA Security' [1996] ECR I-2201 and Judgment of 26th September 2000 'Interpretation of Council Directive 83/189/EEC laying down a procedure for the provision of information in the field of technical standards and regulations – Obligations of notification and postponement of adoption– Applicability in civil proceedings', delivered in Case C-443/98 'Unilever' [2000] ECR I-7535.

before its adoption by the Commission and the other Member States (with the exceptions mentioned in the Directive). If this is not the case, a company, for example, can cite the inapplicability of the regulation in question, should it be accused of non-compliance by an authority. In the event of any national court proceedings resulting from the matter, the court must then set aside the application of the regulation and cannot, as a result, regard it as having been breached.

3. Conclusions

3.1. The four freedoms: the (non-existent?) dividing line between prevention and deterrence

In my opinion it is not unreasonable to conclude that, in view of the sanctions applicable in the case of non-compliance, the "distinction" between preventive and deterrent measures is not always clear.

This is especially true for the free circulation of goods and the measures designed to ensure that this freedom is applied. In my view, the application of the mutual recognition principle, which guarantees free movement of goods and services without the need to harmonise Member States' national legislation[18], and of Regulation (EC) 764/2008 of the European Parliament and of the Council of 9 July 2008 laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State[19] are clear examples of principles or regulations which in theory are not preventive but in practice often prevent (new) obstacles from emerging.

Elsewhere in relation to free circulation I cannot rule out the possibility of certain networks and regulations having a deterring and hence preventive effect. These include the SOLVIT network[20], FIN-NET[21],

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18 Goods which are lawfully produced in one Member State cannot be banned from sale on the territory of another Member State, even if they are produced to technical or quality specifications different from those applied to its own products.

19 [2008] OJ L218/21.

20 < http://ec.europa.eu/solvit/ >.

21 < http://ec.europa.eu/internal_market/finservices-retail/finnet/ >.

or other information exchange networks at a Community level and in particular the procedures contemplated by Council Regulation (EC) 2679/98 on the functioning of the internal market in relation to the free movement of goods among the Member States[22] and Regulation (EC) 765/2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products[23].

3.2. Is a convergence of Community measures aimed at preventing obstacles to the four freedoms desirable, or indeed possible?

As mentioned earlier, in the case of free movement of goods and services there has already been a partial convergence of measures, and these have on occasion been the subject of Community harmonization. The same might be said for the free movement of people, although in the case of the latter what happens in practice is perhaps not so much a convergence as a tendency for measures to become increasingly similar…

The fourth of the fundamental freedoms governing the internal market, the free movement of capital, deserves separate comment. The poor relation of the four, it is also the most recent, having become a directly applicable Treaty freedom only when the Maastricht Treaty came into force. In addition, it has the broadest scope of all Treaty freedoms - by covering the movement of capital between Member States and third countries it is the only one to go beyond the boundaries of the internal market.

3.3. What about the future?

In my opinion the best form of prevention is the effective application of Community legislation at every level. If, as we might hope, the community legislator adopts regulations and seeks full harmonization wherever possible, then in the short and medium term the number of obstacles will decrease. Likewise the *visibility* de European Union Law

22 The "rapid intervention mechanism" [1998] OJ L337/8.

23 [2008] OJ L218/21.

needs to be promoted, especially where it confers rights upon citizens. For while it is true that "Ignorantia juris non excusat", it is equally the case that *ignorance of the law makes enforcement harder*.

In the final analysis, increased attention should be paid to all aspects of implementation, management and enforcement during the development of proposals. This should apply at the impact assessment stage in particular but also throughout the policy cycle.

4. Official documents[24]

(in chronological order)

– Council Directive 65/65/EEC of 26 January 1965 on the approximation of provisions laid down by Law, Regulation or Administrative Action relating to proprietary medicinal products (OJ 22, 9.2.1965, p. 369/65), repealed by Directive 2001/83/EC of 6 November 2001 on the Community code relating to medicinal products for human use (OJ L 311, 28.11.2001, p. 67).

– Council Directive 67/548/EEC of 27 June 1967 on the approximation of laws, regulations and administrative provisions relating to the classification, packaging and labelling of dangerous substances (OJ 196, 16.8.1967, p. 1) and subsequent amendments.

– Council Directive 76/768/EEC of 27 July 1976 on the approximation of the laws of the Member States relating to cosmetic products (OJ L 262, 27.9.1976, p. 169).

– Council Resolution of 7 May 1985 on a new approach to technical harmonisation and standards (OJ C 136, 4.6.1985, p. 1).

– Council Directive 88/182/EEC of 22 March 1988 amending Directive 83/189/EEC laying down a procedure for the provision of information in the field of technical standards and regulations (OJ L 81, 26.3.1988, p. 75).

– Council Directive 89/552/EEC of 3 October 1989 on the coordination of certain provisions laid down by Law, Regulation or

[24] This list is not exhaustive.

Administrative Action in Member States concerning the pursuit of television broadcasting activities (OJ L 298, 17.10.1989, p. 23) as last amended by Directive 97/36/EC (OJ L 202, 30.7.1997, p. 1).

– Council Resolution of 21 December 1989 on a global approach to conformity assessment (OJ C 10, 16.1.1990, p.1).

– Council Directive 90/387/EEC of 28 June 1990 on the establishment of the internal market for telecommunications services through the implementation of open network provision, (OJ L 192, 24.7.1990, p. 1). Repealed by Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (OJ L 108, 24.4.2002, p. 33).

– Council Directive 92/59/EEC of 29th June 1992 on general product safety (OJ L 228, 11.8.1992, p. 24) amended and repealed by Directive 2001/95/EC of the European Parliament and of the Council of 3 December 2001 on general product safety (OJ L 11, 15.1.2002, p. 4).

– Council Regulation EC 315/93 of 8 February 1993 relating to the establishment of Community procedures regarding contaminating substances in foodstuffs (OJ L 37, 13.2.1993, p. 1).

– Council Regulation 793/93/EEC of 23 March 1993 on the evaluation and control of the risks of existing substances (OJ L 84, 5.4.1993, p. 1) as amended by Council Regulation 1882/2003 of 29 September 2003 (OJ L 284, 31.10.2003, p. 1).

– Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (OJ L 141, 11.6.1993, p. 27). Repealed by Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (OJ L 145, 30.4.2004, p. 1).

– Council Directive 93/43/EEC of 14 June 1993 on the hygiene of foodstuffs (OJ L 175, 19.7.1993, p. 1). The latter directive was be repealed by Regulation (EC) 852/2004 of the European Parliament and of the Council of 29 April 2004 on the hygiene of foodstuffs (OJL139, 30.4.2004, p.1).

– Council Decision 93/465/EEC of 22 July 1993 concerning the modules for the various phases of the conformity assessment procedures and the rules for the affixing and use of the CE conformity marking, which

are intended to be used in the technical harmonization directives (OJ L 220, 30.8.1993, p. 23).

– Directive 94/10/EC of the European Parliament and Council of 23 March 1994 materially amending for the second time Directive 83/189/EEC laying down a procedure for the provision of information in the field of technical standards and regulations (OJ L 100, 19.4.1994, p. 30).

– Directive 94/25 of the European Parliament and Council of 16 June 1994 on the approximation of the laws, regulations and administrative provisions of the Member States relating to recreational craft (OJ L 164, 30.6.1994, p. 15), amended by Directive 2003/44/EC of 16 June 2003 (OJ L 214, 26.8.2003, p. 18).

– Directive 94/62/EC of the European Parliament and Council of 20 December 1994 on packaging and packaging waste (OJ L 365, 31.12.1994, p. 10) as amended by Directive 2004/12/EC of 11 February 2004 (OJ L 47, 18.2.2004, p. 26).

– Directive 95/47/EC of the European Parliament and of the Council of 24 October 1995 on the use of standards for the transmission of television signals (OJ L 281, 23.11.1995, p. 51).

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[25] *Idem*.

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– Statistics relating to technical regulations notified in 2007 under the Directive 98/34/EC procedure — Information supplied by

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22

Network Governance in European Competition Law Post-Financial Crisis: what impact on legitimacy?

FIRAT CENGIZ*

ABSTRACT

This paper looks into the legitimacy of network governance in European Union competition policy after the financial crisis. The financial crisis has further decreased the deficient citizen trust in the Union's governance, thus; it exacerbated the Union's notorious legitimacy deficit. Under the shadow of this citizen distrust, proponents of neo-liberal network governance can no longer rely on output legitimacy arguments. If achieving an 'ever closer Union between the peoples of Europe' is to stay as a viable aim for the Union, citizens need to be firmly anchored to policies that affect their daily lives substantially. Looking at Union competition policy from this perspective the paper leads to sceptical conclusions: the recent reforms have oriented Union competition rules towards a more neo-liberal economic approach without sufficient input from Union political institutions and citizens. Likewise, increased reliance on economic and econometric analysis renders the competition law discourse highly technical. This results in exclusivity in governance at the expense of the participation of political institutions, organisations representing consumer interests and ultimately citizens.

KEYWORDS: Financial Crisis, Legitimacy, Accountability, Network Governance, Policy Networks, European Competition Network, European Competition Policy.

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As early as 1922, when writing about the state, society and legitimacy, Max Weber opined that 'bureaucratic administration means fundamentally domination through knowledge'.[1] In this, he astonishingly foresaw the future emergence of bureaucratic networks as a new force in governance in addition or in contrast to the traditional state functions. The rest of us –who were not as far seeing as Weber– had to wait until the emergence of neo-liberalism as the dominant ideology of global economic governance in the twenty-first century to agree with him. Anne Marie Slaughter called networks the 'new world order' in her brilliant book looking into the emergence of networks at the global level as the key governance phenomena in almost all policy fields with a fundamental impact on daily citizen life.[2] Likewise, in his seminal article on epistemic communities, Peter M. Haas convincingly argued that 'knowledge and information is an important dimension of power';[3] thus, clusters of experts surrounding the traditional state functions would be able to influence state's behaviour thanks to their privileged position as the suppliers of scientific knowledge.

Neo-liberal economic governance resulted in the privatisation of formerly state-owned industries that then became subject to extremely technical economic regulation. This was necessary, as those industries were unable to produce the generic benefits of competition due to their natural-monopoly-like characteristics and their propensity for market failures. Since parliaments and executives do not possess the necessary technical expertise to deal with these issues, they delegated the task of regulating those industries to expert independent agencies in policy fields with a fundamental impact on citizens' daily lives, including healthcare, finance, energy and education.[4] The unprecedented level of globalisation meant that regulatory and economic activity in one part of the world was

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1 Richard Swedberg; Ola Agevall, *The Max Weber Dictionary: Key Words and Central Concepts* (Stanford University Press 2005), 18.

2 Anne Marie Slaughter, *A New World Order* (Stanford University Press 2005).

3 Peter M. Haas, 'Introduction: Epistemic Communities and International Policy Coordination', (1992) 46 *International Organization 1*.

4 Mark Thatcher, 'The Creation of European Regulatory Agencies and its Limits: a Comparative Analysis of European Delegation' [2001] 18 *Journal of European Public Policy* 790; David Coen; Mark Thatcher, 'Network Governance and Multi-level Delegation: European Networks of Regulatory Agencies' (2008) 28 *Journal of Public Policy* 49; Mark Thatcher, Alec Stone Sweet (eds.), *The Politics of Delegation* (Routledge 2003).

very likely to result in positive and negative externalities in other parts. Thus, cooperation and coordination at the global level was essential to avoid policy failure. As a result, the new elite bureaucrats, the white collar owners of scientific expertise, began to talk to their peers from various nations and nationalities – and global network governance was born.

The European Union has provided a particularly hospitable platform for network governance. Not only is the Union a neo-liberal 'regulatory state'[5] as called by Majone but it also is an extremely complex multi-level polity that aims to achieve economic policy coherence in currently twenty-eight Member States. Soft network governance based on constant communication between Brussels and national capitals provides a much more efficient alternative to red tape and costly bureaucratic coordination. Thus, the European Commission welcomed network governance with open arms as the key method of achieving the single market in its 2001 Governance White Paper as long as, of course, the Commission itself sits at the centre of pan–European regulatory networks.[6] The regulatory landscape of the Union is replete with examples of network governance, including the comitology committees, open method of coordination, the European regulatory agencies with links in national capitals, the European Competition Network that brings together the Union and national competition officials, and similar networks in the area of telecoms and energy regulation that recently gave birth two new regulatory agencies named BEREC and ACER respectively.

So, network governance is effective, efficient and inevitable given the dynamics of global neo-liberal economic governance, but is it legitimate? This is a question that has been asked only surprisingly recently in the political science literature of network governance. Since Heclo officially coined the term 'policy network' in 1978[7], policy effectiveness, rather than legitimacy has been the exclusive focus of attention. The ultimate question

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5 Giandomenico Majone, 'The Regulatory State and Its Legitimacy Problems' (1999) 22 *Journal of European Public Policy* 1.

6 European Commission, 'European Governance: A White Paper', [2001] COM 278 final, Brussels 25 July; European Commission, Report of the Working Group, [2001] 'Networking People for Good Governance in Europe', Brussels.

7 Hugh Heclo, 'Issue Networks and the Executive Establishment', in A. King (ed.) *The New American Political System* (American Enterprise Institute for Political Research 1978).

was how to design networks that would translate into the most coherent and the most effective policies. The extremely complex structures of networks, the unprecedented level of opacity in their governance and their jellyfish like characteristics that escape the orthodox legitimacy and accountability relationships of the nation state have been noticed much later.[8]

The key argument of this paper is that in the shadow of the global legitimacy crisis caused by the global economic crisis, we can no longer ignore the legitimacy deficit in economic governance and in network governance. Time has long come to voice this legitimacy deficit, discuss it seriously and look for solutions. Before the financial crisis, the proponents of neo-liberal network governance were able to rely on soothing output legitimacy arguments: i.e. even though networks appeared undeniably undemocratic in the light of the governance principles of the nation state, they were believed to produce policies maximising citizen welfare due to their technical expertise.[9] This maximised citizen welfare ultimately attributed legitimacy to network governance. The global financial crisis has shown that the most elite bureaucrats with the greatest technical expertise and regulatory networks accommodating them are still likely to make fundamental mistakes with enormous impacts on citizen welfare. This cold harsh reality renders output legitimacy arguments less credible than ever before.

Arguably, the financial crisis has caused even more profound affects on legitimacy in the European Union. The Union had already suffered from the notorious 'democratic deficit' before the crisis due to its complex and bureaucratic structure that does not sit comfortably with the representative and participatory democracy standards of the nation state.[10] Post-financial crisis governance mechanisms resulted in the penetration of the legitimacy issues also to the Member State

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8 Yannis Papadopoulos, 'Problems of Democratic Accountability in Network and Multi-level Governance' (2007) 13 *European Law Journal* 469; 'Taking Stock of Multi-level Governance Networks' (2005) 4 *European Political Science* 316; 'Cooperative Forms of Governance: Problems of Democratic Accountability in Complex Environments' (2003) 42 *European Journal of Political Research* 473.

9 F. W. Scharpf, 'Economic Integration, Democracy and the Welfare State' (1997) 4 *Journal of European Public Policy* 18.

10 Simon Hix, *What's Wrong with the European Union and How to Fix it* (Polity Press 2008); see contra Andrew Moravcsik, 'In Defence of the Democratic Deficit: Reassessing Legitimacy in the European Union' (2002) 40 *Journal of Common Market Studies* 4.

level. The intergovernmental Treaties with strong economic and fiscal conditionality render the Union-Member State relationship ever more complex and opaque: they open more doors for blame shifting between the Union and the Member State governments; and they threaten the constitutional integrity of the Union.[11]

Of course over time several institutional mechanisms have been developed to cure the legitimacy issues in the Union's governance. Some of those mechanisms, such as the Citizens' Initiative, have been novel and promising.[12] Nevertheless, institutional mechanisms that require organised mass citizen action are unlikely to pay off in the near future with citizen trust in the Union institutions scoring a record low 30 per cent.[13] To kick-start citizen interest in and contribution to Union governance, citizens need to be 'anchored' to policies that have a direct and positive impact on their lives, such as the Union competition policy. At present citizens play some, albeit minor, role in the *enforcement* of competition rules. Most notably, the European Commission has a strong agenda that aims to increase consumer participation in enforcement through private damages actions before the national courts.[14] Nevertheless, to address the systemic issues analysed in this paper, citizens need to play a more fundamental role by contributing not only to the enforcement but also to the *making* of policies.

How this contribution will take place in practice is a broad and open question. The obvious starting point would be the improvement of the contribution of most immediate citizen representatives in policymaking, i.e. the parliaments and the civil society. But, as it will be discussed later in this paper this option – like many others – has its pros and cons. In other

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11 Miguel Poiares Maduro, Bruno de Witte, Mattias Kumm, 'The Democratic Governance of the Euro', RSCAS Policy Paper 2012/08; Anna Kocharov (ed.), 'Another Legal Monster? An EUI Debate on the Fiscal Compact Treaty', EUI Working Paper Law 2012/09; Edoardo Chiti, Gustavo Teixeira, 'The Constitutional Implications of the European Response to the Financial and Public Debt Crisis' (2013) 50 *Common Market Law Review* 683.

12 Art.11 Treaty on European Union; see Michael Dougan, 'What are we to make of the citizens' initiative?' (2011) 48 *Common Market Law Review* 1807.

13 Public Opinion in the Europen Union, Standard Eurobarometer 79/Spring 2013 – TNS Opinion & Social.

14 Proposal for a Directive of The European Parliament and of the Council on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union, Strasbourg, 11.6.2013, COM(2013) 404 final.

words, this paper raises the question, puts forward the argument, thus, it opens the Pandora's box. However, it does not yet have any panacea to offer. Throughout the paper the focus of attention stays primarily in Union competition law. Nevertheless, the key assumptions and conclusions are applicable to other fields of neo-liberal network governance. The paper first deals with the characteristics of network governance that make networks prone to legitimacy issues and then looks into governance in Union competition policy before closing with tentative conclusions. The conclusions particularly point out to the increasingly technical discourse of competition law that excludes certain societal actors, such as the consumer organisations from the policymaking process. It is further argued in the conclusions that the competition network has the potential of serving as a platform of deliberative democracy, by adopting a more accessible discourse and including those societal actors in the policymaking process.

2. What is meant by 'network' and what is meant by 'legitimacy'?

Before addressing the propensity of network governance to legitimacy issues, we need to define what is meant by network and what is meant by legitimacy. Networks are flexible and fluid platforms for interaction between multiple individuals or organisations that share a common attribute or interest. Networks provide an alternative governance structure to both markets and hierarchies, thus, are contrasted to them most of the time.[15] Markets regulate private interactions between individuals on the basis of contracts, whereas hierarchies regulate public interactions on the basis of strict command and control mechanisms. Networks stand somewhere in between: we see networks in the regulation of private as well as public life. Family and other similar social platforms are forms of networks that individuals rely on in the regulation of their private life, whereas networks between bureaucrats and otherwise policy experts regulate public interactions. The focus of this paper is the latter types of networks. Networks are neither as rigid as hierarchies nor are

[15] See e.g. Walter W. Powell, 'Neither Market nor Hierarchy: Market Types of Organisation' in Grahame Thompson (et al. eds.), *Markets Hierarchies and Networks: The Coordination of Social Life* (Sage 1994).

they as fluid as markets: they are flat organisations in which individuals mostly have an equal say and power; and they tend to have a stable nature as their members need constant cooperation and information from each other.

The particular kind of networks between bureaucrats involved in policymaking and enforcement, in other words 'policy networks', are defined as 'complex and dialectical relations between multiple and mutually dependent actors which take part in the making and enforcement of policies.'[16] This abstract and complex definition emphasises three different characteristics of networks: i) bureaucrats and other individuals that partake in networks need each others' cooperation, thus, they are interdependent; ii) networks do not fit to the traditional governance templates of markets and hierarchies, thus, they are complex; iii) networks involve in the making and enforcement of policies.

Legitimacy, on the other hand, is not as easily defined particularly when complex neo-liberal economic governance is at stake. The literature offers several alternative approaches; and ultimately one faces a choice between Weberian and post-Weberian alternatives. This choice can be made purely on a normative basis, as legitimacy as a concept has fundamental political connotations. Alternatively, the subject matter of analysis may dictate a certain approach due to that approach's superior explanatory potential in the particular matter. The Weberian approach takes the society's belief and content as the main reference point of legitimacy: in other words, according to this approach, if people, as subjects of policies and politics, believe that those in power are legitimate to have power, then those in power are considered legitimate power holders.[17] As a result, the policies and actions of those in power also enjoy legitimacy.

Beetham provides an excellent critique of the Weberian approach in which he argues that this approach 'empties the concept of any objective or moral content'; and that it unintentionally gives undemocratic

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16 Firat Cengiz, 'Management of Networks between the Competition Authorities in the EC and the US: Different Polities, Different Designs' (2007) 3 *European Competition Journal* 413.

17 Max Weber, 'Bureaucracy' in H. H. Gerth and C. Mills Wrights (eds.), *Max Weber, Essays in Sociology* (Routledge 1948).

power-holders a convincing argument to use against their opponents[18]: notwithstanding how power has been acquired and the way it has been used, if those in power can create approval in the eyes of the subordinate through any means, including propaganda, then they would be deemed legitimate power-holders. Beetham then goes on to argue: 'power is legitimate where the rules governing it are justifiable and rightful; legitimacy entails *moral justifiability* of power relations.'[19] Nevertheless, this does not mean that we have to engage in endless debates of political philosophy to comment on the degree of legitimacy in any given power relationship, since Beetham provides some further clarification and guidelines as to when power is held legitimately. According to those principles, for any given power relationship to be legitimate: i) it must conform to established rules, ii) those rules must be justifiable by reference to the beliefs of both dominant and subordinate, iii) there must be evidence of consent by subordinate to the particular power relation.[20] In this paper I take Beetham's principles as the key guiding principles of legitimacy. This is not only because I find Beetham's approach more convincing than the Weberian approach, but also because his concrete guiding principles provide an excellent template for the analysis of any type of governance structure.

A brief summary of political power relationships in the modern democratic state governed by the rule of law makes the guiding principles even more concrete: in a nation state political power is acquired by governments and parliaments through popular elections held in accordance with constitutional rules and standards. Political institutions and the majority of society share a fundamental belief in those rules and standards. This is notwithstanding a potential marginal fraction of society who might disagree with some constitutional standards and principles or reject them altogether. The majority of the society shows its consent to the power relation at the macro level through the social contract underlying the making of the constitution and at the micro level by partaking in political elections.

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18 David Beetham, *The Legitimation of Power* (Palgrave 1991), 9.

19 Ibid., 5.

20 Ibid., 16-18.

One important element to add to Beetham's guiding principles is the essential relationship between accountability and legitimacy. Following Bovens, accountability can be defined as the relationship between the power-holder and a forum (that in democratic nation states most typically is a court or the parliament) in which the power-holder needs to explain conduct, the forum can pose questions and pass judgment, and the actor may face consequences.[21] In neo-liberal governance legitimacy and accountability are strongly connected: rules and institutions enjoy greater legitimacy in the presence of independent control and review mechanisms that individuals can utilise when they are not happy with the outcomes. In other words, strong accountability forums provide an alternative to political elections through which the society can take the power away when it is not happy with how it is used.

At the macro political level the European Union does not sit comfortably with this template. This is because the Union has a sui generis supranational institutional structure, whereas the template and our ideals about legitimacy in general are very much informed by representative democracy in the nation state. The debate on the legitimacy of Union's political structure and institutions is rich and ever growing.[22] The essence of this debate is whether indirect citizen representation in the Union institutions provide sufficient basis for legitimacy or should the direct representation mechanisms at the Union level be strengthened. I will not go into the discussion of legitimacy in the Union's institutional structure here. My focus is network governance that is an as vital a pillar of Union's governance. Nevertheless, some key issues in Union's institutional structure, such as the European Parliament's policymaking powers are also key for the purposes of this paper, thus, will be discussed albeit to the extent necessary for the discussion of network governance.

3. Why is network governance not so legitimate?

So, why is network governance prone to legitimacy issues? The answer is simple: network governance has emerged naturally in response

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21 Mark Bovens, 'Analysing and Assessing Accountability: A Conceptual Framework', (2007) 13 *European Law Journal* 447.

22 See Hix; Moravcsik (n. 10).

to the needs and requirements of neo-liberal economic governance as briefly summarised in the introductory part of this paper. Networks provided an alternative and an additional mechanism to the existing traditional governance mechanisms of the nation state – in other words, governance through cooperation and checks and balances between the legislature, executive and the judiciary. Also, network governance has significantly different characteristics from those of the traditional governance mechanisms. Thus, the legitimacy template created for the traditional governance mechanisms of the nation state falls short of catching regulatory networks. In other words, the Union governance at the macro level and network governance at the micro level suffer from legitimacy issues for the very same reason. This is why the legitimacy issues are even exacerbated when it comes to network governance in the Union: as it will be discussed briefly below, the multi-level nature of network governance in the Union render networks even more fluid and opaque.

Networks do not sit comfortably with the legitimacy template of the nation state, because they stretch policy choices and outcomes away from the citizens and their political choices as reflected in the results of political elections. Thus, networks particularly conflict with two guidelines suggested by Beetham's legitimacy framework: they do not fully conform with the established constitutional rules and standards of the polity; and there is no explicit evidence of consent by citizens to the policymaking powers held by networks. This is the result of certain idiosyncrasies of network governance.

Members of regulatory networks are officials of independent regulatory institutions. These institutions enjoy delegated policymaking powers from parliaments due to their technical and scientific expertise in the field. However that very scientific expertise render the political control of their actions by the parliament extremely difficult. In short, parliaments have a principal-agent relationship with regulators; and they suffer from information asymmetries in holding regulators to account as a political accountability forum.[23] When regulators form networks and take action on the basis of cooperation with other network members, the

[23] Katharina Spraull; Dorothea Greiling, 'Accountability and the Challenges of Information Disclosure' (2010) 34 *Public Administration Quarterly* 338.

information asymmetries become graver, as parliaments do not enjoy access to those networks.

Further exacerbating the principal-agent problems, networks suffer from the so-called problem of 'many hands'.[24] In other words, they produce policies on the basis of communication and coordination between various authorities and individuals that partake in them. Also, networks are not subject to general procedural standards, and in particular transparency standards of traditional administrative law. Thus, they enjoy flexibility in the design of their own cooperation mechanisms and the degree of information they share with the outside world with regard to how cooperation takes place within the network. In other words, as a general characteristic, networks tend to be opaque. Coupled with the problem of many hands, opacity renders it difficult to locate individuals responsible for certain actions and to reveal their rationale that resulted in the particular action.

Opacity and the problem of many hands render networks in multi-level polities, such as the European Union, even more complex. This is because multi-level networks accommodate authorities and officials from the Member State as well as the Union levels. However, networks do not involve any hard boundary or official cooperation mechanisms between their members. Thus, they do not sit comfortably with the constitutional template of Union-Member State relations. Due to their opaque and multi-level nature they create multiple principal-agent problems: it becomes extremely difficult to locate the accountability forum that should primarily be responsible to raise questions regarding a particular action taken by the network.[25]

Networks rely on soft informal coordination mechanisms and they produce policy outcomes mostly in the form of soft law and soft coordination. Thus, even in the unlikely scenario of networks facing questions before judicial or political accountability forums, they are very unlikely to be successfully held to account. Their jellyfish like

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[24] Dennis F. Thompson, 'Moral Responsibility of Public Officials: the Problem of Many Hands' (1980) 74 *American Political Science Review* 905.

[25] Firat Cengiz, Multi-Level Governance in Competition Policy: the European Competition Network (2010) 5 *European Law Review* 660, 672.

characteristics make them very difficult to be caught by traditional judicial and political review standards.

Networks speak with an extremely technical language. The common scientific language used by network members constitutes one of the key underlying foundations of the network discourse. Constant interaction with the epistemic community (in other words, the community of scholars, scientific experts, legal and economic counsel) surrounding the network is likely to render the language used by network members even more technical and complex.[26] As a result, policies that profoundly affect people's everyday lives become inaccessible to ordinary members of the public. This further exacerbates the legitimacy issues, as members of public become unable to evaluate if certain policies serve their best interest or not.

Finally, networks and regulatory authorities composing them make and enforce policies that might easily result in a trade off in the welfare of different groups affected by the policies, such as businesses and consumers. In other words, networks might have 'legitimacy clienteles' with different or even opposing interests.[27] As a result, extra effort is required to sustain and prove policy legitimacy, as policies need to serve the general public interest, rather than the interests of particular group(s), to be considered legitimate. Moreover, different societal groups might enjoy unequal access to networks. For instance, businesses are more likely to have regular access to networks through their economic and legal counsel who are members of the epistemic community surrounding the network and who are in regular contact with regulatory authorities and officials.[28] Citizens, on the other hand, do not enjoy the same level of access, because they are very much unlikely to identify and appreciate the impact of the technical policies on their lives.[29] Additionally, due to the complexity of networks they are unlikely to identify who is responsible for those policies. Naturally, policymaking through regular

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26 Firat Cengiz, *Antitrust Federalism in the EU and the US*, (Routledge 2013), 195.

27 Julia Black, 'Constructing and Contesting Legitimacy and Accountability in Polycentric Regulatory Regimes' (2008) 2 *Regulation & Governance* 137.

28 John Braithwaite, Peter Drahos, *Global Business Regulation* (CUP 2000), p.501.

29 Mancur Olson, Jr., *The Logic of Collective Action: Public Goods and the Theory of Groups* (Harvard University Press 1974), 141-48.

political institutions enjoy similar caveats. Laws and regulations adopted by parliaments also create winners and losers. Different pressure groups enjoy unequal lobbying power before parliaments. Nevertheless, those caveats become more prevalent in regulatory networks: the technical language used by networks might conceal the winners and losers of policies. Likewise, since unlike parliaments networks are not subject to transparency rules, issues of unequal access become graver.

4. Alternative legitimacy templates for networks?

As explained in the preceding part, the majority of the legitimacy issues of networks are caused by their idiosyncrasies that do not fit to the legitimacy template of the nation state. Thus, when political scientists discovered the legitimacy issues of network governance they looked for alternative legitimacy templates that reflect network characteristics better.

Perhaps the most famous of those templates is the distinction between input and output legitimacy offered by Scharpf.[30] This distinction has been used extensively not only by proponents of network governance but also by proponents of the regulatory state in general to argue that technical neoliberal market regulations enjoy legitimacy after all.[31] In this template input legitimacy refers to the conventional mechanisms of citizen participation created by representative democracy. Output legitimacy, on the other hand, refers to the effectiveness and efficiency of policies created by expert independent authorities. Those authorities do not score well in input legitimacy, nevertheless, they achieve superior policy outcomes due to their technical expertise which attributes them output legitimacy.

Also, it has been suggested that if meta-governance rules of the networks have been clarified and if networks are made subject to certain procedural standards (so-called 'fire alarm mechanisms') ensuring that networks follow the meta-governance rules the legitimacy issues would

30 Scharpf (n.9).

31 Majone (n.5); Giandomenico Majone, *Regulating Europe* (Routledge 1996), 284-301.

automatically be ameliorated.[32] Those meta-governance rules could substantive, such as economic efficiency as the broad policy aim as well procedural, such as the rule of law and human rights to be observed by networks in their actions. The argument for procedural legitimacy is at times presented as an alternative or an addition to the dichotomy of input and output legitimacy. For instance, Vivien Schmidt offers a trilogy of input, output and throughput legitimacy in which throughput refers to procedural legitimacy.[33]

Some accounts dispute the legitimacy deficit of networks altogether. These accounts argue that networks score low in legitimacy only when one views them from the perspective of representative democracy. On the contrary, if one takes the alternative view of participatory democracy, the legitimacy of networks would appear much less disputed. This is because networks are not subject to the straightjackets imposed by everyday politics; thus, they have the potential of serving as open platforms for meaningful discussions between policymakers and representatives of different societal groups affected by policies.[34] As a result, networks can be argued to materialise Jürgen Habermas' deliberative democracy model.[35]

Finally, alternative models have been offered to reduce the accountability deficit of networks. For instance Scott offers the interdependence and redundancy models as alternative for accountability in the regulatory state.[36] In the former model, authorities who rely on each others' resources keep each other to account; whereas in the latter one-to-one contract based relations between actors create a whole web of accountability, thus, displacing the need for an overarching accountability forum. Additionally, with regard to network governance in the European Union specifically, it has been argued

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32 Majone, ibid., 291-96.

33 Vivien A. Schmidt, 'Democracy and Legitimacy in the European Union Revisited: Input, Output and "Throughput"' (2013) 61 *Political Studies* 2.

34 Eva Sorensen; Jacob Torfing, 'Theoretical Approaches to Democratic Network Governance'; Allan Dreyer Hansen (2008), 'Governance Networks and Participation' both in Eva Sorensen; Jacob Torfing *Theories of Democratic Network Governance* (Palgrave 2008).

35 Jürgen Habermas, *Between Facts and Norms: Contributions to a Discourse Theory of Law and Democracy* (MIT Press 1996); *The Structural Transformation of the Public Sphere: An Inquiry into a Category of Bourgeois Society* (Polity Press 2005).

36 Colin Scott, 'Accountability in the Regulatory State' (2000) 27 *Journal of Law and Society* 38.

that multi-level networks can be hold effectively to account by forming similar multi-level networks between accountability forums that would avoid the boundary problems between those forums and create a culture of cooperation and coordination instead.[37]

Nevertheless, none of these templates succeeded in offering a convincing alternative to the existing templates of the nation state. Output legitimacy arguments relying on scientific expertise are criticised for being exclusionary and technocratic. For instance, Beetham strongly rejects such arguments, as they are based on the illusion that issues with a profound impact on citizen welfare are merely technical policy issues devoid of any political content:

> '…science could provide a definitive and non-controversial basis to social rules of power was premised on the assumption that all issues of social organisation in the industrial age could be reduced to technical questions of production. For all the prestige of science today, this conception of a wholly de-politicised social and legal order is in principle unattainable, despite the frequent recurrence of technocratic illusions to this effect.'[38]

Likewise, output legitimacy arguments are much less convincing after the financial crisis as admitted by Sharpf himself, who designed the input-output legitimacy model.[39] The fact that officials with scientific expertise were not able to see the crisis coming and that they were not able to address the results of the crisis effectively created a fundamental distrust in the society to white collar regulators. This was particularly so in the European Union since the Union had already suffered from the infamous legitimacy deficit even before the crisis, and since the multi-level nature of this polity provides a hospitable environment for blame shifting between the national and Union authorities and officials. Under such opacity, citizens cannot locate those who are responsible for bad policy choices. This is not to say that the crisis and its aftermath were primarily the responsibility of economic regulators and that political institutions had no role to play in this process. The reality, as far as the

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37 Carol Harlow and Richard Rawlings, 'Promoting Accountability in Multilevel Governance: a Network Approach' (2007) 13 *European Law Journal* 542.

38 Beetham (n.18) 74.

39 Fritz W. Scharpf, 'Legitimacy Intermediation in the Multilevel European Polity and Its Collapse after the Euro Crisis', Max Planck Institute for the Study of Societies Discussion Paper 12/6.

European Union is concerned, is quite the contrary as the Member States were primarily responsible for the institutional architecture of the monetary union. Nevertheless, political institutions and independent regulators are merged in the minds of the members of public. And the public is now less convinced than ever that the new white-collar ruling class adopts policies that serve the society's best interest, because they have superior scientific expertise.

The arguments for procedural control and meta-governance (or throughput as conceptualised by Schmidt) are very much context and network dependent. Networks mostly emerge through soft cooperation mechanisms. Thus, states or the Union political institutions may not always enjoy leverage to determine meta-governance rules or procedural standards of network governance. Likewise, networks themselves determine to what extent they provide an open platform for different groups affected by policies. In other words networks have the ultimate power to make the decision whether or not they will satisfy the conditions of deliberative democracy. Their degree of inclusiveness depends most crucially on the substantive policy context and to what extent they need societal actors' cooperation in policy enforcement.[40] For instance, networks between equality agencies are naturally expected to be inclusive and transparent to groups that suffer from inequalities. On the other hand, networks between economic regulators and competition authorities tend not to be particularly open to consumer/citizen groups due to the technical network discourse that might also involve discussions of sensitive and confidential issues.

Alternative accountability mechanisms for networks, although appear creative in theory, have not been tried and proven to be effective empirically. Scott's interdependence and redundancy models might not prove as effective under certain circumstances: although it is likely that officials who share the same scientific knowledge and language might keep each other on their toes, they might also get locked in the cosy network environment and lose contact with citizens and consumers.[41] Likewise, a

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[40] J.J. Richardson and AG Jordan, *Governing under Pressure: the Policy Process in a Post-Parliamentary Democracy* (Blackwell Publishing 1985).

[41] Arthur Benz, 'Accountable Multi-level Governance by the Open Method of Coordination?' (2007) 13 *European Law Journal* 505, 512; Guy Peters and Jon Pierre 'Multi-level Governance and Democracy: a Faustian Bargain?', in Ian Bache and Matthew Flinders (eds.), *Multi-level Governance*, (OUP 2005).

shared discourse and a shared devotion to neo-liberal economic theory and models might result in over-confidence that prevents officials from predicting some undesirable consequences of their policy choices. On the other hand, accountability networks between political and judicial accountability forums of different levels are not very likely to work unless they are supported with hard-law: law needs to determine the principles of work division and cooperation between courts, parliaments and other accountability forums. Ultimately, if the meta-governance rules and procedural standards of networks are not determined in a way applicable by accountability forums, those forums will not be able to perform their task effectively even acting as a network.

So, what is the panacea for the legitimacy issues facing network governance? As emphasised in the introduction, I have no perfect solution to offer in this paper. The key message of this paper is that network governance and the regulatory state in general suffer from an even graver legitimacy deficit post-financial crisis. Political science has not yet developed a convincing alternative to the legitimacy template provided by the nation state and its representative and participatory democracy. Thus, we need to reconsider the involvement of citizens and political and judicial institutions in the making of technical economic policies. Naturally, we need to find a way short of political and judicial coercion so that politics and judicial politics do not prevent the adoption of sound economic policies. Nevertheless, checks and balances should be introduced or the existing ones should be strengthened to make sure that those policies are indeed sound. On the other hand, citizens need to be anchored to policies that affect their welfare at the early policymaking stage, so that they will be able to identify and appreciate the impact of the policies; that they can correctly identify the authorities responsible for those policies; and that they can initiate action before accountability forums when they are not happy with the policy outcomes. Depending on the policy in question and the costs of different methods, such citizen involvement could materialise either by talking to groups of citizens directly or talking to them indirectly through civil society and parliamentary committees. The next section looks into the reform of EU competition law from this perspective.

5. Network governance, reform and legitimacy in european union competition law regime

Competition law, broadly speaking, aims at preventing cartels, monopolistic behaviour and anticompetitive mergers that raise prices and/or reduce consumer choice. These kinds of economic behaviour are considered inefficient and detrimental to the functioning of the liberal market economy.[42] The general aims of competition law overlap with public interest, thus, their legitimacy is beyond dispute. Nevertheless, when one goes into the detail the connection between the aims of competition law and public interest becomes less obvious: economic theory is unanimous with regard to the inefficiency of certain anticompetitive activities, such as cartels. On the other hand, there is ambivalence with regard to the efficiency effects of monopolistic behaviour as well as horizontal and vertical agreements between firms that although fall short of a cartel, might result in reduced competition. As a result, different competition law regimes treat these kinds of behaviour differently: for instance, the American antitrust regime requires much stronger economic evidence than the European competition law regime to rule on the existence of monopolistic behaviour.[43] Most notably, in contrast to European law, American law does not prohibit the so-called exploitative abuses (such as unfair prices or discrimination) as a category. American law is similarly more lenient than European law towards vertical agreements, including minimum price agreements that are considered efficiency enhancing.[44] Merger analysis, on the other hand, is forward looking by nature, thus, requires hypothetical economic and econometric analysis and modelling, including simulation models, to forecast the market structure after the merger.

In summary, preventing inefficient behaviour appears a legitimate policy aim, at least as far as one takes a neo-liberal economic approach. Nevertheless, different regimes might disagree with regard to what

42 Massimo Motta, *Competition Policy* (CUP 2005), 9-30.

43 Eleanor M. Fox, 'US and EU Competition Law: A Comparison', in Edward Montgomery Graham, J. David Richardson (eds.), *Global Competition Policy* (Institute for International Economics 1995).

44 Thomas A. Lambert, 'A Decision-Theoretic Rule of Reason for Minimum Resale Price Maintenance' (2010) 55 Antitrust Bulletin 167; *Leegin Creative Leather Products, Inc.L v. PSKS, Inc.*, 551 U.S. 877 (2007).

constitutes inefficient behaviour and they might rely on different techniques to determine whether or not such inefficient behaviour has actually taken place. Similarly, there is a strong connection between the dominant economic ideology of the time and competition law. This connection resulted in the emergence of different schools, most notably the Harvard, Chicago and post-Chicago Schools in the US and the Ordoliberal School in Europe, that were dominant at different times and that relied on different policy objectives.[45]

The particular policy aim(s) of competition law in the context of the European Union have been more ambivalent and are yet to be settled. In the early years, there was a strong connection between the single market objective and competition law.[46] This was criticised harshly for imposing straightjackets on business models and practices. The epistemic community and businesses that were increasingly informed about the American experiences have been vocal about their discontent with the European competition law regime.[47] Largely responding to this discontent, since the late 1990s Union competition law has been subject to a substantial reform process that oriented the enforcement of competition law towards a neo-liberal economic approach.[48]

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45 Philip Mirowski, Dieter Piehwe (eds.), *The Road from Mont Pelerin: The Making of the Neoliberal Thought Collective* (*Harvard University Press* 2009); Robert Pitofsky (ed.); *How the Chicago School* Overshot the Mark: *The Effect of Conservative Economic Analysis on U.S. Antitrust* (OUP 2008); Yannis Karagiannis, 'The origins of European competition policy: redistributive versus ideational explanations', (2013) 20 *JEPP* 777.

46 David J. Gerber, 'The Transformation of European Community Competition Law' (1994) 35 *Harvard International Law Journal* 97, 143.

47 Cengiz (n.26), 157.

48 The reforms affected all substantive as well as procedural aspects of European competition law. European policy of vertical agreements were reformed with the Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices, [1999] OJ L 336, that was later replaced with the Commission Regulation 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices, [2010] OJ L 102. European policy of abuse of dominance was reformed with the Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, [2009] OJ C45/7. See also DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Brussels, December 2005. European merger policy was primarily reformed with See Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, [2004] OJ L 24/1, Art.2(2) that introduced the significant lessening of competition test to substantive merger evaluation. Finally, the enforcement of Union competition rules were reformed with the Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the

Nevertheless, the underlying objective of Union competition law is still subject to disagreement between Union institutions: most notably, the Court of Justice of the European Union has not been particularly supportive of economic efficiency as the primary objective but is still devoted to single market as a valid objective of Union competition law.[49]

Union competition rules are primarily enforced by the Directorate General for Competition of the European Commission. The Commission also enjoys delegated policymaking powers from the Member States and the Union legislature that includes the European Parliament as well as the Member States represented in the Council.[50] Similarly, national competition authorities of the Member States, although significantly differing between the current twenty-eight member states in terms of their structure, powers and resources are subject to principal-agent relations with their national governments and parliaments. They also enjoy authority to enforce Union rules against anticompetitive agreements and the abuse of dominance.[51] National authorities cooperate with each other and the European Commission in the framework of the 'European Competition Network'.[52] Nevertheless, in this network the Commission enjoys a superior managerial position.[53] Likewise, Union law and case-law of the Union courts require national authorities to respect and follow the interpretations of competition rules by the Commission and the Union courts.[54]

European Competition Network was first established as an enforcement network to support decentralised enforcement of Union

rules on competition laid down in Articles 81 and 82 of the Treaty, [2003] OJ L1/1, that decentralized the enforcement of competition rules and increased the administrative discretion of the European Commission.

49 See e.g. C-501, 513, 515, 519/06, *Commission v GlaxoSmithKline*.

50 See Council Regulation No 19/65/EEC of 2 March 1965 on application of Article 85 (3) of the Treaty to certain categories of agreements and concerted practices Official Journal 36, 6.3.1965, p. 533–535: Council Regulation (EC) No 1215/1999 of 10 June 1999 amending Regulation No 19/65/EEC on the application of Article 81(3) of the Treaty to certain categories of agreements and concerted practices. Official Journal L 148, 15.6.1999, p. 1–4.

51 See Regulation 1/2003 (n.48), Art.3(1).

52 Commission Notice on cooperation within the Network of Competition Authorities (2004/C, 101/03).

53 Cengiz (n.26), 159-166.

54 Regulation 1/2003 (n.48), Art.16; C-344/98, *Masterfoods Ltd. V. HB Ice Cream Ltd.* [2000] ECR I-11369, para.51; C-234/89, *Delimitis v. Henninger Bräu* [ECR] I-935, para.41; C-453/99, *Courage Ltd. V. Bernard Crehan and Bernard Crehan v. Courage Ltd. and Others* [2001] ECR-I 6297.

competition rules. The network would provide a platform for cooperation between competition authorities, thus, prevent inconsistent enforcement.[55] In contrast to many other multi-level networks, this network has a juridified structure. The European Commission had determined the network's cooperation mechanisms in detail before it even came to existence as a safeguard against uncertainties involving decentralised enforcement.[56] Nevertheless, most of the network rules are determined in soft law, thus, are not enforceable by the Union Courts.[57]

Although the network was first established as a policy *enforcement* network, it has also functioned as a policy *making* network.[58] The Commission claims that the network has been particularly operational in the reform of the enforcement of Art.102 Treaty on the Functioning of the European Union (the Union rule against the abuse of dominance) and in the preparation of the proposed Directive for the private enforcement of competition rules through damages actions.[59] The reform of Art.102 took place through a deliberation process with stakeholders consisting mostly of businesses and the legal services industry as well as the epistemic community of legal and economic scholars. Then, the Commission declared its changed enforcement priorities towards a more neo-liberal economic approach through a soft law document.[60] In other words, Union political institutions and consumers and their representatives have not been particularly active in this process.

Naturally, reform of competition rules and their enforcement through network governance constitutes an efficient alternative to

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55 Notice on Cooperation within the Network of Competition Authorities (n.52), para.3.

56 Cengiz (n.26), 158.

57 T-340/03, *France Telecom SA (formerly Wanadoo Interactive SA) v Commission of the European Communities* [2007] ECR-II 107.

58 Cengiz (n.25), 667-71.

59 European Commission, Report on Competition Policy 2005 SEC(2006) 761 final, paras.202-206. See also Communication from the Commission to the Parliament and the Council, Report on the Functioning of Regulation 1/2003, Brussels 24.9.2009, COM(2009) 206 final; Commission Staff Working Paper accompanying the Communication from the Commission to the Parliament and Council, Brussels, 24.9.2009, SEC(2009) 574 final.

60 Communication from the Commission: Guidance on its enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings, OJ C 45, 24.2.2009, p.7–20.

political reform through legislation. This also prevents technical economic matters being opened to politicisation. Nevertheless, such reform process satisfies the conditions of legitimacy as long as reforms stay within the technical 'policy' realm and do not touch on broader political issues that require the involvement of political institutions and deliberation with different citizen groups. The reform of competition rules in the light of neo-liberal economic model is very much connected to the broader political objective of making Europe worlds' most competitive economy in the framework of the European Union's Lisbon and the Europe 2020 Agendas.[61] Nevertheless, this connection is hardly observed by the epistemic community that relies on an extremely technical discourse and communicates with the broader governance issues at a minimum level.[62] The legitimacy of the reform process appears questionable in the light of the connection with the broader economic policy objectives.

This is not to say that the Commission and the network have high jacked the reform process and made it deliberately inaccessible to political institutions and societal actors. On the quite contrary, political institutions of the Union, particularly the European Parliament, have not been as fierce in the field of competition law as they have been in other fields to increase their authority against the other Union institutions. For instance, policymaking in the area of competition law is one of the very few areas still subject to special legislative procedure that only requires consultation with the European Parliament. The minimal involvement of the Parliament appears particularly puzzling when one considers that the Treaty defines competition as exclusive Union competence. In any case policymaking in competition law takes place largely through soft-law and soft coordination within the network. Legislation is exception apart from block exemption regulations adopted by the Commission under delegated authority from the Union legislature.

As a result, the proposed Directive for private enforcement through damages actions will be a test case for the Union legislator's and in particular the Parliament's engagement with issues related to competition law. The Commission needed to address the issue of private

61 Herbert Buch-Hansen, Angela Wigger, *The Politics of European Competition Regulation – A Critical Political Economy Perspective* (Routledge 2011).

62 Cengiz (n.25), 676.

enforcement with legislation rather than soft-law, as the Commission's private enforcement agenda required harmonisation of otherwise intimate standards of national procedural law. Treaty provisions on competition law (Art.103) do not give the Commission the power to harmonise national standards, thus, internal market rules (Art.114 TFEU) are chosen as the main basis of the Directive. Since internal market rules require legislation through ordinary legislative procedure, the adoption process of the Directive provides an exceptional opportunity for the European Parliament to be involved in competition issues. Nevertheless, since the primary objective of the Directive is the harmonisation of national procedural standards, the debate in the Parliament will most probably revolve around issues such as subsidiarity, national procedural autonomy and the Union competences for the harmonisation of national standards, rather than substantive competition law issues.

Similar to the Union legislator, the role of civil society organisations representing consumer interests has been limited in the reform process. In contrast to business organisations, consumers as a disperse group with incremental individual stake in policy outcomes and limited resources suffer from collective action problems in access to policymaking. Thus, they fundamentally rely on civil society organisations to represent their interests. Civil society organisations themselves enjoy debatable legitimacy and accountability particularly when they are geographically and organisationally distant from the citizens they represent.[63] Nevertheless, in the presence of collective action problems, they still provide a second best option for consumer participation to policymaking.

In Union policymaking, consumer interests are represented to a large extent through the European Consumers Consultative Group that was set up by a Commission decision in 2003. The Consultative Group brings together representatives of national consumer organisations of the Member States and the European Economic Area observers as well as one member from the European Consumers' Organisation (BEUC) and one member from European Consumer Voice in Standardisation

[63] Andrew Arato, *Civil Society, Constitution and Legitimacy* (Rowman & Littlefield 2000); Thomas Persson, 'Civil Society Participation and Accountability', in Skerver Gustavsson (et al. eds.), *The Illusion of Accountability in the European Union* (Routledge 2009).

(ANEC).[64] In 2009 a competition sub-group was established under the framework of the Consultative Group. Naturally, like any societal actor, the Consultative Group as well as its individual members could actively voice the consumer interests and perspectives by responding to European Commission's policy initiatives and green and white papers. For instance, the Consultative Group responded to the European Commission's White Paper on damages actions[65] and it also discussed the proposed Directive for private enforcement.[66] Likewise, BEUC individually responded to the Commission's Green and White Paper on damages actions as well as its reform of Art.102 TFEU. In addition to its participation to policymaking, BEUC also responds to enforcement actions: for instance, it has recently voiced concerns against the Commission's proposed settlement in the Art.102 investigation against Google.[67] Nevertheless, still, consumer representation in policymaking appears less than limited compared with business representation. For instance, BEUC and the UK consumer organisation Which? were the only consumer representatives contributing to the deliberation process regarding private enforcement.[68] Similarly, BEUC was the only consumer representative contributing to the deliberation process of the reform of Art.102.

In addition to the limited involvement of Union institutions and organisations representing consumer interests, the technical reform discourse as well as the increased technicality in the enforcement of competition law after the reforms jeopardise the legitimacy of competition law. The reforms promised a competition law that is based on sound economic principles and models and that does not interfere

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64 See <http://ec.europa.eu/consumers/empowerment/eccg_en.htm> (visited 9 December 2013).

65 European consumer consultative group – Opinion on private damages actions, available at <http://ec.europa.eu/consumers/empowerment/docs/ECCG_opinion_on_actions_for_damages_18112010.pdf> accessed 9 December 2013.

66 European Commission, Health And Consumers Directorate-General, Minutes of the European Consumer Consultative Group (ECCG) meeting 11 June 2013 (09.30 - 17.30), 12 June 2013 (09.00 - 13.00), available at <http://ec.europa.eu/consumers/empowerment/minutes/minutes_11-12062013_en.pdf> accessed 9 December 2013.

67 Google Internet Search Case – BEUC Response to the Market Case, available at <http://www.consumerwatchdog.org/resources/beucgoogle052413.pdf> accessed 9 December 2013.

68 Hikaru Yoshizawa, 'Towards Regulatory and Yet Democratic Governance? Consumer Involvement and the Legitimacy of EU Competition Policy', paper presented at the 14th UACES Student Forum Research Conference, 8-9 July 2013, Lougborough University.

with the functioning of the liberal market economy more than necessary. Consumers and the concept of 'consumer welfare' have been identified as the key objectives of reforms.[69] This substantial reliance on the concept of consumer welfare masks the potential trade offs between the businesses and consumers that the reforms might cause. For instance, in the context of the reform of Art.102 TFEU the Commission declared that it intends to investigate only abuses that result in 'inefficient' exclusion, in other words, exclusion of a so-called 'as efficient competitor' that results in a price increase or output decrease.[70] In other words, certain types behaviours that were considered harmful before are not considered so anymore. Likewise, after the reforms increased technical economic evidence proving inefficient exclusion is required for the enforcement of competition rules by the Commission as well as national competition authorities and the national courts who are required to follow the same standards. This implies at least increased enforcement costs for consumers as well as small businesses that might not have access to technical economic expertise.

Additionally, in contrast to the redundant reliance on the concept of the concept of consumer welfare in the reform discourse, after the reforms competition law has become less consumer-friendly due to extreme technicality in the language of competition law. Due to the increased involvement of economic theory and modelling, the debates of competition law have become less and less accessible to the legal community let alone lay members of the public. This is not to say that the reforms have not been plausible from a substantive policy perspective. Nevertheless, the reforms' implications on consumers and the rest of the society required a broader deliberative discourse involving societal actors –and not only network members and members of the epistemic community– for the reforms to enjoy unquestionable legitimacy. The increasingly technical language of competition law prevents the emergence of such deliberative discourse.

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69 See Communication from the Commission (n.60); Report by the EAGCP, 'An economic approach to Article 82', July 2005, available at <http://ec.europa.eu/dgs/competition/economist/eagcp_july_21_05.pdf> accessed 9 December 2013; European Commission, DG Competition, discussion paper on the application of Article 82 of the Treaty to exclusionary abuses, Public consultation, Brussels, December 2005, available at <http://ec.europa.eu/competition/antitrust/art82/discpaper2005.pdf> accessed 9 December 2013.

70 Communication from the Commission (n.60), paras.19 et seq.

The European Parliament and the Union Courts provide the political and judicial accountability forums of Union competition law respectively. As mentioned above, the European Parliament has historically been less active in the field of competition compared with other policies with a substantial connection with the single market. For instance, the Parliament has not established a special committee focusing on competition policy related issues. The Parliament's involvement in this area has been limited to discussing the Commission's Annual Reports and responding to its policy initiatives. The Union Courts have subjected the European Commission to effective judicial review. Nevertheless, their role as an accountability forum has been subject to certain caveats: first of all, judicial review mainly centres on the European Commission's enforcement actions, rather than its policy initiatives that take place mostly through soft-law and other soft governance methods, including network governance. Secondly, the Union Courts naturally respect the technical expertise of the Commission that resulted in the delegation of enforcement and policymaking authority from the Union legislature to the Commission. The Courts show deference to European Commission's 'margin of appreciation' in the judicial review of Commission decisions applying Union competition rules.[71] Nevertheless, the degree of judicial deference might change from case to case. Additionally, the reform of competition law injected some extra complexity to the enforcement of competition rules.[72] This has caused fragmentation in the judicial voice, as the General Court and the Court of Justice disagree where the Commission's margin of appreciation ends and where the domain of judicial review begins.[73]

All of this is not to say that the Commission and the national competition authorities of the Member States have not made any effort to improve consumer representation in policymaking and enforcement. Since 2003 the Directorate General of Competition of the European

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71 C-28/03 *Holcim (Deutschland) v Commission* [2005] ECR II-1357, para.95, citing C-42/84 *Remia and Others v Commission* [1985] ECR ECR 2545 para.34; C-7/95 *John Deere v Commission* [1988] ECR I-3111, para.34.

72 Firat Cengiz, 'Judicial Review and the Rule of Law in the EU Competition Law Regime After *Alrosa*' (2011) 7 *European Competition Journal* 127.

73 Compare Case T-170/06 *Alrosa Company Ltd. v Commission of the European Communities* [2007] ECR II-0260 with Case C-441/07P *European Commission v Alrosa Company Ltd* [2010] ECR I- 05949.

Commission hosts an in house Consumer Liaison Office that is responsible for communicating with consumer organisations, national competition authorities and other directorates of the Commission in issues involving consumer interests. The Commission has also attempted to make the European Competition Network more transparent by, among other things, publishing regular network briefs communicating news about issues discussed and decisions taken within the network. Additionally, the Commission has recently begun to issue citizens' summaries to make its policy initiatives more accessible for the members of the public.

Nevertheless, the ever-decreasing citizen distrusts in policymaking in the Union particularly by white-collar policy experts imply that strategies need to be developed to anchor citizens more firmly to policies that have a direct impact on them. This is necessary not only for the legitimacy of those particular policies but also for the legitimacy of the Union as a polity. Also, this would result in more effective enforcement particularly through private damages actions, as individuals are unlikely to contribute to the enforcement of policies if they do not have a substantial belief in the legitimacy of those policies.[74]

In this paper I have not (yet) any panacea to offer for increased consumer involvement in competition law. This paper has merely identified the key legitimacy issues in competition law: an increased reliance on soft multi-level governance methods, including network governance and less than optimal participation of institutions and organisations representing consumer/citizens interests, including societal organisations, the European Parliament and the Union Courts. Thus, any solution would primarily involve a reconsideration of the involvement of these organisations and institutions. This is, of course, not to say that competition policy should be open to politicisation and juridification through the regular involvements of the legislature and the judiciary.

Nevertheless, extensive deliberations with the Union political institutions as well as societal organisations representing different interests are indispensible particularly when certain political choices informed by the general economic policy agenda, rather than technical

74 See Beetham (n.18), 28.

policy choices, are made. Likewise, the increased technicality and increased involvement of economics and econometrics appear to be the common cause for the limited access of political and judicial institutions as well as the consumer organisations to competition policy. Thus, not only the European Commission and other competition authorities but also members of the epistemic community need to appreciate that the consumer is supposed to be the ultimate beneficiary of competition law. Consumers need to play not only a passive role as agents in economic models or plaintiffs filling the enforcement void through damages actions, but they need to actively partake in the making of the policies. Thus, competition authorities and the epistemic community need to adopt an accessible language that would avoid making competition law the exclusive domain of an elite group of officials and scientific experts. Likewise, the membership of the competition network could be extended to include consumer organisations and other institutions representing citizen interests when different policy choices with an impact on consumers are discussed. This way the network could fulfil its potential as a post-modern deliberative legitimacy forum.

6. Tentative conclusions

The financial has crisis resulted in fundamental citizen distrust in authorities in charge of economic regulation. Thus, the crisis further jeopardised the already questionable legitimacy of the European Union's multi-level governance regime. The issue of legitimacy cannot be ignored if the Treaty objective of creating an ever closer Union between the peoples of Europe is to remain valid and credible. Anchoring citizens firmly to Union policies that impact citizen welfare is an alternative and potentially more promising strategy than institutional strategies adopted so far to increase the legitimacy of Union governance. Competition policy is a natural candidate to fulfil this task as it directly impacts citizen welfare. Nevertheless, the reform process of the Union competition rules implies that the trend in European competition law has been the opposite: the reforms oriented Union competition rules towards a neo-liberal economic approach without the substantial involvement of either the Union political institutions or societal organisations representing citizen interests. Likewise, the idiosyncrasies of multi-level network governance as well as increased technicality in competition law after the reforms

impede the effectiveness of accountability mechanisms. The increased technicality in the discourse of competition law appears to be the key reason that results in limited access to competition law by the Union political institutions, organisations representing consumer interests and the judiciary. None of this is to argue that the reforms have not been plausible from the substantive policy perspective. Nevertheless, a less technical discourse that is accessible to citizens and more deliberative policymaking processes are required not only to increase the legitimacy of the competition law but also legitimacy in Union governance as a whole.

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Coherence between the internal and external side of the internal European market: The case of the EU-Turkey customs union

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ABSTRACT

This work is concerned with the application of one of the cornerstones of the EU internal market *i.e.* the mutual recognition principle, to products originating outside the EU, particularly in Turkey. This application of the mutual recognition principle raises the question of the boundaries of the coherence between the internal and the external side of the Internal European market, that is, of the legitimate limits of a full and automatic extension of a crucial principle for the achievement and functioning of the internal market to products originating, not in a Member State but in a foreign country. After reviewing those possible limits, this contribution concludes that such an extension seems to be at odds with the Treaty architecture and the case-law of the Court of Justice of the EU.

KEYWORDS: Coherence, Internal And External Side of Internal Market, Free Movement of Goods, Mutual Recognition Principle.

1. Introduction

This work is concerned with the application of one of the cornerstones of the EU internal market i.e. the mutual recognition principle, to products originating outside the EU, particularly in Turkey. The extension of the mutual recognition principle to Turkish products is defended y the European Commission, which also defends the inclusion of EU-Turkey

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mutual recognition clauses in the domestic legislation of EU Member States.[1]

The application of the mutual recognition principle to products originating outside the EU raises the question of the boundaries of the coherence between the internal and the external side of the Internal European market, that is, of the legitimate limits of a full and automatic extension of a crucial principle for the achievement and functioning of the internal market to products originating, not in a Member State but in a foreign country. Such an extension, as will be discussed, seems to be at odds with the Treaty architecture and the case-law of the Court of Justice of the EU.

2. The application of the mutual recognition principle to products originating in turkey

According to the European Commission, 'if a product is manufactured in another Member State, in Turkey, or in an EFTA State that is a contracting party to the Agreement on the European Economic Area, according to the manufacturing rules and methods approved there, it is considered as being lawfully manufactured [for the purposes of the application of the mutual recognition principle]'.[2]

This is so, explains the Commission, because 'Articles 5 to 7 of Decision No 1/95 of the EC-Turkey Association Council of 22 December 1995 on implementing the final phase of the Customs Union (OJ L 35, 13 February 1996, p. 1) provide for the elimination of measures having an effect equivalent to customs duties between the European Union and

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1 See Commission, 'Commission interpretative communication on facilitating the access of products to the markets of other Member States: the practical application of mutual recognition' (2003/C 265/02), OJ C 265/2, 4.11.2003, point 2.2. We focus on this article on the application of the mutual recognition principle to Turkey, leaving aside its application to EFTA countries parties to the EEA agreement. See also for a very recent enunciation of the same principle: Commission. Working Document, 'Guidance document. The concept of 'lawfully marketed' in the Mutual Recognition Regulation (EC) No 764/2008. Brussels, 16.8.2013 COM(2013) 592 final, page 5: 'the principle of mutual recognition also applies to EU-Turkey relations'. See also footnotes 7-8.

2 Commission 'Commission interpretative communication on facilitating the access of products to the markets of other Member States: the practical application of mutual recognition' (2003/C 265/02), OJ C 265/2, 4.11.2003, point 2.2.

Turkey. Pursuant to Article 66 of Decision 1/95, Articles 5 to 7 must, for the purposes of their implementation and application to products covered by the Customs Union, be interpreted in conformity with the relevant Judgments of the Court of Justice. Consequently, principles resulting from the Court of Justice's case law on issues which are related to Articles 28 and 30 of the EC Treaty [today´s articles 34 and 36 of the Treaty on the Functioning of the European Union (TFEU)], particularly the 'Cassis de Dijon' case, apply to the Member States and to Turkey.'[3]

The Decision to which the Commission refers to in the Communication implements the so-called Ankara Agreement, the Association agreement signed by the then EEC and Turkey in 1963.[4] Article 10 of that agreement provided for the progressive establishment of a customs union between the Community and Turkey covering all trade in goods. Such customs union would involve, *inter alia* 'the prohibition between Member States of the Community and Turkey, of customs duties on imports and exports and of all charges having equivalent effect, quantitative restrictions and all other measures having equivalent effect which are designed to protect national production in a manner contrary to the objectives of this Agreement.'[5]

Article 10 was developed by the Additional Protocol to the Ankara Agreement, signed in 1970, which established the conditions, arrangements and timetable for implementing the Agreement. Specifically, the Protocol required the parties to refrain from introducing any new export customs duties and charges having equivalent effect, and from increasing those already in force, unless authorized by the Association Council [a body created by the Association agreement to implement and develop the Agreement]. In addition, under Article 9 of the Protocol, the Community undertook to abolish customs duties and

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3 Commission, 'Commission interpretative communication on facilitating the access of products to the markets of other Member States: the practical application of mutual recognition' (2003/C 265/02), OJ C 265/2, 4.11.2003, footnote 18.

4 See for the history and evolution of the Ankara Agreement Edgard Lenski, 'Turkey and the EU: On the Road to Nowhere?', [2003] 63 ZaöRV 77

5 Publication, in English and in Danish, of the Agreement establishing an Association signed on 12 September 1963 and of the Additional Protocol signed on 23 November 1970, the original texts of which were published in the Official Journal of the European Communities 1964, page 3687/64 and OJ No L 293 of 29 December 1972, page 4, Article 10 of the Association Agreement.

charges having equivalent effect on imports from Turkey while the latter agreed to reduce those duties and taxes progressively. The Parties also agreed not to introduce any new quantitative restrictions and measures having equivalent effect on imports. Also in this case, Turkey committed to do so gradually.

Finally, the already mentioned Decision No 1/95 of the EC-Turkey Association Council of 22 December 1995 on implementing the final phase of the Customs Union (hereinafter 'the Decision'), completes this process by suppressing entirely quantitative restrictions and measures having equivalent effect for a vast range or products covered by this Decision. In particular, Articles 5 and 6 of the Decision prohibit quantitative restrictions on imports and exports between the Contracting Parties and all measures having an equivalent effect. These articles reproduce almost literally the content of Articles 34 and 35 TFEU. In addition, Article 7 of the Decision reproduces literally the content of Article 36 TFEU, thus, the possible justifications of restrictions on imports and exports under articles 5 or 6.[6] To conclude, Article 8 of the Decision provides for the gradual incorporation into the Turkish legal order of the Community instruments relating to the removal of technical barriers to trade.

Before entering into the analysis of the lawfulness of the mutual recognition principle as applied to EU-Turkish products under Decision 1/95, it may be convenient to remind briefly the legal value of that Decision within the EU legal order. In this regard, the Decision emanates from the EU-Turkey Association Agreement, an international agreement validly concluded by the Community, now Union. These agreements, in accordance with Article 216 (2) TFEU and the case-law of the Court of Justice take precedence over EU legislation although they must respect the Treaties.[7] In other words, they have, as mentioned by Advocate

6 Article 7: 'The provisions of Articles 5 and 6 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between the Parties.'

7 See, e.g., C-61/94 *Commission/Germany* [1996] ECR I-3989, paragraph 52 or C-286/02 *Bellio F.lli Srl* [2004] ECR I-3465 at paragraph 33.

General Kokott, an 'intermediate status'.[8] In this regard, it should be remembered that the Union legal system is monistic (Article 216 (2) TFEU). Therefore, an international agreement validly concluded by the Union shall take effect in the Community legal order without any act of transposition. The Court has also stated that the issue of the effect that the provisions of an international agreement have in the EU legal order is a matter of interpretation that must be resolved by the Court, if it has not been regulated in the agreement itself.[9]

In this regard, the provisions of international agreements such as the Ankara Agreement can be directly applicable in the EU legal order. Indeed, 'A provision in an agreement concluded by the Community with non-member countries must be regarded as being directly applicable when, regard being had to its wording and the purpose and nature of the agreement itself, the provision contains a clear and precise obligation which is not subject, in its implementation or effects, to the adoption of any subsequent measure.'[10]

Applying this case-law to the Ankara Agreement, the Court of Justice has concluded that this agreement, validly concluded by an institution of the Union –the Council-, is part of the Community legal order,[11] having primacy over EU legislation, and that some of its provisions could have direct effect. [12] Similarly, the Court has also analyzed whether some of the provisions of the Additional protocol to the Ankara agreement signed in 1970 could have direct effect, reaching the conclusion that an article of that Protocol had indeed that effect.[13] Finally, and relevant for our purposes, not only the provisions of the Ankara agreement and of the Additional protocol but also the provisions included in decisions of the

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8 Opinión of Advocate General Kokott in case C-467/03 *Ikegami* [2005] ECR I-02389, paragraph 31: 'international law obligations of the Community enjoy an 'intermediate status', that is to say, they take effect subject to primary law, but take precedence over Community secondary law. Community secondary law […] must therefore be interpreted in line with the requirements of the [International obligation].'

9 See e.g. C-149/96 *Portugal/Council* [1999] ECR I-8395, paragraph 34.

10 See, e.g. C-12/86 *Demirel* [1987] ECR 3719, paragraph 14.

11 Id. paragraph 7.

12 Id. paragraph 23.

13 C-37/98 *The Queen and Secretary of State for the Home Department ex parte: Abdulnasir Savas* [2000] ECR I-02927, at paragraph 46.

Association Council may have direct effect within the EU legal order.[14] This is also true for Decision 1/95 of the Association Council according to the Court if the provisions of that Decision under review are sufficiently clear and precise in accordance with the requirements for direct effect.[15]

In this framework, as mentioned before, the articles of Decision 1/95 to which the Commission refers in the Communication cited, articles 5 and 7, reproduce almost literally the wording of articles 34 to 36 TFEU, articles that have long been recognized as capable of being directly applied. Therefore, those articles seem *prima facie* equally capable of having direct effect.

However, according to the case-law of the Court, not only the wording but also 'the purpose and nature of the agreement itself' have to be taken into account for the purposes of assessing whether a provision included in an international agreement has direct effect.[16] In this regard, according to the Court of Justice, the purpose of the Ankara agreement is 'to establish an association designed to promote the development of trade and economic relations between the contracting parties, including, in the area of self-employment, the progressive abolition of restrictions on freedom of establishment, so as to improve the living conditions of the Turkish people and facilitate the accession of the Republic of Turkey to the Community at a later date.'[17] This purpose is hence in line with the aim of the articles at stake and should not preclude the Court of Justice from recognizing their direct effect in the EU legal order. Consequently, individuals should in our view have the right to rely on these provisions before the courts of Member States.

The coherence between the purpose of the agreement and the recognition of the direct effect of articles 5 and 7 is further corroborated by Article 66 (under the heading "interpretation") which states the following: 'The provisions of this Decision, in so far as they are identical

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14 See C-192/89 *Sevince* [1990] ECR I-3461, paragraph 18 and 26 and C-171/01 *Wählergruppe Gemeinsam* [2003] ECR I-04301, paras 54-67.

15 See C-372/06 *Asda Stores* [2007] ECR I-11223, at 82-83 and case-law cited therein.

16 See, e.g. C-12/86 *Demirel* [1987] ECR 3719, paragraph 14.

17 C-37/98 *The Queen and Secretary of State for the Home Department ex parte: Abdulnasir Savas* [2000] ECR I-02927, paragraph 52.

in substance to the corresponding provisions of the Treaty establishing the European Community shall be interpreted for the purposes of their implementation and application to products covered by the Customs Union, in conformity with the relevant decisions of the Court of Justice of the European Communities.' This article is in fact mentioned by the Commission in the Communication cited above as a basis for the extension of the mutual recognition principle to EU-Turkish products covered by the customs union. According to some authors, Article 66 was however principally directed at Turkish judges in order to underline that they have to follow the case-law of the Court of Justice of the EU.[18]

In sum, Decision 1/95 of the Association Council forms part of the EU legal order, takes precedence over EU legislation, some of its provisions, particularly articles 5 and 7, should in our view be accorded direct effect, and, according to the European Commission, they should be interpreted in the same way as the corresponding articles 34 and 36 TFEU, including the judge-made principle of mutual recognition laid down by the Court of Justice in the famous Cassis de Dijon judgment in relation to the interpretation of today´s article 34 TFEU.[19]

3. Possible limits to the extension of the mutual recognition principle to products originating in a non-member State

In light of the foregoing, national judges, both those of the Member States of the EU and Turkish judges, should interpret articles 5 and 7 of Decision 1/95 as the Court of Justice of the EU has interpreted the corresponding articles of the TFEU (articles 34 and 36). This is mandatory as Decision 1/95 forms part of the EU legal order and even takes precedence over EU secondary law, and over national law. International agreements

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[18] See Allan F. Tatham, 'Ensuring compliance? Enhancing judicial application of the acquis communautaire before accession' CLEER Working Papers, 2009/5, p. 8: 'Article 66 of Decision 1/95 is a very clear direction to Turkish courts to follow and apply ECJ case-law in cases before them within the ambit of the subject matter addressed in the Association Council Decision. As a further step, it might be that a reading together of Article 7 AA and Article 66 of Decision 1/95 could establish a sound basis for Turkish judges to evolve a more dynamic approach to the use of EC law and ECJ rulings in domestic cases within the entire area covered by the Ankara Agreement, its Protocols, the Customs Union and beyond.'

[19] C-120/78 *Cassis de Dijon* [1979] ECR 649.

may not, however, contradict EU primary law as interpreted by the Court of Justice. In this regard, one could wonder whether the principle of mutual recognition, as construed by the Court of Justice, may be extended by way of a decision of the Association Council to a non-member State.

In relation to the above, as it is well known, in the Cassis de Dijon judgment the Court laid down the fundamentals of the mutual recognition principle, namely,[20] that a Member State cannot prohibit the sale on its territory of products sold and /or lawfully manufactured in another Member State, even if those products are manufactured according to technical standards different from those required for their own goods, unless exceptional circumstances –either those provided for in article 36 TFEU or the mandatory requirements that emanate from the jurisprudence of the Court- justify such prohibition. The principle of mutual recognition applies only to products which have not been harmonized at EU level.

The Court of Justice referred in the Cassis de Dijon judgment, and in subsequent cases, to products either sold or lawfully manufactured (or in free circulation) in another Member State, and not outside the EU. This was surely due to the facts of the case. However, the Court has, in the *Bouchara* judgment, referred to the mutual confidence between Member States as the basis for the mutual recognition principle. In the Court´s words, 'although Member States are not prohibited from requiring prior approval of certain products, even if those products have already been approved in another Member State, the authorities of the State of importation are however not entitled unnecessarily to require technical or chemical analyses when the same analyses or tests have already been carried out in another Member State and their results are available to those authorities. That rule is a particular application of a more general principle of mutual trust between the authorities of the Member States and must therefore also apply when the verification is the responsibility of the importer himself.'[21]

Similarly, Advocate General La Pergola, with reference to the Bouchara judgment, to Commission documents, and to the opinion

[20] Ibid.

[21] See C-25/88 *Bouchara* [1989] ECR 01105, paragraph 18.

of commentators concluded that 'The undertakings mutually entered into by the Member States by acceding to the Treaty mean that each of them demonstrates its trust in the capacity of the others to supervise the manufacture of goods, the supply of services and the training of economic operators in their trade or business. Thus the idea emerges that the legislative action of one Member State may be equivalent to that of another, as regards their respective protective effects'.[22]

In the same vein Alfonso Mattera, Special Adviser to the President of the European Commission and recognized expert in the field of free movement of goods has recently stated, with reference to the Bouchara judgment that 'the Court underlines that the acceptance on the part of a Member State of the controls, laboratory tests and analyses carried out by other Member States is a specific expression of the principle of 'mutual confidence', which is the basis of the principle of 'mutual recognition'. The adoption of those principles constitutes an exceptional element of cohesion and integration between States which, in spite of their different traditions and legislations, have common cultural and scientific roots and belong to the same Community, which is held together by links stemming from a common-body legislation, common institutions and a supranational jurisdiction within which rulings apply to all states. Hence, the 'guarantees offered' are such that, even in the absence of common rules and regulations, they justify the need for each Member State to exhibit confidence in its 'neighbour' and in its legislation, administrative structures, control bodies and procedures.'[23]

Similarly, the European Commission has also referred to the principle of mutual trust between Member States as the basis for the application of the principle of mutual recognition in other areas of EU law such as the recognition of professional qualifications.[24]

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[22] See Opinion of Advocate General La Pergola in case C-184/96 *Foie Gras* [1998] ECR I-06197, paragraph 28. See also paragraph 31.

[23] Alfonso Mattera, 'The Principle of Mutual Recognition and Respect for National, Regional and Local Identities and Traditions', in F. K. PADOA SCHIOPPA (ed.), *The Principle of Mutual Recognition in the European Integration Process* (Palgrave Macmillan 2005), p. 11.

[24] See e.g. Bulletin of the European Communities, Supplement 8/85 'A general system for the recognition of higher education diplomas, Explanatory memorandum, p. 7: 'The introduction of an information exchange and coordination procedure (…), both between the Member States and between the Member States and the Commission, would have only a limited effect and ultimately be of slight practical advantage to the citizens of Europe if its application were not based on the idea of reciprocal confidence.'

Therefore, the foregoing considerations cast doubts as to the possibility of extending the application of the mutual recognition principle to non-member States given that the confidence or trust between Member States, let alone the existence of 'a common-body legislation, common institutions and a supranational jurisdiction within which rulings apply to all states' as mentioned by Mattera, in which that principle would be based may not be automatically presumed in the case of national authorities from outside the EU.

In addition, other reasons put into question the automatic extension of the principle of mutual recognition to products originating in non-Member States. In particular, according to Article 28(2) TFEU 'The provisions of Article 30 and of Chapter 2 of this Title shall apply to products originating in Member States and to products coming from third countries which are in free circulation in Member States'. Similarly, article 29 TFEU states that 'Products coming from a third country shall be considered to be in free circulation in a Member State if the import formalities have been complied with and any customs duties or charges having equivalent effect which are payable have been levied in that Member State, and if they have not benefited from a total or partial drawback of such duties or charges.' In other words, products coming from third countries are assimilated to products coming from Member States once they are in *free circulation*, that is, once the import formalities have been complied with and any customs duties or charges having equivalent effect have been levied, if necessary, in a Member State.

These articles recognize that once the customs authorities of a Member State are satisfied with a product originating in a third country the other customs authorities must not restrict the circulation of that product within the internal market. In this regard, as professor Eeckout has observed, the principle of mutual recognition also applies to products in free circulation because that principle is not so much concerned with the origin of the product but with the fact that the product is in free circulation within the Union after the requirements of article 29 TFEU have been fulfilled.[25] Indeed, as the Court of Justice famously stated in the *Donckerwolcke* case 'The result of this assimilation [the assimilation

[25] Piet Eeckhout, *EU External Relations Law* (OUP 2011), at page 445.

between products of Member States and products originating outside the Community but in free circulation] is that the provisions of Article 30 concerning the elimination of quantitative restrictions and all measures having equivalent effect are applicable without distinction to products originating in the Community and to those which were put into free circulation in any one of the Member States, irrespective of the actual origin of these products.'[26]

Therefore, in light of the two arguments reviewed so far one could say that the principle of mutual recognition applies only between Member States because it is based on the mutual trust between them, something corroborated by the fact that once customs formalities for products originating outside the Community has been satisfied in a Member State, the other Member States must allow the 'free circulation' of those products and must consider them as "EU products", including for the purposes of Articles 30 and 34 TFEU, and for the application of the mutual recognition principle.

A third possible limitation to the extension of the principle of mutual recognition to products originating outside the Union has to do with the traditional case-law of the Court of Justice according to which 'the similarity or even uniformity between the wording of provisions of an agreement with a non-member country and the corresponding provisions of the Union Treaties does not in itself suffice to extend the case-law on the provisions of the Union Treaties to the agreement with the non-member country.'[27]

This well-settled case-law, known as the *Polydor* jurisprudence after the first case in which it was laid down, seem *prima facie* relevant as it is the similarity or almost uniformity between articles 5 and 7 of the Decision 1/95 and the corresponding provisions of the Union Treaties

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[26] Case 41/76 *Donckerwolcke v. Procureur de la République* [1976] ECR 1921, paragraph 18.

[27] Case 270/80 *Polydor and RSO Records* [1982] ECR 329, paras 14 to 19; Case 104/81 *Kupferberg* [1982] ECR 3641, paragraph 30; Case C-312/91 *Metalsa* [1993] ECR I-3751, paras 10 to 12; Case C-162/00 *Pokrzeptowicz-Meyer* [2002] ECR I-1049, paras 32 and 33; Case C-351/08 *Grimme* [2009] ECR I-10777 paras 27 and 29; Case C-541/08 *Fokus Invest* [2010] ECR I-1025, paras 28 and 29; and Case C-70/09 *Hengartner and Gasser* [2010] ECR I-7233, paras 41 und 42. See for a recent reproduction and for the reference to this case-law the Opinion of AG Cruz Villalón in case C-221/11, *Demirkan*, not yet published, paragraph 62 and footnote 40.

concerning free movement of goods what has led the Commission to suggest the extension of the mutual recognition principle to products originating in Turkey. This case-law, together with the doubts previously expressed concerning the principle of mutual trust between Member States and the general treatment given to foreign products before being put in free circulation in a Member State, would contribute to put into question the extension of the mutual recognition principle.

However, one could argue that the Polydor case-law only says that similarity or even uniformity between the wording of provisions of an agreement with a non-member country and the corresponding provisions of the Union Treaties **does not in itself suffice** to extend the case-law on the provisions of the Union Treaties to the agreement with the non-member country. This does not mean that such similarity coupled with other elements might justify the extension of the case-law of the Court.

In this regard, it should be noted that Decision 1/95 also includes article 66 which clearly states the intention of the Union to extend the case-law of the Court concerning the free movement of goods to products originating from Turkey (although the principle of mutual recognition is not expressly mentioned). Article 66 of Decision 1/95 may however not be enough if one takes into account the case-law of the Court of Justice in relation to a similar provision contained in the EEA Agreement, namely, article 6 of that agreement.[28]

According to Article 6 EEA 'Without prejudice to future developments of case-law, the provisions of this Agreement, in so far as they are identical in substance to corresponding rules of the Treaty establishing the European Economic Community and the Treaty establishing the European Coal and Steel Community and to acts adopted in application of these two Treaties, shall, in their implementation and application, be interpreted in conformity with the relevant rulings of the Court of Justice of the European Communities given prior to the date of signature of this agreement'.

[28] Agreement on the European Economic Area, 2 May 1992 (OJ 1994, L 1, p. 3; hereinafter «EEA Agreement»).

Article 66 of Decision 1/95 is therefore very similar to Article 6 of the EEA Agreement, and even has a broader scope of application as Article 66 is not limited to the case-law of the Court prior to 1992. In any event, the most important case-law of the Court of Justice concerning the mutual recognition principle, and particularly the Cassis de Dijon judgment, had already been issued before 1992, the date of signature of the EEA Agreement, so that both provisions are in this sense very similar.

In this regard, the Court found in Opinion 1/91 that 'The fact that the provisions of the agreement and the corresponding Community provisions are identically worded does not mean that they must necessarily be interpreted identically. An international treaty is to be interpreted not only on the basis of its wording, but also in the light of its objectives. Article 31 of the Vienna Convention of 23 May 1969 on the law of treaties stipulates in this respect that a treaty is to be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in their context and in the light of its object and purpose.'[29]

The Court thus held that the objectives of the EEA agreement were related to the application of rules on free trade and competition in economic and commercial relations and that, by contrast, the objectives of the Community were more ambitious going beyond that of the EEA agreement. In this regard, the Court concluded that the EEC Treaty rules on free movement and competition were not in themselves but instruments towards the achievement of more important goals such as the establishment of an internal market, economic and monetary union and European unity.

Finally, the Court concluded that Article 6 of the Agreement was not enough to alter the findings reached for essentially two reasons, namely, the temporal limitation of Article 6 to the case-law prior to 1992 and the fact that Article 6 of the agreement did not clearly specify whether it referred to the Court's case-law as a whole, and in particular the case-law on the direct effect and primacy of Union law. For these reasons the homogeneity of EU law throughout the EEA was, in the Court´s view, compromised.

[29] Opinion 1/91 [1991] ECR I-06079, paragraph 14.

In light of this case-law it is necessary to look at the objectives and the context of the Ankara agreement in order to assess whether the homogeneity of EU law may be warranted. In this regard, as mentioned before, according to the Court of Justice, the purpose of the Ankara agreement is 'to establish an association designed to promote the development of trade and economic relations between the contracting parties, including, in the area of self-employment, the progressive abolition of restrictions on freedom of establishment, so as to improve the living conditions of the Turkish people and facilitate the accession of the Republic of Turkey to the Community at a later date.'[30] The objective is therefore primarily economic, namely, to promote economic and trade relations, although the Ankara Agreement equally reflects the aim of improving the standard of living of the Turkish people and that of promoting the accession of Turkey to the Community.

The objectives of the Ankara agreement remain therefore primarily economic. However, even if the Ankara agreement, and its implementing acts, aims at promoting trade between the EU and Turkey, that goal falls short of the EU internal market goal of merging all national markets into a single market for the entire EU. Indeed, as Advocate General Cruz Villalón has recently stated in relation to a case concerning the Ankara agreement: 'That objective and structure of the Association Agreement stands in contrast to the objective and structure of the Community and Union Treaties. As case-law has consistently held, their purpose, inter alia, is to create an internal market, that is, to merge the national markets into a single market, the establishment of which involves the abolition of obstacles to the free movement of goods, persons, services and capital between Member States.'[31]

This part of the opinion of the AG Cruz seems to have been followed by the Grand Chamber of the Court in this case. As the Court has stated 'under European Union law, protection of passive freedom to provide services is based on the objective of establishing an internal market, conceived as an area without internal borders, by removing all obstacles to the establishment of such a market. It is precisely that objective which

[30] C-37/98 *The Queen and Secretary of State for the Home Department ex parte: Abdulnasir Savas* [2000] ECR I-02927, paragraph 52.

[31] See Opinion of AG Cruz Villalón in case C-221/11 *Demirkan*, not yet published, paragraph 67.

distinguishes the Treaty from the Association Agreement, which pursues an essentially economic purpose'.[32]

In addition, and in line with the broader goal of 'European unity' mentioned by the Court in the 1/91 Opinion, the Advocate General has also mentioned that certain non-market goals are equally important in the EU context, what makes this context difficult to extend to other agreements signed between the EU and third parties. As Advocate General has phrased it 'a true internal market can only develop if citizens are acknowledged and protected also in spheres outside of their economic activities. In that context, the development of Union citizenship and the freedom of movement associated therewith has a significant role to play. Placing the Union citizen at the heart of EU law connects the EU with its objectives going far beyond the economic dimension.'[33]

Finally, as the Court of Justice has also held in previous cases, the fact that an international agreement validly concluded by the Union provides for the progressive integration of the non-member State contracting with the EU is not enough in itself to alter the Polydor case-law mentioned supra, ultimately followed by the Court in Opinion 1/91.[34] In this regard, as Cremona affirmed in relation to the Opinion 1/91 'These substantive distinctions point to two legal orders with essentially different structures. If specific sectors are extracted from the organic whole of the Community legal order, we should not expect the extracted elements to operate in an identical way outside the Community framework.'[35] Therefore, the different objectives of the EU and the Ankara Treaties cast doubts as to the extension of the principle of mutual recognition to products originating in Turkey.

Furthermore, as required by Opinion 1/91, not only the objectives but also the context in which the provisions under consideration are

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32 C-221/11 *Demirkan*, not yet published, paragraph 56.

33 Opinion of AG Cruz Villalón in case C-221/11 *Demirkan*, not yet published, paragraph 67.

34 Id, paragraph 63. See also the judgments to which the AG makes reference in that paragraph: Case C-17/81 *Pabst & Richarz KG* ECR [1982] p. 1331, paras 26 & 27, and C-63/99 *Gloszczuck* C-63/99, Rec. p. I-6369, paras 49-52.

35 Marise Cremona, 'The "Dynamic and Homogeneous" EEA: Byzantine Structures and Variable Geometry', (1994) 19 EL Rev, 520.

inserted is relevant. In this regard, as in the EEA agreement, the case-law of the Court concerning primacy and direct effect is not automatically extended to the relationship between the EU and Turkey by operation of the agreement. Therefore, just as the Court underlined in relation to the EEA agreement, this gap may compromise the homogeneity of EU law. Some authors have indeed noted that the direct effect of Decision 1/95 in Turkey is controversial, and commentators disagree as to the value of that decision under Turkish constitutional law.[36]

In other words, it would seem disproportionate and lacking reciprocity that EU Courts, including national courts, would apply directly the principle of mutual recognition to Turkish products –due to the principles of primacy and direct effect– if Turkish Courts do not observe those principles. In this regard, the Court of Justice has referred in the past to the importance of reciprocity. The Court has indeed observed in other areas of EU law the importance of that principle in relation to the legal treatment that trading partners give to international agreements also ratified by the Union.[37]

In this context, although the Communication mentioned supra in which the European Commission suggested the extension of the mutual recognition principle to Turkish products under Decision 1/95 dates from 2003, the application of such principle in Turkish legislation has remained under doubt due to the unclear direct effect of Decision 1/95 in Turkey until January 2013, when a mutual recognition regulation entered into force. This regulation was long-awaited by the Commission and in any case it is not primarily directed at national courts but at national administrative authorities.[38]

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36 Josef Drexl, 'Competence of the European Community in the Field of International Trade Law: Limitations on Foreign Policy of the Member States and Turkey?' (2006) 3 Ankara Law Review 99, 106.

37 See C-149/96 *Portugal/Council* [1999], ECR I-8395, paras 43 & 45. See also C-104/81 *Kupferberg* [1982] ECR 3641, paragraph 18.

38 Commission, Commission Staff Working Document Turkey 2012 Progress Report accompanying the document communication from the Commission to the European parliament and the Council Enlargement Strategy and Main Challenges 2012-2013 {COM(2012) 600 final}, p. 44: 'As a major step in alignment, Turkey adopted a long-awaited regulation on mutual recognition in the non-harmonised area. The regulation will enter into force on 1 January 2013. It is expected that this will remove a number of technical barriers to the free movement of goods.' However, according to the Turkish Government Article 11 of the Decree on Technical Regulations and Standardization for Foreign Trade (published in the Official Gazette No. 25965, 13.10.2005) 'importation of the products

The regulation, discussed infra, will indeed not solve all problems immediately. In fact, in the position paper submitted for a recent meeting of the EU-Turkey Association Council the Commission, while welcoming some progress in the area of free movement of goods, reminds that there are still some outstanding commitments and that mutual recognition in the non-harmonized area would only take place since July 2013.

In the Commission´s words: 'In the field of free movement of goods, alignment is generally quite advanced. The EU welcomes the recent good progress made in the alignment of general principles applicable to free movement of goods. The EU welcomes the accession of Turkey in December 2012 to the Common Transit Convention and the Convention on the simplification of formalities in trade of goods. The EU welcomes the introduction of the mutual recognition principle into Turkish legislation and the use of this principle in the import control of products in the non-harmonised area. The EU looks forward to the mutual recognition in the non-harmonised area taking effect as of 1 July 2013. There are some remaining technical barriers to trade preventing free circulation of goods such as in the area of pharmaceuticals, textiles, second-hand goods, aluminium, paper and copper scrap and alcoholic beverages.'[39]

Therefore, to sum up, as EU law currently stands, it seems that the case-law of the Court of Justice of the European Union casts doubts to the

covered by the Customs Union cannot be restricted or impeded provided that these products are lawfully produced and/or put into free circulation in Member States of the EU in conformity with the relevant harmonised EU legislation and/or national legislation of Member States.' See the non-exhaustive list of issues and questions to facilitate preparations for bilateral screening meetings with Croatia and turkey in the area of: chapter 1: free movement of goods. It can be consulted at http://www.abgs.gov.tr/tarama/tarama_files/01/sorular%20ve%20cevaplar_files/Cevaplar.pdf

[39] 51st Meeting of the EU-Turkey Association Council (Brussels – 27 May 2013) Position of the European Union, at page 10. It can be consulted online at http://www.parlament.gv.at/PAKT/EU/XXIV/EU/11/55/EU_115526/imfname_10404184.pdf. See for the specific outstanding commitments regarding the free movement of goods page 18: 'With regard to free movement of goods, there are a number of outstanding commitments under the Customs Union. This relates in particular to the Turkish import regime which requires import permits for old, second-hand and renovated goods. The requirement of control certificates for alcoholic beverages was abolished and since January 2012 a prior notification system has been in place instead. Market access for EU products in certain sectors, including alcoholic beverages and textiles, is made difficult through non-tariff barriers and needs to be addressed. Turkey introduced and maintains a restrictive, non-automatic export-licensing regime for copper scrap, aluminium and paper. The Union urges Turkey to remove remaining import and export licences requirements for goods which are in breach of Turkey's commitments under the Customs Union.'

extension of the principle of mutual recognition to Turkish products, and, more generally, to a country not yet party to the European Union, and this for two main reasons: (i) the principle of mutual recognition is based on the principle of mutual trust between the authorities of Member States, something corroborated by the fact that any Member State may under the Treaty put a product from outside the Union into free circulation and this will have to be respected by the other Member States and (ii) because the objectives pursued by the Ankara agreement and the context in which Articles 5 and 7 of Decision 1/95 apply are distinct and less ambitious than the objectives of the European Union Treaties, characterized by the desire to merge national markets into a single market as an instrument towards "European unity", that is, beyond the economic dimension of the market, 'placing the Union citizen at the heart of EU law connects the EU with its objectives going far beyond the economic dimension.'[40]In addition, the context in which the EU Treaties are applied, characterized by the application of the principles of primacy and direct effect of EU law cannot automatically be transposed to the relationship with other countries if the observance of those principles is not guaranteed. Finally, some authors have also noted that the extension of the mutual recognition principle to non-member States could also be contrary to WTO law, which is also binding on the EU institutions, and in particular to the Most Favored Nation principle, given that the EU would be discriminating in favour of Turkey vis-à-vis the rest of the WTO members.[41]

4. the adoption by turkey of the regulation on mutual recognition in the non-harmonised area, a new beginning?

On June 23rd 2012 Turkey published on the Official Gazette the Regulation on Mutual Recognition in the Non-Harmonised Area ('the Regulation'). The date of entry into force of the Regulation was set for January 1st 2013.

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40 See Opinion of AG Cruz Villalón in case C-221/11, *Demirkan*, not yet published, at 67.

41 Lorand Bartels, 'The legality of the EC mutual recognition clause Ander WTO law', (2005) Journal of International Economic Law 8(3), 691 or Joel P. Trachtman, 'Toward Open Recognition? Standardization and Regional Integration Under Article XXIV of GATT' (2003) 6 (2): 459.

According to article 1 of the Regulation 'This Regulation lays down the rules and procedures to be followed when taking decisions that may hinder the free movement of the goods which are in the non-harmonised area and lawfully manufactured or put into free circulation in a Member State of the European Union; and the rules on the drafting and screening of the national technical legislation in the non-harmonised area and inserting of the mutual recognition clause into these legislation.' The purpose of this Regulation is thus similar to the objective of the 'mutual recognition Regulation' in the internal market.[42] The scope of the Turkish Regulation is necessarily limited to the products within the scope of Decision No. 1/95 of the EC-Turkey Association Council establishing the Customs Union.[43]

The Regulation provides, under the heading 'free movement of goods' that 'Import or making available on the market of a product lawfully manufactured or put into free circulation in a Member State of the European Union shall not be impeded, even if the product in question was manufactured according to different technical legislation, standard or quality rules than those implemented in Turkey, without prejudice to the rules and scope of Decision No. 1/95 of the Turkey-EC Association Council and this Regulation.'[44] Naturally, the Regulation also provides for justifications that take into account the evolution of the case-law of the Court of Justice of the EU to which it explicitly refers as follows: 'The provision of Article 5 shall not preclude the prohibitions or restrictions on the import, making available on the market and transit of the products, justified on grounds of public morality, public order or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property or on grounds of other reasons recognised by national courts or the Court of Justice of the European Union as public interests like the protection of consumers, environment and road safety. Such prohibitions or restrictions shall not,

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42 Regulation (EC) no 764/2008 of the European Parliament and of the Council of 9 July 2008 laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State and repealing Decision No 3052/95/EC [2008] OJ L 218/21, see in this regard, for example, article 1.2.

43 See Regulation on Mutual Recognition in the Non-Harmonised Area (Published on Official Gazette on 23 June 2012 and will enter into force on 1 January 2013), article 2(2).

44 Id. at article 5.

however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Turkey and the European Union.'

Chapter III of the Regulation lays down procedural rules to be followed in order to ensure the application of the mutual recognition principle. These rules are very similar to those included in Regulation (EC) no 764/2008. These procedures will not apply to selling arrangements, 'in particular mandatory restrictions on the hours and place of sale, sales promotions, national pricing rules'.[45]

Within this chapter, Article 9 regulates the mutual recognition of the level of competence of accredited conformity assessment bodies. This provision obliges Turkish authorities to accept certificates and test reports issued by a conformity assessment body establish in Turkey or in a Member State of the European Union. However, in relation to the latter, the article makes clear that regard will have to be paid to the principle of reciprocity, an important principle in international relations and international law but not so much in EU law, and in both cases the body will have to be registered and accredited under Turkish law.[46] Articles 10 and 11 reproduce almost literally articles 6 and 7 of Regulation no 764/2008 concerning the assessment of the need to apply a technical rule and the temporary suspension of the marketing of a product. Finally, Article 12 recalls national authorities that the procedures established in this chapter will be carried out 'in the course of market surveillance activities after the product is placed on the market', unless legislation provides otherwise.[47]

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45 See in this regard article 7(4) of the Regulation.

46 Article 9 of the Regulation: 'Competent authorities shall not refuse certificates and test reports issued by a conformity-assessment body established in Turkey or, without prejudice to the reciprocity principle, in a Member State of the European Union, and accredited for the appropriate field of conformity-assessment activity in accordance with the rules laid down in Article 4(7) of Regulation on Conformity Assessment Bodies and Notified Bodies put into force by a Decision of Council of Ministers dated 16/12/2011 and numbered 2011/2621, on grounds related to the competence of that body.'

47 See Article 12(1) of the Regulation and, as to the exceptions provided for by legislation the second indent: '(2) Nonetheless, where the legislation requires, the competent authorities may request the information specified in Article 8 before the product is placed on the market or where the placing on the market is subject to a prior authorization, in the course of application for this authorization to identify whether the product in question provides the equivalent protection level that the national legislation seek for. As a result of the evaluation of this information, the supervision procedure laid down in this Chapter may be carried out before the product is placed on the market in case a doubt arises that the placing on the market of the product may pose a serious risk to the one of public interests referred to in Article 6.'

After regulating the product contact points in Chapter IV, also modelled after the equivalent provisions of Regulation no 764/2008, the Turkish mutual recognition regulation includes an original provision in its chapter V, a provision that may not be found in the EU mutual recognition regulation. According to article 15(3) of the Regulation:

> 'Competent authorities, in all applicable and necessary cases, shall insert mutual recognition clause[s], an example of which is given in Annex 1, to the technical regulations they have drafted and shall specify, if it is required, the conditions in which the products lawfully manufactured or put into free circulation in a Member State of the European Union shall be deemed to be providing equivalent level of protection that these regulations seek for.'

In this regard, Annex 1 of the regulation includes the following example of a mutual recognition clause:

> 'Article x- (1) The provisions of this (By-Law/Regulation/Communiqué etc.) shall not apply to the products lawfully manufactured or put into free circulation in a Member State of the European Union.
>
> (2) Nonetheless, (the competent authority) may submit the product referred to in paragraph (1) to an evaluation following the rules and procedures laid down in Chapter Three of Regulation on Mutual Recognition in Non-Harmonised Area which was put into force by Decision of Council of Ministers No. 2012/3169 of 2/5/2012 and as a result of this evaluation if it finds out that this product does not provide a level of protection equivalent to that sought by this (By-Law/Regulation/Communiqué etc.) it may prohibit placing on the market of the product, make its placing on the market subject to prior conditions or have the product withdrawn or recalled from the market.'

In light of the foregoing, Turkish competent authorities are obliged to insert mutual recognition clauses as the one described above in order to exempt products lawfully manufactured or put into free circulation in a Member State of the European Union from the application of a given national technical regulation. The obligation is however nuanced by the vague provision 'in all applicable and necessary cases'. It is submitted that this vagueness is related to the evolution of the case-law of the Court of Justice concerning mutual recognition clauses under Article 34 TFEU, a case-law that, in light of Decision 1/95 -and particularly its Article 66-, Turkish authorities must observe.

In this regard, it appeared from the early case-law of the Court of Justice dealing with mutual recognition clauses that failure to include a

mutual recognition clause requested by the European Commission in a national technical legislation could constitute a violation of today´s Article 34 TFEU. This conclusion emerged from the text of the famous *Foie-gras* judgment in which the Court concluded that '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 30 of the Treaty.'[48]

The decision of the Court in this case, which was not shared by the Advocate General (and in any event referred to products originating in other Member States and not outside the EU),[49] has been tacitly rejected in subsequent judgments in which the same question was posed, namely, whether Article 34 TFEU demands the introduction of mutual recognition clauses in national legislations.[50] In those judgments, three of which were rendered on the same day, the Court rejected the Commission´s proposal, based on the Foie gras decision of the Court, according to which the mere absence of a mutual recognition clause could suffice to constitute a violation of today´s article 34 TFEU.[51] The Court's conclusion was supported this time by the opinion of the Advocate General.[52] This case-law has been recently confirmed by the Court of Justice.[53]

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48 C-184/96 *Foie Gras* [1998] ECR I-06197 paragraph 28.

49 See Opinion of Advocate General La Pergola in C-184/96 *Foie Gras* [1998] ECR I-06197 paragraph 38: 'Consequently, failure to insert a mutual recognition clause in the Decree cannot be said to be contrary to Community law.'

50 C-24/00 *Commission/France* [2004] ECR I-01277; C-270/02 *Commission/Italia* [2004] ECR I- 01559; and C-95/01 *Greenham and Abel* [2004] ECR I- 01333.

51 See for the Commission´s argument as summarized by the Court: 'Relying on the judgment in Case C-184/96 *Commission v France* [1998] ECR I-6197, the Commission argues that the absence in the French legislation of provision for mutual recognition is sufficient to demonstrate the failure to fulfil obligations.' C-24/00 *Commission/France* [2004] ECR I-01277, paragraph 17.

52 See Opinions of AG Micho in cases C-24/00 *Commission/France* [2004] ECR I-01277 and C-95/01 *Greenham and Abel* [2004] p. ECR I- 01333. See for example his conclusion in the latter case at paras 78-79: 'Mr Greenham and Mr Abel, referring to Case C-184/96 Commission v France, request the Court to find that the French Republic has failed to include in its legislation any mutual recognition clause which would allow the marketing on French territory of food supplements freely marketed in other Member States. In that regard, I should like to refer to my Opinion of 26 June 2001, cited above, where I concluded that Articles 28 EC and 30 EC do not impose the inclusion of a mutual recognition clause in national legislation[...].

53 See C-333/08 *Commission/France* [2010] ECR I-00757.

The Court has therefore rejected the existence of an obligation under Article 34 TFEU to include mutual recognition clauses. Indeed, in the EU context the Commission recommends Member States to include those clauses yet it has not, allegedly in light of the case-law described, considered it mandatory under Article 34 TFEU.[54] The Commission´s suggested examples of mutual recognition clauses also cover products originating in Turkey.[55]These examples can be found in national legislations in force in the Member States.[56]

The evolution of the case-law of the Court may therefore explain the ambiguity of the phrase 'in all applicable and necessary cases' given that a strict obligation to include mutual recognition clauses could go against the case-law of the Court under Article 34 TFEU, something that Decision 1/95, and particularly Article 66, forbids.

Finally, Chapter VI of the Regulation, entitled 'Miscellaneous and Final Provisions' provides for some reporting obligations, in particular for the obligation of Turkey to send annual reports to the Commission concerning the application of the Regulation. This Chapter also includes, in Article 19, a sort of `Trade barriers regulation" for economic operators

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54 See Commission, 'Commission interpretative communication on facilitating the access of products to the markets of other Member States: the practical application of mutual recognition' (2003/C 265/02) [2003] OJ C 265/2, point 6.1: 'the Commission wants Member States to include, in their national laws, a mutual recognition clause designed to apply the principle of mutual recognition correctly'.

55 Ibid: '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.[…].

56 See, *e.g.*, German legislation mentioned by the Court of Justice in a case concerning free movement (The Regulation of 13 January 2010 (BGBl. 2010 I, p. 10), of which the amended Paragraph 12(4) of the ABVWasserV states as follows: 'Only products and devices supplied in accordance with the recognised rules of technology may be used. Compliance with the conditions laid down in the first sentence shall be assumed if they have specific CE marking for drinking water use. Where such CE marking is not stipulated, it shall also be assumed if the product or device bears the mark of an accredited certifying body for the industry, in particular the DIN-DVGW or DVGW mark. Products and devices which 1. were lawfully manufactured in another contracting state of the Agreement on the European Economic Area or 2. were lawfully manufactured or marketed in another Member State of the European Union or in Turkey and do not meet the technical specifications for the mark referred to in the third sentence shall be treated as equivalent, inclusive of the inspections and surveillance carried out in the aforementioned States, if the same level of protection as required in Germany is thereby permanently ensured.' C-171/11 *Fra.bo* not yet published, at 5. See, for other Member States, e.g., the Spanish Royal Decree 2060/2008, of 12 December, approving the Regulation on pressure equipment and technical instructions. Official Gazette ("BOE") no. 31 of February 5, 2009, pages 12297-12388, second additional provision.

exporting from Turkey to the European Union, as they will be able to apply to the Turkish Government for its intervention in case their access or their free circulation within the EU internal market is hindered. Among other final provisions, the Chapter also states that the Regulation would entry into force in January 1st 2013 and would be implemented by the [Turkish] Council of Ministers.

In light of the foregoing, the publication of the Turkish mutual recognition regulation does not seem sufficient to overcome the difficulties outlined in previous sections concerning the extension of the mutual recognition principle to EU-Turkey products. This is so given that the Regulation is logically limited to the free movement of goods in the non-harmonised area covered by Decision 1/95, thus leaving aside other more ambitious non-market goals observed by the Court, such as European Unity or citizenship. Similarly, the Regulation remains silent as to the application of the principles of primacy and direct effect of general EU law in Turkey, another factor considered crucial by the Court.

5. Conclusions

The coherence between the internal and the external side of the internal European market, and in particular the expansion of the EU internal market, is an area of growing interest as can be inferred from recent writings by prestigious commentators.[57] This work attempts to contribute to the debate by analyzing the possible limits to a full and automatic extension of the principle of mutual recognition, a cornerstone of the internal market, beyond its original field of application.

The review undertaken shows that this principle is inextricably linked to the principle of mutual trust between Member States, a factor that makes its extension beyond them difficult. The contribution also shows that not only this principle but also the case-law of the Court is ill-suited to be exported to non-EU countries as the Court and its advocate generals have underlined the close relationship between the internal market and some ambitious non-market goals, from the European Unity

[57] See e.g. Marise Cremina 'Expanding the internal market: an external regulatory policy for the EU?' in Bart Van Vooren, Steven Blockmans, and Jan Wouters (eds), *The EU's role in global governance : the legal dimension* (OUP 2013) at page 162 *et seq*.

to European citizenship. These goals go far beyond the goals usually included in free trade or customs unions agreements.

Finally, the Court of Justice has also underlined that its case-law on free movement may not be automatically extended via an international agreement concluded by the EU in isolation from core principles of EU law such as the principles of primacy and direct effect. In other words, those principles should also apply to the international relation at stake for the case-law of the Court of Justice to be fully applicable to the provisions of that agreement.

To conclude, the publication of the Turkish mutual recognition regulation does not seem sufficient to overcome the difficulties outlined. Having said that, this regulation will represent in our view an important step towards the building of reciprocal confidence between the EU and Turkey in free movement issues. It will also represent, at least it is hoped so, an important push towards the closing of the remaining chapters for Turkish accession to the EU, a journey initiated in the 1963 Ankara agreement, where the prospect of accession was already mentioned, that gained momentum precisely eight years ago, in October, when the decision was taken to initiate formal accession negotiations with Turkey.

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