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European regulatory private law –
autonomy, competition and regulation
in European private law

Edited by:

Guido Comparato / Hans-W. Micklitz / Yane Svetiev



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**EUROPEAN REGULATORY PRIVATE LAW – AUTONOMY,
COMPETITION AND REGULATION IN EUROPEAN PRIVATE LAW**

Edited by Guido Comparato / Hans-W. Micklitz / Yane Svetiev

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European Regulatory Private Law: The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation (ERPL)

A 60 month European Research Council grant has been awarded to Prof. Hans-Wolfgang Micklitz for the project “European Regulatory Private Law: the Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation” (ERPL).

The focus of the socio-legal project lies in the search for a normative model which could shape a self-sufficient European private legal order in its interaction with national private law systems. The project aims at a new-orientation of the structures and methods of European private law based on its transformation from autonomy to functionalism in competition and regulation. It suggests the emergence of a self-sufficient European private law, composed of three different layers (1) the sectorial substance of ERPL, (2) the general principles – provisionally termed competitive contract law – and (3) common principles of civil law. It elaborates on the interaction between ERPL and national private law systems around four normative models: (1) intrusion and substitution, (2) conflict and resistance, (3) hybridisation and (4) convergence. It analyses the new order of values, enshrined in the concept of access justice (*Zugangsgerechtigkeit*).

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Abstract

This working paper addresses the theme of the transformation of private law considering in particular the concepts of autonomy, competition and regulation in European private law. The contributions included in this working paper present some of the outcomes of the research done during the fourth year of the project on European Regulatory Private law which was presented and discussed with external guests at the fourth annual workshop of the project on 18 and 19 June 2015 at the European University Institute in Florence. After having discussed in the three prior annual meetings the parameters around which European regulatory private law is organized, the fourth workshop focused on the key framing proposition of the investigation, i.e. the transformation of private law from autonomy to functionalism in competition and regulation.

In the first part of the working paper, the central concepts of the suggested transformation will be introduced and placed in the theoretical framework of the research project, addressing the issue of the drivers of the transformation, of autonomy and regulation, and of competition. In the second part, the transformation is looked for in specific sectors of European regulatory private law, i.e. telecommunication, energy, standardization, and the financial sector highlighting the aspects that may illustrate the posited transformation of the operative private law in these areas.

Keywords

European private law, regulation, autonomy, competition, transformation

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Introduction

This working paper addresses the theme of the transformation of private law considering in particular the concepts of autonomy, competition and regulation in European private law. The contributions included in this working paper present some of the outcomes of the research done during the fourth year of the project on European Regulatory Private law which was presented and discussed with external guests at the fourth annual workshop of the project on 18 and 19 June 2015 at the European University Institute in Florence. After having discussed in the three prior annual meetings the parameters around which European regulatory private law is organized, the fourth workshop focused on the key framing proposition of the investigation, i.e. the transformation of private law from autonomy to functionalism in competition and regulation.

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SECTION I. FOUNDATIONS

Factors behind the transformations of private law

Guido Comparato

Private law in Europe has undergone several transformations, especially over the course of the last decades. The notion of European regulatory private law describes the most recent of these. These transformations are not a development endogenous to the legal discipline, but have on the contrary been linked to more general transformations of the State and economy, which political science scholarship has already identified. In turn, these transformations of the State allegedly have different causes, and each of them can indirectly or even directly affect private law in diverse ways. This short contribution builds upon the main ideas of informative literature, drawn from different areas not necessarily and immediately related to legal studies, which show both the theoretical aspects of the transformations of the State and particular issues which are relevant for private law in the frame of that transformation. After introducing the idea of the transformation of the State, the focus is placed on specific factors that can be considered as drivers of these transformations, i.e. economy & globalization, technology, and society, considering them in a general sense but looking also at their repercussions in one specific field which is highly emblematic for the transformations of the current era, i.e. the internet and the regulation of it.

Introduction

The idea of European Regulatory Private Law (ERPL) assumes a transformation of private law in Europe from autonomy to functionalism in competition and regulation. That is to say, private law is taking on new tasks of promoting policy aims such as ensuring competition or establishing an internal market in the European Union. These tasks do not necessarily replace the traditional ones; therefore Regulatory Private Law can represent at least a partially detached and self-sufficient branch of law, distinguished from the traditional one which is still mostly regulated at the national level despite being of transnational origin. However, in fact the coexistence of these two sets of rules can be problematic, and instances of clashes and resistance can occur.¹

The European Union, through its directives and regulations in several fields, has had a fundamental impact in this transformation which nonetheless more fundamentally concerns the very structure of the State, not only in its European manifestations. Private law is in fact highly dependent on the evolution of the State and the developing political economy thereof, although the traditional view of private law as based on the principle of private autonomy tends to consider this branch as fully independent from public law as primarily produced by the State. As the State regulates the economy (which obviously might also include a regulatory choice for non-intervention) it necessarily has to be involved in the economic relations among private individuals which are usually governed by private law. The dynamics and evolution of this transformation of private law have already been covered abundantly elsewhere,² and this paper follows that conceptualization. Instead of focusing primarily on instances which show how the evolution of private law is affected by the evolution of the State's political economy through, for example, processes of liberalization and privatisation, this introductory contribution will sketch the transformation of the State in more general terms focusing in particular on

¹ In this sense, the ERPL idea assumes that the concrete interactions between those legal orders can be described in terms of convergence, hybridization or conflict and resistance.

² H.-W. Micklitz and Y. Svetiev, 'The transformation(s) of private law', in H.-W. Micklitz, Y. Svetiev, G. Comparato (ed), *European Regulatory Private Law. The Paradigms Tested* EUI Working Paper LAW 2014/04, 69-97

some pivotal drivers of that evolution, i.e. economization and globalization as well as society and technology. These are considered through their interrelations, and as the theoretical background through which the concrete transformation(s) of private law in more specific areas have to be placed. Without the pretence of offering a full picture of the developments introduced, or a comprehensive account of the relevant literature and the trends of scientific debates, the contribution builds upon literature drawn from different areas not necessarily and immediately related to legal studies, which nonetheless helps to consider both the theoretical aspects of the transformations of the State, and particular issues which are relevant for private law in the frame of that transformation.

The transformation of the state

The current model of the ‘territorially consolidated, centralized, sovereign state has been the dominant paradigm in western political thought [...] It was considered to be the model which any political community that strove towards modernity was expected to embrace’.³ Even despite our modern tendency to take that model of the State for granted, it is essential to emphasise that such a model is not universal either in time or in space. Considering space, this model is mostly a European phenomenon exported with some significant modifications to America, while its frequently imperfect rehash in other extra-European contexts has often been the result of policies of colonialism, in which even institutions such as the United Nations have played a role in the universalization and spread of the model.⁴ Even less can it be considered universal in time, as the modern State has been the result of a long historical evolution in which different stages can be distinguished, and is still the object of transformations. While the State has been slowly evolving over the centuries, it is in particular more recently that ‘the territorially consolidated, sovereign nation-state has faced increasing pressures over the past few decades’.⁵

In the scholarly debate, Bobbit among others have distinguished various stages in the evolution of the State, of which in particular the latest is of interest for the purposes of describing the evolution of private law in Europe, i.e. what Bobbit calls the market-state. This form of State ‘depends on the international capital markets and, to a lesser degree, on the modern multinational business network to create stability in the world economy’.⁶ Indeed, in particular the pressures suffered from ‘above’, and the rise of global financial markets, have been such that the legitimation bases of the State have been weakened, as the State has started to appear incapable of continuing to provide welfare directly to its citizens.

This therefore describes a State which has become highly dependent on private actors at the global level, and thus represents the possible evolution of the State in the context of globalization and economisation. These trends have already led political science to ask whether, in this global context, the State has started to disappear or whether the ‘Leviathan’ has been dispossessed of its power.⁷ It is now commonplace that the phenomenon of globalization has put the State under considerable pressure, to the extent that the ‘crisis’ or even the ‘end’ of the State have been preannounced several times in political discourse. Several crises have been seen since, but no end is in sight yet. Such awareness, interlinked with concerns about the maintenance of world peace and promotion of economic integration, has been particularly important in promoting the process of supranationalisation in Europe, in which important features of national statehood have been transferred to a higher

³ R. Axtmann, ‘The State of the State: The Model of the Modern State and its Contemporary Transformation’ (2004) 25(3) *International Political Science Review* 259-279, 259

⁴ Ibid, 262-264

⁵ Ibid, 264

⁶ P. Bobbit, *The shield of Achilles: War, Peace and the Course of History*, London, Allen Lane, 2002, 229.

⁷ See M. Bach (ed), *Der entmachtete Leviathan. Löst sich der souveräne Staat auf?*, Sonderband 5 Zeitschrift für Politik, Nomos, 2013

governance level rather than suppressed. If it is true that globalization has stimulated the emergence of new global actors, a different view closer to the trend of 'realism' underlines, however, that even in the more interdependent globalized context, when it comes to taking economically important decisions the State remains the main actor (although of course not all concrete States are influential in the same way).⁸ This is visible even in the European integration process, in which the persistence of certain national interests is still visible even in certain supranational interventions.⁹ The likely answer to the question of whether the Leviathan is disappearing therefore appears to be that the State is still present in this context, but its role and function is undergoing modifications. This entails consequences not only for public law, but for private law as well.

It remains to be seen which factors, gathered under the umbrella concept of 'globalization', engender a State transformation. A now usual, but nonetheless still meaningful, explanation suggests that changes to the concept of State and statehood are determined by the fact that national communities find new incentives to cooperate due to the new global risks that have emerged recently. In this sense, the new global problems and risk, often determined by technological developments and in any case furthered by the growing interconnectedness of the planet, pose a kind of 'cosmopolitan imperative' which requires in the first place an abandonment of methodological nationalism which 'equates modern society with society organized in territorially limited nation-states'.¹⁰

This does not, however, mean that a form of Kantian cosmopolitanism will arise in the form of a new super state – which would hint to the recognition of the traditional State model at an improbable global level rather than a radical change in the structure and functions of the State – but rather implies a process of cosmopolitanization which to a certain extent does not even come into conflict with the traditional nation state model.¹¹ At any rate, the existence of global risks and trends of cosmopolitanization lead to changes in at least some of the characteristics of the nation state historically intended as a community of the past, limited and exclusive to the extent that its citizens are 'ready to die for the fatherland', as the rhetoric of the nation-state portrayed them. On the contrary, as Beck puts it, cosmopolitanization would require a common view to the future, the necessity of inclusiveness and the desire to 'survive' rather than to die.¹² Beck goes on to explain that the European Union, where member states practice 'reflexive self-limiting strategies in their own best interest', could be regarded, at least in theory, as an example of this tendency in the European context.¹³ At a conceptual level, this idea of cosmopolitanization tends therefore to downplay the mostly definitional debate as to whether European integration amounts to a form of globalization or rather regionalization. Regardless of scientific elaborations, however, the shift towards cosmopolitanization is but one possible trend, as current tendencies show that on the contrary the countermove towards more methodological or even political nationalism might be stronger.

Rather than imagining possible global institutional evolutions, which is an exercise as fascinating as it is unproductive in this area, it is more opportune for our purposes to look at the way in which globalization in particular has affected some features and functions of national states, with specific regard for their political economy. That is to say, leaving aside even important political questions of legitimacy, accountability, representativeness and the like, what are the consequences for the economic policies pursued by nation States?

⁸ R. Gilpin, *Global Political Economy. Understanding the International Economic Order* (Princeton, Princeton University Press, 2001) 15

⁹ S. Wood, *Germany, Europe and the Persistence of Nations. Transformation, Interests and Identity, 1989-1996* (Aldershot, Ashgate, 1998) 2

¹⁰ U. Beck, 'Cosmopolitanism as Imagined Communities of Global Risk' (2011) *American Behavioral Scientist* 1346-1361, 1347

¹¹ *Ibid*, 1357

¹² *Ibid*, 1346-1361

¹³ *Ibid*, 1356

In particular, Stiglitz has shown how globalization has had an impact on the State leading to a redefinition of its economic role.¹⁴ This entails consequences specifically for the distinction between the role of the private and the public sector. Today, one can say that a third way is generally pleaded for between the *laissez-faire* and socialist model, whereby the former model has more emphasis in the private sphere, while the second is more influential in the public sector. More specifically, there is now in the US and Europe a larger consensus as to the impossibility of drawing a clear distinction between what is public and what is private, and this tendency equally regard both the legal field, in which the falseness of the public/private divide has become commonplace – as acceptable in theory as potentially hazardous it is in judicial practice – but also, and most importantly, the economy. Here, a form of partnership and complementarity between private and public sector can be found. As a telling example of this development, one can consider the case of old age security. Since the beginning of the 20th century, and through the models of administrative and welfare State, providing individuals with old age security has mostly been a matter for the State. In more recent times, and as the Welfare State was weakened, this model has started being re-discussed also under the influence of global institutions like the International Monetary Fund, which have mostly advocated the efficiency of private schemes. Yet, in concrete cases, these models have also appeared to be inefficient and have ultimately failed both economically and socially. Adopting an integrated private/public perspective which acknowledges the interaction between the two dimensions, the question should nonetheless be not how to replace the public with the private, but rather how to improve public provisions.¹⁵ What makes things more complicated, however, is that, ‘Everyone agrees that there is a role for the state in providing old age security. Everyone agrees that there is a role for the private sector. But they do not agree about what constitutes the right mix’.¹⁶

The State and the European integration process

In the European context, the changing role of the State against the background of the processes of globalization and regionalization is best illustrated by the establishment of the European Communities. As is well-known, one of the reasons behind this creation was the deliberate intention of tying the hands of the nation-state not only in its military potential, which already expressed itself in the first half of the 20th century, but also in its economic ambitions, determining a clear blow to the still central (though often unspeakable) Weberian idea that economic processes are of pivotal national interest and that national economy is a political economy.¹⁷ In this sense, one of the characteristics of the new European model was the development of an economic constitution in the sense and with the features of the German *ordo-liberal* model at the European level (curiously more well represented at the EU than at the German level where it coexisted with strong elements of corporatist tradition)¹⁸ – including the later shift to a common currency union – which could coexist with national models more oriented to the different types of welfare state that European countries had developed over time. In this sense, rather than rehashing the model of the State at the supranational level in a wider federative form, the EU has so far led to a situation in which, as Weiler pointed out, there is a balance and difficult coexistence of supranational law and intergovernmental politics.¹⁹ The decoupling of

¹⁴ J. Stiglitz, ‘Globalization and the economic role of the state’ (2003) 12 *Industrial and Corporate Change* 3-26, 5

¹⁵ *Ibid*, 16

¹⁶ *Ibid*, 23

¹⁷ C. Joerges, ‘Europas Wirtschaftsverfassung in der Krise’ 357-385, 358

¹⁸ C. Joerges, ‘The European Economic Constitution and its transformation through the financial crisis’

¹⁹ J. Weiler, ‘The Community System. The dual character of supranationalism’ (1981) *Yearbook of European Law* 257

economic and social politics represented, however, a construction mistake which has put European integrity in danger several times over the course of history.²⁰

The consequences of the decoupling of economic and social constitutions have always been considered problems which could be solved, while the European social model could guarantee the coexistence of the different forms of European capitalism. This view has nonetheless appeared to be weakened through the years, to the point of making the social model appear utopian²¹ until the moment in which it was simply considered to have gone at the peak of the currency crisis.²² The way in which the common currency was built indeed represented an attempt to decouple monetary policies from politics and give them to law coherently with the move away from the politics of Keynesianism.²³

In the current scenario, even the traditional idea of economic constitution is undergoing a new modification in Europe. Initially, the European communities laid the foundations of a microeconomic constitution,²⁴ which had a direct significance for private law in the extension of private autonomy beyond national borders through the recognition of the four freedoms.²⁵ The Treaty of Rome, on the contrary, laid the foundation of a macroeconomic constitution, which included new public objectives such as price stability, inflation and so on,²⁶ to which more recently the new overall objective of financial stability was also added. The repercussions of this approach for private law became clearer only later. Most recently, the concept of economic constitution in the aftermath of the crisis is being replaced by a more generic notion of 'economic governance' the goals, limits, and institutions of which are much less well-defined and more problematic from the rule of law perspective.²⁷ This seems in line with design at the global level, where one can identify uncertain global governance without a global government.²⁸

The financial crisis and the responses which have been given to it represent just the latest and most dramatic episode of this development. In general, it can be observed that in the aftermath of the crisis, a new consensus as to the role of State and regulation is again emerging. In particular, the role of the state and regulation is especially needed in those sectors such as the financial sector or the healthcare sector in which problems like imperfect information make markets work in an inefficient way.²⁹ The above mentioned case of inefficient private pension schemes slowly replacing mandatory public ones can be considered as one of these instances too, but in the current scenario the most paradigmatic 'risk' field, with complementarity of the private and the (supranational?) public to counteract certain global risks, appears to be internet regulation.

Even in transnational fields such as the internet, in which the global nature of the phenomenon together with the risks that it entails are more evident – the clearest example is offered by the issue of data protection – and are counterbalanced by a State organized on a limited territorial basis, new forms

²⁰ C. Joerges, 'Europas Wirtschaftsverfassung in der Krise' 357-385, 358 with reference to Fritz Scharpf, 'weshalb die EU nicht zur sozialen Marktwirtschaft werden kann', (2009) 7 *Zeitschrift für Staats- und Europawissenschaften* 419

²¹ C. Joerges, 'Europas Wirtschaftsverfassung in der Krise' 357-385, 364

²² Interview to Mario Draghi, *The Wall Street Journal*, 24 February 2012

²³ C. Joerges, 'Europas Wirtschaftsverfassung in der Krise' 357-385, 365

²⁴ K. Tuori and K. Tuori, *The Eurozone Crisis. A Constitutional Analysis* (Cambridge University Press, 2014)

²⁵ P.-C. Müller-Graff, 'Basic Freedoms – Extending Party Autonomy across Borders', in S. Grundmann, W. Kerber, S. Weatherill (eds) *Party Autonomy and the role of Information in the Internal Market* (Berlin, Walter de Gruyter, 2001) 133-150

²⁶ K. Tuori and K. Tuori

²⁷ C. Joerges, 'The European Economic Constitution and its transformation through the financial crisis'

²⁸ Stiglitz, 4

²⁹ Stiglitz, 8

of regulation appear to be developing. This has recently become an area in which even the European Union judiciary has started infusing fundamental rights thinking in order to obtain better regulation.³⁰ Therefore, even in this context, and despite the repeatedly uttered calls for internet anarchy, therefore, the State is completely absent and everything rests on self-regulation. On the contrary, ‘self-governance is surely gaining in importance in the privacy field, and some of its forms can be seen as private equivalents of legal regulation. But the story does not end there. Self-governance mechanisms of privacy protection have recently become the subject of closer influence by governments and other public bodies again.’³¹ In particular, mechanisms of consultation, or even certification of compliance of self-regulation with standards, are emerging in Europe as a form of ‘regulated self-regulation’.³² In particular, the State – or organizations of States – is still intruding in the regulation of contractual relations in order to achieve certain policy objectives. These developments therefore affect the substance of contracting: one can see that ‘contracts are often used as a case-by-case substitute for missing privacy legislation’.³³ This does not mean that the policy objective of data protection is efficiently achieved by private parties alone through their contracting; on the contrary, the EU data protection directive of 1995 – ‘the most influential international policy instrument to date’³⁴ – ‘accepts standard contractual clauses to ensure an adequate level of protection for trans-border data flows to third countries. These standard clauses must be verified or developed by the EU Commission’.³⁵ At the same time, companies all over the world are slowly starting to comply with the standards incorporating those terms.³⁶ In the more recent case of the regulation of cloud computing services, for instance, ‘contracts have played a particularly important role in embracing (and absorbing) some of the challenges associated with the technological innovation’,³⁷ and two phases can be distinguished. In a first phase, characterized by more self-regulation, ‘cloud providers and customers have addressed core issues using contractual agreements’,³⁸ while these arrangements continue to evolve in line with new developments. In a second phase, the role of the State appears on the contrary to be more important and hints to forms of co-regulation, as ‘various stakeholders have started to work towards best practice models’.³⁹ ‘For instance the US CIO Council, in collaboration with other government units, developed guidelines for effective cloud computing contract for the federal government’, while steps in the same directions have been taken by the European Commission.⁴⁰

In sum, if one considers not only the reactions to the recent financial crisis, but also particular fields of transnational law, one can conclude that ‘the state is coming back – but in a different shape’.⁴¹

³⁰ G. Comparato and H.-W. Micklitz, ‘Regulated Autonomy between Market Freedoms and Fundamental Rights in the Case Law of the CJEU’, in U. Bernitz, X. Groussot, F. Schulyok (ed), *General principles of EU law and European private law* (Alphen aan den Rijn, Kluwer, 2013)

³¹ R. Bendorath, Privacy Self-Regulation and the changing role of the State. From public law to social and technical mechanisms of governance, WP No. 59 Transformations of the State CRC 597 6

³² Ibid 28

³³ Ibid 17

³⁴ Ibid 9

³⁵ Ibid 17

³⁶ Ibid 17

³⁷ U. Gasser, ‘Cloud Innovation and the Law: Issues, Approaches, and Interplay’, NCCR trade regulation, WP 2013/21, 2

³⁸ Ibid, 17

³⁹ Ibid

⁴⁰ Ibid

⁴¹ R. Bendorath, 6

Economization and globalization

According to the conceptualization of Bobbit, the nation-state is that form of State organization which arose after the Treaty of Versailles of 1919 and that, differently from previous forms, accepted the responsibility of providing economic security and public goods to its people.⁴² The terminology used by this author can be quite puzzling, especially for European scholars who are used to understanding the 'nation-state' as quite a different and earlier phenomenon, i.e. a political organization characterized by the coincidence of State and nation. Re-adapting Bobbit's terminology, it would be better to resort to the more generic notion of the modern State. At any rate, the capacity of this State to provide public goods to the citizens represented the political basis of its legitimacy, as appeared quite clearly in its later evolution as a 'welfare State'. Nonetheless, different factors such as, primarily, the rise of global capitalism as well as global communication networks, weaken the capacity of the State to guarantee what it has promised. It is in this context that the model of the welfare State has started being slowly weakened. Those public functions which were initially provided for by the welfare State have started being shifted to the private sector itself. This trend determined a sort of 'economization' and even 'privatization' of State policies, which have started being delivered through reliance on economic private actors.

One of the factors that has determined this development can be considered to be globalization, and more particularly the globalization of capital. There is a wide literature on the rather contentious subject of globalization which, although starting in the 1960s from the consideration that State internal affairs were becoming more and more dependent on external relation, has evolved in particular since the 1980s when capitalism became the main economic ideology worldwide. From that point of view and despite having different social and political aspects, globalization is per se a phenomenon highly interlinked with (capitalist) economy, at least in its scholarly portrayal. Even the development of one of the most pertinent symbols and drivers of globalization, i.e. the internet, is firmly interlinked with economic processes of liberalization (in particular of the telecommunication market in the US) and immediately appeared to be an ideal playing field for a few big corporations prepared to provide new services, even some of those traditionally provided by the public sector, to the citizens/users of the internet.⁴³ For our purposes, therefore, just two dimensions of globalization can be addressed, i.e. its economic and its societal element.

In economic terms, globalization is most clearly represented by the global dimension of capital. This move has had important repercussions for the State. On the one hand, State economy has become more dependent on finance, something which can be defined as 'financialization', while finance itself was becoming less dependent on the State. This phenomenon has been favoured by financial innovation, especially in the 1980s, with the invention of new financial instruments such as securitization and credit default swaps, which were then traded in global markets.

At the same time, the shift towards global financialization has not been casual but on the contrary has been favoured by specific policies, often of a fiscal nature, in countries which have been forerunners of this development, in particular the US. 'A post-industrial economy is thus largely a financialized economy that carries its debt burden by borrowing against capital gains to pay the interest and taxes falling due'.⁴⁴

This development stands in contrast with the one of the Welfare State period in different ways. In the first sense, the Welfare State relied more strongly on public indebtedness rather than private indebtedness, which is on the contrary continuously on the rise in highly financialized economies. Inasmuch as it has been favoured by tax law regimes, this development marks a difference from the

⁴² Bobbit 215

⁴³ See D. Schiller, *Digital Capitalism. Networking the Global Market System* (Cambridge, MIT Press, 1999)

⁴⁴ M. Hudson, 'The Transition from Industrial Capitalism to a Financialized Bubble Economy' (2010) Levy Economics Institute, WP 627

policies pursued by the State even in older times, as ‘the Progressive Era a century ago advocated that taxes should fall mainly on rent and other property returns. The aim was to free economies from rent and interest, so that prices would only reflect necessary costs of production – wages and profits for labor and capital. But governments have pursued the opposite fiscal philosophy since World War I, and especially since 1980’.⁴⁵ ‘The idea is that shifting taxes off property and finance promotes a “free market”. What it actually does is favour the debt-leveraged buying and selling of real estate, stocks and bonds, distorting markets in ways that de-industrialize the economy’.⁴⁶ According to this reading, therefore, financialization almost naturally requires globalization and the spread of the financialized model to other countries, since ‘international equilibrium can be maintained only if all other economies are financialized in a symmetrical fashion – a proliferation of the debt burden that in fact has become a distinguishing characteristic of today’s globalization’.⁴⁷

Nonetheless, this phenomenon comes at the price of important societal repercussions: ‘Global capitalism has brought in its wake regional disparities and economic dislocations. Deindustrialization and unemployment, rising prices, and declining living standards have intensified the demands by citizens for protection and security.’⁴⁸ On the one hand, the higher mobility of global capital has reduced the capability of the State to react and obliges it to be more competitive: the very dynamics of globalization weaken the State capacity to be proactive, so that, as Stiglitz puts it: ‘The process of globalization, the integration of economies around the world [...] has put new demands on nation-states at the very same time that, in many ways, it has reduced their capacities to deal with those demands’.⁴⁹ Policies of liberalization, privatization and marketization have been often presented as necessary in the global context, but have *de facto* accelerated the transition from the industrial welfare state to the new model of ‘competition state’.⁵⁰ On the other hand, citizens which belong to social classes and groups most adversely affected by globalization and ‘thus excluded from strategies of purchasing ‘privatized’ services’ expect the State to act in their interest.⁵¹ Confronted with such social claims, ‘the economic subsystem in its capitalist form has always externalized the cost of securing the existence of the worker and let other forms of association, such as the family, state, or charitable organizations, deal with it’.⁵² The power of the State to regulate appears weakened, paradoxically, while societal claims make that power to regulate more compellingly necessary.

In fact, the phenomenon of globalization appears to a certain extent to reduce voluntarily the role of the State, and in particular its capacity to regulate. Most recently, this criticism has been uttered in the debate as to new trade negotiations between the EU and the US. Although lobbyists and law firms resolutely reject the criticisms as ungrounded expressions of concerns which have always been uttered in the history of European legal integration without concretizing, and even represent the manifestation of a ‘European closed-mindedness’,⁵³ several commentators circumstantiate their denunciations on very specific issues. Among others, a group of scholars commenting on the proposed investor-state arbitration mechanism in the TTIP has denounced the proposal as having the effect of entrusting a set of commercial arbitrators with the role of ‘balancing the right to regulate of sovereign states and the property rights of foreign investors’,⁵⁴ in a context in which any contractual breach seems able to

⁴⁵ Ibid, 7

⁴⁶ Ibid, 32

⁴⁷ Ibid, 34

⁴⁸ R. Axtmann, 266

⁴⁹ Stiglitz, 3

⁵⁰ R. Axtmann, 274, referring to Cerny 2000

⁵¹ R. Axtmann, 268

⁵² R. Axtmann, 262-264

⁵³ A. Geiger, ‘TTIP, TPP und die europäischen Kleingeister’ (2014) 18 *Europäische Zeitschrift für Wirtschaftsrecht* 681-682

⁵⁴ H. Schepel et al, Public consultation on investor-state arbitration in TTIP – Comment, 1

become a breach of treaty obligation,⁵⁵ and in which the sovereign power to expropriate,⁵⁶ as well as perform ‘haircuts’ on government bonds in case of sovereign debt crises,⁵⁷ appears to be highly and problematically reduced. More generally, commentators have also denounced how these kind of investor-state arbitration schemes – a mechanism often used when there is low reliance on the domestic courts of certain contracting states – in the TTIP reflects ‘a vision of failed statehood’.⁵⁸ Such distrust in domestic courts should actually not come as a surprise. It has already been argued that such a ‘loss of faith in adjudication’ is a characteristic common to both neo-formalist and neo-functional approaches to contract law, as evidence of a ‘turn to market’⁵⁹ in a globalized scenario in which contract law becomes an example of ‘law after the welfare state’ considered mostly for its capacity to enable private ordering.⁶⁰

Concerning the regulation of the internet, ‘the globalization of the economy led to an increase in trans-border data flow. On the other hand, one of the official goals of international economic policy was (and is) free trade. Personal data, as soon as it was more widely available than before, also became a commodity’.⁶¹ It was later the fear that data protection rules might limit the possibility of some companies in the US to enter the EU market that led the US to push for more self-regulation in Europe. The compromise of these divergences was the “Safe Harbor” agreement of 2000 which was a link between two different regulatory approaches: ‘The European, law-based and comprehensive privacy regulation and the American, private sector-based and sectoral privacy regulation’.⁶² In this framework, ‘most of the oversight function as well as the day-to-day supervision are done by the private sector itself. The states only set the minimum data protection level, and it has the means of last resort in case there are serious non-compliance problems’.⁶³

The importance of this area, and the way in which it is interlinked both to changes in the economy and statehood, means that it is compelling now to look more closely at the role of technology in the mentioned transformation.

Technology

Technological developments have always been an important driver of the change of social and legal relations throughout human history. The very beginning of new eras in the history of mankind is marked by some technological development which considerably alters social organization. Concerning the effect on legal relations, and without having to look too far back in history, it suffices here to think of the developments of industrialization and labour law. Technology, however, certainly does not influence only productive processes. For example, the creation of nation-states (in the common understanding rather than in the aforementioned conceptualization of Bobit) and the spread of a sense of national belonging were also due to the new printing technologies which allowed people all over the country to be informed about events taking place in all parts of the newly formed nation state.⁶⁴ In this

⁵⁵ Comment 11

⁵⁶ Comment 12

⁵⁷ Comment 5

⁵⁸ Comment 2

⁵⁹ P. Zumbansen, ‘Law after the Welfare State: Formalism, Functionalism and the Ironic Turn of Reflexive Law’ (2009) *TranState* WP 82, 23

⁶⁰ *Ibid* 26 ff.

⁶¹ R. Bendorath, 8 with reference to Weichert 2000

⁶² R. Bendorath, 12

⁶³ *Ibid* 13

⁶⁴ B. Anderson, *Imagined Communities* (London, Verso, 1983)

sense, technological developments served not only the economy, but also had important repercussions for society at large.

Just as technologies trigger economic innovations, they also have an impact on society and social awareness about certain facts. In this sense, Beck has noted that global crises are certainly often the result of technological developments in fields like nuclear power and financial markets characterized by high communication interconnectivity, but that they are also ‘extremely dependent on global news media’.⁶⁵ This has an impact on the formation of global awareness about such problems, since ‘cosmopolitan events are highly mediatized, highly selective, highly variable, highly symbolic, local and global, national and international material and communicative reflective experiences and blow of fate. They transcend and efface all social boundaries and overturn the global order that holds sway in people’s minds’.⁶⁶

Curiously, while the spread of global risks is not always counterbalanced by political institutions which are equally global, ‘the only institutions that are just as global and operate in real time just as the financial system does, are the mass media’.⁶⁷ The reporting of such news, and in particular of the recent financial crisis, might in this sense contribute to the creation of a ‘public sphere’.⁶⁸ If the concept of State is still undergoing transformation in a global dimension then economy, technology and societal awareness are already, though to different extents, ahead in that process of globalization. If it is true that such public spheres, potentially capable of sustaining democratic deliberations in the Habermasian sense, are evolving at the global level, it seems consequent that those global institutions have to become more representative of those claims.

The State organization has already been strongly influenced by technological developments as well, in as much as these have triggered a series of economic innovations and social modifications. For instance, the fall of communication and transportation costs was one of the forces that led first to nation-building and that are still driving the process of globalization.⁶⁹ Technological development has had and will arguably still have ‘enormous impacts, not only on the economies, but on the role of government’.⁷⁰

This concerns not only the historical development of the nation-state and the evolution of statehood after industrialized countries. For Bobbit, the transition from older state forms to the market State is mostly technology-driven, although mediated through political leadership.⁷¹ The development of new technologies for moving people and information is more likely to make social communities discontinuous rather than homogeneous as required by the traditional nation-state model, pointing to a focus on function rather than territory.⁷² In this sense, one can say that ‘with the increasing importance of high-tech, high know-how economies, scale and space become less important in economic terms’.⁷³ One of the most direct consequences of these developments, which in modern society comprehend technical evolutions in telecoms, energy, mass media, pharmaceuticals, the internet and so on, is that in order to effectively regulate such intricate fields, the role of expert- and knowledge-based regulation and co-regulation has emerged more strongly.

⁶⁵ Beck, 1349

⁶⁶ Ibid

⁶⁷ Ibid, 1350

⁶⁸ Ibid, 1351

⁶⁹ Stiglitz, 3

⁷⁰ Stiglitz, 7

⁷¹ R. Axtmann, 274

⁷² Ibid 271

⁷³ Ibid 266

Again, these dynamics are best illustrated by the development of the internet. In respect to older phenomena, the internet presents some aspects which are novel and pose new challenges, the most important of which is its transnational character, which makes the idea of State regulation a particularly complex issue. This is even hardly comparable to telephone networks, ‘which were designed by hierarchical forms of coordination in and between nation states’, while ‘the Internet seemed to be immune to any form of central steering’.⁷⁴ In this framework, a wide literature has dealt with the subject and can be roughly divided between ‘cyber-separatists’, often claiming ideologically the separateness of the phenomenon of internet from the State, and ‘traditionalists’ who, starting from the consideration that even internet infrastructure remain territorially based and therefore linked to a particular legal order, claim a more important role for the State.⁷⁵ What might be noticed in this regard is a certain complementarity between self-regulation in the private sector and by the State, often organized in supranational or international forums in which new devices are being created to regulate the phenomenon. This appears in particular if one considers the much discussed issue of privacy on the internet, which obliges law makers and private norm-setting bodies to reach to technical change.⁷⁶ ‘The driving force behind the move towards more self-regulatory approaches in data protection was therefore a change in the structure of the regulated problem. If everybody became a potential user and collector of personal data, then top-down enforcement and central oversight mechanisms would not work anymore’.⁷⁷

Pure self-regulation in the field has, however, been considered inefficient to a certain extent, and has not gained much popular support, thus leading to a more prominent role for State regulation. Nonetheless, given the structure of the phenomenon even regulation has assumed a particular form, occasionally considering the technical characteristics of the phenomenon to be regulated: ‘instead of regulating individual data banks and data centres like in the 1970s, it is concentrating on technical infrastructures and standards that will have a widespread impact on the use of personal data’.⁷⁸

Such an approach is the idea of the ‘code’, introduced by Lessig,⁷⁹ according to which individual behaviour can be steered, and therefore the same result of ‘regulation’ can be achieved not by imposing a certain conduct on individual operators, but rather by influencing the technical infrastructure of their activities.⁸⁰ In this sense, the development of certain technologies offers to the State not only new challenges and problems to be regulated, but possibly even new instruments of regulation. This is evident in particular if one considers one of the most recent developments of the internet, i.e. the spread of cloud computing services, ‘outsourced systems where third parties provide aggregated computational resources and services on an as-needed basis from remote locations’.⁸¹ These pose renewed concerns in terms of data protection for which different regulatory responses are conceivable, including a stronger role for contract law and the development of best practices.⁸²

⁷⁴ R. Bendorath, 1

⁷⁵ Ibid 2

⁷⁶ Ibid 5

⁷⁷ Ibid 11

⁷⁸ Ibid 30

⁷⁹ L. Lessig, *Code and Other Laws of Cyberspace* (Basic Books, 1999)

⁸⁰ Discussed by R. Brownsword, ‘Whither the Law and the Law Books? From Prescription to Possibility’ (2012) 39 *Journal of Law and Society* 296-308

⁸¹ U. Gasser, ‘Cloud Innovation and the Law: Issues, Approaches, and Interplay’, NCCR trade regulation, WP 2013/21, 2

⁸² Ibid, 16-17

Societal changes

The model of the modern state, mostly in its nation-state form, developed in a context characterized by social pluralism, while ‘the modern state project aimed at replacing these overlapping and often contentious jurisdictions through the institutions of a centralized state’.⁸³ This was created as an allegedly ‘homogeneous’ institution with an overlap of nation and state through an operation that was also determined by nationalism, which assumed the cultural homogeneity of the national society. The social model in this context was one in which loyalty was given directly to the State, especially in war times.⁸⁴ Much of today’s structure and principles of private law in Europe stem from this period.⁸⁵ Later, the development of the welfare state made it possible for the state to start addressing the ‘social question’, in which the state could ‘shape the national economy through state subsidies, the elimination of internal trade barriers (such as tariffs), and the imposition of import duties; and to expand the transport infrastructure as well as the communication infrastructure more generally, including state education’.⁸⁶

In this sense, the modern state ‘pulled society into its political space, at the same time as it was trying to shape society according to its own objectives’.⁸⁷ This development was characterized mostly in democratic terms through an association of nationalism and liberalism which assumed that every individual was well-equipped to participate in the democratic process.⁸⁸ This state therefore created a homogeneous legal space where the members of the national community could move freely, and in which citizens are equal and not differentiated on the basis of intermediate communities.⁸⁹ The State has in this sense an active role inasmuch as it helps to produce such homogeneity, while even laws and judicial decisions and all the other ways in which individuals are regulated are instruments to this aim. It is in this context that in continental Europe the first civil codifications were enacted. Therefore, ‘as a moral regulator, the state ‘creates’ society’, although recently its ‘moral regulation has become ever less powerful’.⁹⁰

This societal model, fully coincident with the State organized on a national basis, is however considered also to be in a state of crisis, again mostly through heterogeneous processes such as globalization, which implies both financialization and multiculturalism, but also through endogenous factors such as functional differentiation and growing complexity. In such complex and multicultural settings, differently from the past but paradoxically similarly to the pre-modern State era, autonomous groups claim ‘self-government in certain key matters such as education, health, or family law’.⁹¹ New models therefore respond to such forms of functional differentiation.⁹² ‘Restrictions on the exercise of any centralized power as well as the dynamic of the ‘subsystems’ as a result of the increase in ‘efficiency’ [...] lie behind the incessant drive to ever greater specialization, professionalization, and organizational structuration of each ‘subsystem’’.⁹³

⁸³ R. Axtmann, 260

⁸⁴ Ibid 261

⁸⁵ G. Comparato, *Nationalism and Private Law in Europe* (Oxford, Hart Publishing, 2014)

⁸⁶ R. Axtmann, 261

⁸⁷ Ibid 261

⁸⁸ Ibid 262

⁸⁹ Ibid 264, reference to Parekh, 2002

⁹⁰ Ibid 267

⁹¹ Ibid 264

⁹² Ibid 267

⁹³ Ibid 268

This augmented complexity, associated with the phenomena of globalization, determines that ‘we live in a world of radical uncertainty’,⁹⁴ characterized by the ‘internationalization of problems’ and the emergence of global risks, as touched upon above, which are detached from the exclusively national level and can be the result of technological improvement consisting for example in environmental risks. Modern societies are characterized by the spread not only of risk, becoming risk societies, but also global risks.⁹⁵ These are mostly due to human activities connected with ecological and technological factors, as well as from insufficiently regulated financial markets.⁹⁶

In this context, ‘in a world of global crises and of dangers produced by civilization, the old dualisms of internal and external, national and international, and us and them lose their validity, and the imagined community of cosmopolitanism becomes essential to survive’.⁹⁷ If, on the one hand and as already stated, this results in a ‘denationalization of the state’,⁹⁸ which among other things requires a redrawing of the public-private divide and the reallocation of tasks accordingly,⁹⁹ on the other hand it determines the development of a new space for the ‘civil society’, which is particularly active, for instance, in environmental matters both at the national and at the global level.¹⁰⁰

The consequence of such ‘internationalization of society’ can become a claim for an ‘internationality of political decision-making’¹⁰¹, especially when the societal perception of problems as being of international significance may lead to transnational cooperation between societal actors and hence to societal internationalization.¹⁰² Indeed, it is not only the spread of global problems but also the spread of awareness about those problems that contributes to that development: ‘the reception of such media reporting creates an awareness that strangers in distant places are following the same events with the same fears and worries as oneself’.¹⁰³ This is a process of economic globalization and technological evolution as well, which as a result entails a globalization of communication, so that ‘the flow of information and communication on a global scale has become a regularized and pervasive feature of social life’.¹⁰⁴ This is a process which is in a way comparable to the one described by Anderson of the creation of nations as imagined communities where news spread freely from one side to the other of the country thanks to print technologies.¹⁰⁵ In this sense, the literature has for many years started wondering whether or not the new information technologies might help develop a new international public sphere in a context characterized by the globalization of an economic neoliberal model.¹⁰⁶

Again, the internet offers a good example of these new risks, but also of changes in the societal structure of States which call for new forms of regulation. As the internet became more important for society and the possibilities of abuses linked to data retention were augmented, there arose a stronger need to protect citizens directly. In this sense, ‘contrary to the first generation of data protection laws that tried to regulate the corporations, the new laws and amendments, and the developing case law in

⁹⁴ Ibid 268

⁹⁵ Beck, 1346

⁹⁶ Ibid, 1346

⁹⁷ Ibid, 1349

⁹⁸ R. Axtmann, 269

⁹⁹ Ibid 270, Jessop 2002 199

¹⁰⁰ Ibid 270

¹⁰¹ Ibid 269

¹⁰² Ibid 269

¹⁰³ Beck, 1350

¹⁰⁴ J.B. Thompson, ‘The globalization of communication’

¹⁰⁵ B. Anderson, *Imagined Communities*

¹⁰⁶ C. Calloun, ‘Information technology and the international public sphere’, in D. Schuler and P. Day (ed), *Shaping the Network Society. The New Role of Civil Society in Cyberspace* (MIT Press, 2004) 229-251

the 1980s gave the citizens a say in the process. Their consent – at least in Europe – became a precondition for the use and processing of personal data'.¹⁰⁷ Even more recently, news about misuse of personal information by internet companies, fears about credit card data frauds and so on have 'led to a public demand for more effective privacy protection online'.¹⁰⁸ This has translated into a renewed need for State involvement in the regulation of the internet.¹⁰⁹

The economic role of the State also has to be considered in light of the social demands in certain countries. In the first place, given the social structure of some countries, it is not clear whether certain institutional principles like, for example, the independence of central banks could work efficiently. In this sense, 'the degree of independence is something which democracies should debate'.¹¹⁰ Unfortunately, global institutions like the IMF are structured in a way that does not give sufficient consideration to the social claims coming from the population of some countries, and while their policies 'affect the livelihoods and lives of millions of people, workers and small businesses',¹¹¹ occasionally leading to social and political turmoil,¹¹² these policies are highly dependent on the governance structure and do not seem to allow for a sufficient democratic process which takes into consideration the requirements of social justice.¹¹³ This situation does not seem to have significantly changed even after the reforms in the aftermath of the financial crisis, and it might even have deteriorated.

Even if in this period new efforts have been made at the global level to coordinate the macroeconomic responses to the crisis, the G20 design, which show institutional problems of both representativeness and efficiency, might even represent 'a step in the wrong direction'¹¹⁴ because an 'ad-hoc self-appointed body can never replace representative institutions in a well-structured international governance framework'.¹¹⁵

These internationalising tendencies therefore have an obvious dark side, which is an 'extreme tension between the effectiveness of political problem-solving at the "international" level, on the one hand, and democratic legitimacy which remains embedded in "domestic" political institutional arrangements, on the other'.¹¹⁶ The problem is that 'while "democracy beyond the nation-state" remains weak, "democracy within the nation-state" is thus weakened as well'.¹¹⁷ Again, private law is not indifferent to this process: the renewed research interest in the link between contract law and democracy,¹¹⁸ for instance, can be considered as a possible reaction to these deeper developments.

Conclusion: What role for private law?

This contribution has tried to highlight some of the dynamics which are taking place in contemporary society, and which are contributing to the evolution of our traditional idea of public and private law.

¹⁰⁷ R. Bendorath, 21

¹⁰⁸ Ibid 26

¹⁰⁹ Ibid 26

¹¹⁰ Stiglitz, 25

¹¹¹ Ibid, 11

¹¹² Ibid, 7

¹¹³ Ibid, 11

¹¹⁴ J.A. Ocampo and J.E. Stiglitz, 'From the G-20 to a Global Economic Coordination Council' (2012) 2 *Journal of Globalization and Development* 3

¹¹⁵ Ibid

¹¹⁶ R. Axtmann, 270

¹¹⁷ Ibid 270

¹¹⁸ M.W. Hesselink, 'Democratic Contract Law' (2015) *European Review of Contract Law*

Statehood and law in more general terms have been constantly in a process of modification over the course of history. What is important then is to highlight both the characteristics of this evolution, and the factors which are determining it. Private law cannot be considered as detached from that background. In this sense, the development of a new but still embryonic and difficult to conceptualize form of post-modern State, or Market State, poses challenges to both traditional autonomy-based and social-functionalist visions of private law, employing private law in possible new ways in the heterogeneous yet interlinked processes which characterize this historical era such as liberalization, privatization, globalization and digitalization. This development is inscribed at least partially in the picture already outlined a decade ago by Duncan Kennedy, who depicted the emergence of a third form of globalization of law and legal thought tentatively labelled as contemporary legal thought.¹¹⁹

It is possible to see in particular how the concept of private autonomy, which is of pivotal importance in contract law theory, has undergone modifications during the phases of those transformations, and under the influence of the elements identified. Despite the tendency to consider private autonomy as a pre-legal form of liberty detached from the State, it is in particular clear that modifications in the structure of the State have led to modifications to private autonomy as well. The liberal approach to the economy which characterized the 19th century liberal State did not require particular regulation of the contents of contracts, and therefore allowed for the liberal choices contained in the grand codifications of private law in continental Europe at that time. This has progressively changed over the phases of the transformations of the State, in which the regulation of the contents of contracts has become more important.

Later codifications adopted in the era of a rising interventionist State included norms which gave the already long unified State a more prominent role in the regulation of even the economic contents of the contract, including notably the power to dictate prices. The later development of the democratic state paradoxically employed those very provisions to achieve results in line with the policies of the welfare State. This process has determined the emergence of a new rationale of private law which has been difficult to reconcile within the political framework of a code thought of as the economic constitution of a liberal or even economic interventionist State. As is well-known, it is in this context that in Europe the idea of code started going through a crisis, leading to a tendency to ‘de-codification’, which refers to the loss of centrality of the category of the code with its rationality, and the emergence of a series of special statutes outside of the code often inspired by social regulation.¹²⁰

The development of this kind of socialized private law which relies on a materialized autonomy is indicative of the growing influence of social regulation of a new State which, having liberalized and privatized several of its key areas, can only regulate and demand a higher consideration for economic and social objectives in those fields. Different to the liberal State, and more similar to the welfare State, however, the regulatory State cannot rely on a classical understanding of private law by renouncing its role in employing private autonomy as an object of regulation and at the same time a regulatory tool in itself.

The timid re-regulation of areas such as the financial sector adopted in the aftermath of the financial crisis, often under the influence of European law, does not however represent a return to the logic of the welfare state nor the liberal state. Still, the new regulatory approach impacting on contractual relations can be viewed as a new wave of limitations to private autonomy, bringing new informative requirements, and even heading towards a more ‘paternalistic’ direction. In this case as well, the dynamics of private autonomy point to a contextual extension and limitation, and more fundamentally to a continuous redefinition of autonomy within the context of the new legal and social order.

¹¹⁹ D. Kennedy, ‘Three Globalizations of Law and Legal Thought: 1850–2000’, in D.M. Trubek and A. Santos (eds), *The New Law and Economic Development A Critical Appraisal* (Cambridge University Press, 2006) 19-73

¹²⁰ See L. Niglia, *The Struggle for European Private Law. A Critique of Codification* (Oxford, Hart, 2015)

Competition or regulation? Private law platforms for transnational market-making

Yane Svetiev

By way of background

“Arriving at constructive solutions demands rethinking radically, the ordoliberal straightjacket that ... the European legal order [has] created for states. It may well be necessary to abandon the strictures that European competition law presents for states. States are necessary, not only to provide public services, but to offer employment for those who do not want to live competitive lives. It may be wise to return to an understanding of fundamental freedoms that predates the revolution brought about by cases such as *Cassis de Dijon*, *Bosman*, and *Centros*.”¹²¹

“The ‘darker’ side of [*Van Gend*] – a proxy for governance – [is] its contribution to a European narrative of efficiency which disregards the traditional mechanism of democratic legitimacy. ... The preliminary reference always posits an individual vindicating a personal, private interest against the national public good ... [It is] another building block in that construct which places the individual in the centre but turns him into a self-centred individual.”¹²²

“No Treaty should ask a state to commit to a purpose unless that purpose is rigorously ring-fenced, highly consensual or unless [it] contains workable mechanisms for deep political legitimation, and for self-questioning, so that autonomy is moved rather than eliminated ... Perhaps the most urgent need, if we are not to entirely re-write the treaties, is for more precision about what an internal market needs – both what kind of harmonization can be said to serve the object of the internal market and what kinds of national measures can be seen as obstacles.”¹²³

“Contrary to what I have argued at several occasions ... I no longer believe that the seminal holding in *Cassis de Dijon* can be translated into a conflicts-law decision. ... Since both countries were committed to the free trade objective, they should also be prepared to accept that restrictions of free trade must be based on credible regulatory concerns. The ECJ, however restricted the concerns which European law accepts as legitimate drastically. There is a striking parallel with the infamous *Lochner* case of 1905”¹²⁴

Introduction

Darkening clouds over Europe have been accompanied by increasingly gloomy reflections on the state of EU legal integration. Many of the original advantages of the integration process, including the (neo)functionalist focus on building a common market as the route for deepening interdependence and peace, as well as the introduction of competitive principles and deliberative discipline on national policy-making are increasingly identified as crucial constraints for EU democracy, legitimacy or social justice. The “genius” of the preliminary reference, as well as the hallmark cases of the once lauded “integration through law”, are reinterpreted as the original sin through which self-interested

¹²¹Alexander Somek, “Europe: Political, Not Cosmopolitan”, *European Law Journal*, vol. 20:2, pp.142–163 (2014), p. 162.

¹²² Joseph Weiler, “Van Gend en Loos: The Individual as Subject and Object and the dilemma of European legitimacy”, *International Journal of Constitutional Law*, vol. 12:1, pp. 94-103 (2014), pp. 94, 103.

¹²³ Gareth Davies, “Democracy and Legitimacy in the Shadow of Purposive Competence”, *European Law Journal*, vol. 21:1, pp. 2-22 (2015), pp. 19-20.

¹²⁴ Christian Joerges, *Market Integration and Europeanization of Private Law*, Paper presented at the Jean Monnet Project Conference on European Economy and People’s Mobility, Jena 7-9 May 2015.

individuals (and firms) could exploit EU law to gradually undermine the bases of national solidarity embodied in national democratically legitimated law. Such scholarly reflection on the EU as a purely market-promoting actor must be viewed in conjunction with the evidence of an apparent Polanyian “double movement” of a distinctly national if not nationalist character¹²⁵.

The general tenor of disappointment palpable in the EU scholarship is reminiscent of the despondent tone prevalent among American Critical Legal Studies (CLS) scholars at the dusk of the Great Society era of court-led emancipation of group rights and social justice in the US.¹²⁶ The CLS scholars lamented the passing of the era in which robust Supreme Court majorities favoured progress in emancipation of disadvantaged groups and individual rights. However, by focusing too narrowly on the proximate realities at the court level, CLS possibly over-looked limited outcomes on the ground of court-triggered emancipation, unless it produced policy and deliberative innovations at both State and federal level, supported by civil society. Further, possible deeper transformations of both the social and economic environment in which the legal system operates were overlooked, which may operate as further constraints on court-led emancipation. The combined effect of such blindspots tended to inhibit the capacity of the CLS scholarship to offer a constructive and affirmative project. Namely, to the extent that robust Supreme Court majorities in favour of gender or racial emancipation, affirmative action, rights protection of marginalized groups were unlikely to be either forthcoming or successful, what were other mechanisms that could advance those causes through alternative routes?¹²⁷

The same tenor can be detected in the scholarship on EU private law. Much of the initial complaint against EU intervention in private law was the instrumental character, which undermined conceptions of autonomy and inter-personal justice said to underlie national private law orders. Such complaints saw promise in the proposal for a codification at the EU level, because a codification would temper the instrumentalised interventions with more traditional justice-based rules.¹²⁸ The unfavourable political reaction to that project, focused on traditional concerns about national competences and EU competence creep was paralleled by academic claims about the impossibility of harmonization of private law as a reflection of national identity encoding national legal culture and practice.¹²⁹ However, somewhat lost in the debate about competences, national identity and culture was a more Europeanist critique of the codification project. Namely, Wilhelmsson argued that private law, at national as well as EU level, typically does embody various and differing welfarist concerns that are impossible to subsume in a comprehensive codification. Instead, he argued that EU private law should cherish and stimulate pluralism and provide a platform for mutual learning, a view that is wholly consistent with Joerges’¹³⁰ conceptualization of diagonal conflicts of law as a source of deliberative learning across legal systems:

“A general European civil code ... would probably be too static an instrument to allow sufficient space for a welfarist, more scattered and decisionistic, improvement of the rules. [T]o safeguard the legitimacy of the decisions—as the legitimacy cannot be sought in the idea of a coherent system—there should be sufficient room for continuous development at national level in addition to the required EC measures.

¹²⁵ Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (1944) (Boston, Beacon Press, 2001).

¹²⁶ See Mark Tushnet, *The New Constitutional Order* (Princeton, Princeton University Press, 2004).

¹²⁷ Michael Dorf, “After Bureaucracy”, *University of Chicago Law Review*, vol 71: 3, pp.1245-1273 (2004), p. 1246 (“skepticism leaves them ill equipped to argue for an affirmative project.”).

¹²⁸ Cristoph Schmid, “The Instrumentalist Conception of the *Acquis Communautaire* in Consumer Law and its Implications on a European Contract Law Code”, *European Review of Contract Law*, vol. 1:2, pp. 211-227 (2005).

¹²⁹ Pierre Legrand, “Antivonbar”, *Journal of Comparative Law*, vol. 1:1, pp. 13-40 (2006), p. 31 (viewing the proposed codification as a form of “imperial commodification of thought” that prospers by ruling “local knowledge inadmissible”).

¹³⁰ Christian Joerges “The Challenges of Europeanization in the Field of Private Law: A Plea for a New Legal Discipline”, *Duke Journal of Comparative & International Law*, vol. 14:2, pp. 149-196 (2004).

Welfarism requires a constantly learning law ... a process of Europeanisation through a free movement of legal ideas and doctrines, across the borders”¹³¹

EU institutions and private law: Rationality or habit?

In the area of private law, the attempt by the Commission to salvage some of the work and resources committed to the private law harmonization crystallized in a proposal for a Common European Sales Law optional instrument to be used for cross-border sales of goods. This initiative must be viewed in the broader context of the Digital Agenda for Europe and the identification of the completion of the digital single market as a top political priority for the Commission. The criticisms of the CESL project, now itself apparently doomed to failure, have a similar undertone to the broader scepticism about the effects of EU law outlined above. Thus, Bartl argues that EU private law building is driven by an “internal market rationality”¹³². While the proposal does contain certain measures protective of transacting parties who have a weaker bargaining power and contracting capacity, on this view, such protections are consistent with the market rationality. Namely, such protections help individuals only in their capacity as consumers who are to be empowered to act as agents of and for the digital single market, but not in the other capacities in which individuals may act consistent with their other normative or social commitments.¹³³

Moreover, the argument is that the market rationality is so all-encompassing that it disables EU level actors to even problematize the goals that they set out to achieve, such as market integration or the digital single market. Once the legislative goal is set out by the EU Commission’s legislative initiative, it is not subjected to contestation, even by actors who would be expected to do so by pointing out the possible costs of completing the digital single market by adversely affecting other policy goals, such as environmental and health protection, or even social cohesion and urban planning. Thus, Bartl argues that such issues were not ventilated in the pre-legislative knowledge production, through the preparatory documents or regulatory impact assessments. Moreover, the politicization and democratization of EU law-making through the enhanced role of the Parliament does not help either, as neither the left nor the green parties’ groupings sought to raise those objections in the debate before the EU Parliament. Notably, neither did the Member States’ government representatives do so.¹³⁴

It may be helpful to make a number of refinements to this argument from the perspective of the ERPL project, including (i) the necessity to focus on drivers of the transformation of the form and function of private law beyond EU interventions; (ii) the need to look at the problem from both the EU and the MS perspectives and (iii) the need for more precision in the concept of “internal market rationality”.

Thinking from the perspective of the broader drivers of transformation can help to be more careful in the attribution of causation and responsibility for certain outcomes to singular factors or actors. Thus, it may be fair to say that by the time the proposals for a cross-border sales law and the digital single market were put on the EU legislative table by the Commission, the online market was by and large already a reality for quite some time due to technological developments. Moreover, given the ubiquitous nature of Internet technology online market platforms ordinarily do not respect existing

¹³¹ Thomas Wilhelmsson, “Varieties of Welfarism in European Contract Law”, *European Law Journal*, vol. 10:6, pp. 712-733 (2004), p. 733.

¹³² Marija Bartl, “Internal Market Rationality, Private Law and the Direction of the Union: Resuscitating the Market as the Object of the Political”, *European Law Journal* (forthcoming 2015) (“internal market rationality” is made of a series of normative and cognitive elements – “laws, values, principles, ‘common sense’, economic doctrines” limiting the permitted policy goals and instruments to achieve them in the EU).

¹³³ Such a view may also implicitly give precedence to law over other drivers of social and economic transformation of individual and social identities.

¹³⁴ See Marija Bartl, “The Way We Do Europe: Subsidiarity and the *Substantive* Democratic Deficit”, *European Law Journal*, vol. 21:1, pp. 23-43 (2015).

State-jurisdictional boundaries. Novel forms of reaching consumers directly for promotion and marketing, as well as platforms for concluding transactions and dispute resolution have challenged national private law and regulation substantively and procedurally, as well as challenging EU law itself, thereby producing both national and EU-level reactions.¹³⁵

Consistent with other EU legislative interventions aimed at regulating the impact of technology on transactions,¹³⁶ we may fairly ask whether in light of the proliferation of online platforms for transacting and dispute resolution, the addition of an optional cross-border sales law even contribute towards the creation or completion of an online market, or whether it would have had little or no influence on that goal in light of technological, economic and social developments. Thinking on the basis of the drivers of transformation is useful not because it helps to identify a single exogenous cause of transformations in the transacting environment: these factors operate simultaneously and endogenously influence each other. However, thinking in terms of broader drivers - in the context of EU scholarship – may prevent the tendency to ascribe effects (either actual or just potential) to EU interventions.¹³⁷ It may also help to clarify whether the EU is a cause, just a catalyst or can even be seen as a coping mechanism for transformations in the underlying environment for law and regulation.

But if the optional instrument was unlikely to be particularly effective either as a response to or an instrument for the construction of online markets, we might ask why the EU legislator would go to the trouble of producing, justifying and promoting its enactment? This leads us to another interpretation of “rationality” of a legal order that is based not on an all-encompassing code or logic that fully explains each intervention, but on habit. Thus, if functional differentiation of normative orders can be understood through the prism of specialization, the “rationality” of a legal or regulatory regime may be understood as the combination of the goal(s) habitually pursued with an allocated instrument for achieving that goal.¹³⁸ EU action is typically justified on the basis of the goal of creating the internal market through the tool of legal harmonization.¹³⁹ Specialised institutions may pursue the allocated policy instrument even in circumstances where it is unlikely to be effective in achieving the allocated

¹³⁵ Mateja Djurovic, “The Apple Case: The Commencement of Pan-European Battle Against Unfair Commercial Practices”, *European Review of Contract Law*, 9:3, pp. 253-266, (2003).

¹³⁶ Bruno Deffains and Jane Winn, “The effects of electronic commerce technologies on business contracting behaviors”, in Eric Brousseau, Meryem Marzouki and Cécile Méadel, *Governance, Regulation and Powers on the Internet* (Cambridge, Cambridge University Press, 2012) (EU digital signatures project).

¹³⁷ Take by way of example the claim that the EU instrumentalises private law which otherwise in the national legal orders is oriented towards inter-personal justice. Franz Wieacker long ago observed that interventions by the State into specific areas was destroying the coherence of private law (*A History of Private Law in Europe*, Oxford, Oxford University Press, 1996). Moreover, different kinds of welfarist considerations were introduced into private law through discourses internal to the law by judges, practitioners or legal academics. Eg, Olha Cherednychenko, “The Constitutionalization of Contract Law: Something New under the Sun?”, *Electronic Journal of Comparative Law*, vol. 8:1 (2004). While in some cases judges sought to reconcile adjustments to traditional doctrines with autonomy and justice-based accounts of private law, in other cases such as the “constitutionalisation” of private law by the German Constitutional Court explicitly infused private law with considerations external to the relationship of the parties. Moreover, these were developments occurring across different jurisdictions, through different channels, but again entirely internal to the law. Aurelia Colombi Ciacchi, “Non-legislative Harmonisation of Private Law Under the European Constitution: the Case of Unfair Suretyships.” *European Review of Private Law*, vol. 13:3, pp. 285-308 (2005). This could be evidence that economic and social transformation brought different types of problems before the courts and made certain case outcomes or forms of reasoning more acceptable within the “legal field”. Pierre Bourdieu, “The Force of Law: Toward a Sociology of the Juridical Field”, *Hastings Law Journal*, vol. 38, pp. 814-853 (1986).

¹³⁸ Yane Svetiev, *European Regulatory Private Law: From Conflicts to Platforms*, in Kai Purnhagen and Peter Rott (eds.), *Varieties of European Economic Law and Regulation* (Springer, 2014).

¹³⁹ Thus, insistence on strict competence allocation for policy goals as between the EU and the Member States can be understood as a version of the “Tinberger rule” linking policy instruments to targets. See Jan Tinbergen, *On the Theory of Economic Policy* (Amsterdam, North Holland, 1952).

goal or may cause damage to other relevant objectives not within the actor's purview.¹⁴⁰ In the case of the common sales instrument, for instance, this path-dependent tendency towards harmonisation may be worsened by a variant of the sunk-cost fallacy: an attempt to salvage the investment in the failed project of codifying an EU contract law.

Such a path-dependent goal-instrument combination is reinforced by the competence view of EU integration and the way in which the EU's competences are defined in the Treaties, which gives greater flexibility in the use of the internal market power. It is also reinforced by the forms of discipline on the exercise of the legislative initiative by the Commission through ex ante tools, such as regulatory impact assessments which are constrained due to the lack of reliable methodologies to predict the impact of an instrument such as CESL even on the most directly salient parameters, such as the quantity of transactions and intra-Community trade, let alone longer-term effects on more diffuse goals such as the environment or social cohesion. Such ex ante exercises therefore invite efforts at self-justification. Thus, if the EU, and in particular the Commission is expected to be a specialised technocratic trustee of economic efficiency¹⁴¹, it should not be a surprise if it acts as one.

As such, the promotion of harmonised instruments, such as CESL, may be regarded as an instance of what Sparrow characterizes as beginning from legal rules and yet thereby targeting conduct or issues that are not of real regulatory concern.¹⁴² He contrasts this by a problem-solving orientation, which begins with actual problems detected on the ground, triggering a search for available legal or regulatory tools with which to solve them. An example of problem-oriented EU action in the context of the digital market may be the recent Commission investigation of Google practices with respect to search results on Internet shopping websites. The investigation was triggered by complaints that Google search results favoured Google-related businesses, thereby disadvantaging other operators. Given Google's overwhelming share of search queries, the Commission pursued the problem as a potential abuse of dominance under the competition laws, even if there was uncertainty about the likely effects of such conduct and whether it fell within the scope of Art. 102. Precisely the uncertainty about the extent of the problem and about possible solutions suggests that neither reliance on prior rules or precedents, nor technocratic methodologies may offer particularly promising bases of intervention.¹⁴³ The Commission initially envisaged using the commitments procedure, by negotiating remedies directly with Google, including formats for the presentation of search results and provision of real-time disclosures to consumers to interpret search results in the context of Internet shopping. Moreover, given that commitments are subjected to pre-implementation market testing as well as on-going monitoring obligations, such interventions create platform for on-going deliberation about the online transaction ecology among different stakeholders in a way that might both advanced the online market, while also identifying and remedying other policy concerns triggered by online transactions. Such an outcome is made possible by the elasticity of the competition rules on abuse of dominance, the absence of narrow competence constrains on the intervention, flexible instruments for intervention, as well as the fairly heterodox goals of EU competition policy never formally limited to short run allocative efficiency.¹⁴⁴

¹⁴⁰ Charles Lindblom, "The Science of Muddling Through", *Public Administration Review*, vol. 19:2, pp. 79-88 (1959), p. 80 (policymakers when confronted with complex policy problems "combine into one the choice among values and the choice among instruments for reaching values").

¹⁴¹ Giandomenico Majone, "Two Logics of Delegation: Agency and Fiduciary Relations in EU Governance" *European Union Politics*, vol. 2:1, pp. 103-122 (2001).

¹⁴² Malcolm Sparrow, *The Regulatory Craft: Controlling Risks, Solving Problems & Managing Compliance* (Washington DC, Brookings Institution Press, 2000).

¹⁴³ Yane Svetiev, "Settling or Learning? Commitment Decisions as a Competition Enforcement Paradigm", *Yearbook of European Law*, vol 33: 1, pp. 466-500, (2014), p. 481-483.

¹⁴⁴ *Ibid.*, p. 483 ("From the perspective of goals, the intervention might be situated at the intersection of consumer, competition and innovation policy, in that it promotes consumer interests by enabling users, as well as the Commission through the envisaged monitoring mechanism, to learn about the market even as it continues to evolve.")

The CJEU and policy-making in the Member States

Quite apart from the EU legislative process ordinarily triggered by the Commission's initiative, the CJEU has itself been subject to criticism for its decision-making under free movement law, which is said to disturb delicate and stable national balances between market autonomy and welfarist regulation promoting social and cohesion policy goals. Such criticisms became more vocal in the wake of the CJEU's decisions in cases such as *Viking*¹⁴⁵ and *Laval*,¹⁴⁶ and more recently have led to a re-evaluation of the Court's previously lauded role as the key motor of integration through law. The bases of such criticisms appear to be two-fold. Firstly, there is the familiar criticism about the limited structural capacity of courts to advance positive rights, such as social, economic or environmental rights that have increasingly found expression both in the Treaties and in secondary legislation. Thus, even when the CJEU, as in *Laval*, recognizes the fundamental nature of social rights, in the one-shot litigation game the fundamental freedoms of movement are more easily susceptible to judicial enforcement.¹⁴⁷ The second reason for criticism relates to the way in which the CJEU's free movement jurisprudence restricts the available public interest justifications that Member States can proffer for their (democratically approved) rules and regulations.¹⁴⁸ Both of these reasons for criticism invite some comment and refinement.

Let's begin with the second argument about the restriction of policy-making and in particular policy justification autonomy of the Member States. To analyse this claim, it might be helpful to recall what is arguably a quite typical anecdote from teaching EU law cases such as *Cassis de Dijon*¹⁴⁹ or the German beer case.¹⁵⁰ A typical reaction by an uninitiated student to hearing the facts of the *Cassis* case is puzzlement due to a combination of national stereotypes and the peculiarity of the national rules at issue. Moreover, even before hearing the full reasoning of the Court, students will typically struggle to understand the policy behind the rule, including grappling with the justification offered by the court, some will resort to "culture" as a limit to any explanation, others might wonder if it is somehow a measure that protects existing players. The very persistent student will go on to ask whether there is any effect from admitting *Cassis* in the German market. The intuition is that to understand the effects of the case holding, it is also necessary to understand the way in which it has been contextualised and the effects that it has in the local context following the CJEU and national court decisions.

The anecdote may seem banal, but it illustrates a few important points. Namely, the uninitiated will subject national rule-making to equally searching scrutiny as that of the EU institutions. She may also be interested to know about how a decision of the CJEU is ultimately contextualized back into the national setting, where it might have negative, but also positive or altogether negligible effects. Even if the rule is not protectionist, a national rule might reflect insider concentrated interests who are better represented in the national political process, in turn excluding even domestic let alone foreign "outsiders". Or it might simply reflect the omission of a worthy public policy objective that was not salient at the time the rule was enacted, but that can be illuminated by confronting national with EU

¹⁴⁵ Case C-438/05 *International Transport Workers' Federation & Finnish Seamen's Union v. Viking Line ABP and OÜ Viking Line Eesti* (CJEU, 11 December 2007).

¹⁴⁶ Case C-341/05, *Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundet* (CJEU, 18 December 2007).

¹⁴⁷ Loic Azoulai, "The Court of Justice and the Social Market Economy: the Emergence of an Ideal and the Conditions for its Realization", *Common Market Law Review*, vol.45, p. 1335, (2008). Azoulai recognizes that the case essentially triggers an institutional inquiry about how to protect social rights vis-à-vis economic freedoms.

¹⁴⁸ See also Gareth Davies, "Internal Market Adjudication and the Quality of Life in Europe", *EUI Working Paper Law*, 2014/07.

¹⁴⁹ Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein* (ECJ, 20 February 1979).

¹⁵⁰ Case 178/84, *Re Purity Requirements for Beer: E.C. Commission v Germany* (ECJ, 12 March 1987)

law obligations.¹⁵¹ Some degree of deliberative examination of the purpose or effect of domestic rules that could foreclose market access is inevitable in an organization such as the EU.

That does not exclude the possibility that national rules could take on either their purpose or their expressive value through implementation, rather than through enactment. The CJEU – and EU law more broadly – does not typically foreclose public interest requirements for a regulation that have emerged through its implementation, nor has it foreclosed facially valid considerations of the public interest of a more expressive kind, such as shop opening hours or the protection of media pluralism. Even the Commission in exercise of its competition enforcement powers acceded to the national book pricing laws that may have emerged as a type of cartel, but were said to have taken on an expressive and cultural purpose.¹⁵² To this day the existence of such schemes are a source of comparative knowledge about how different jurisdictions are coping with the emergence and effects of online markets¹⁵³, which could lead to reevaluation of the utility of such arrangements in the countries that adopted them and a source of inspiration for the others. It is precisely EU law that has provided deliberative architectures for such reevaluation¹⁵⁴, whether through the preliminary reference before the CJEU, networks of administrative authorities, or even pan-European networks of consumer representative organisations.

This brings me to the other complaint about the effect of the CJEU jurisprudence, namely that it asymmetrically promote negative (in the case of the EU free movement) rights as opposed to positive socio-economic or environmental rights. Here, it is possible to point to the fact that in individual cases over time the CJEU has acted so as to protect rights including positive rights,¹⁵⁵ but this does not exclude the possibility that on balance the jurisprudence might favour economic freedoms, not only just facially (ie, in the decisions themselves) but also in how those decisions eventually touch down and are contextualized locally. Moreover, the Court may be bolstering individual rights and capacities only to the extent that they act as (selfish) market actors, but not otherwise.

More recently, considerable attention has been attracted by the increasing activity of the CJEU in contract law cases, with numerous preliminary references reaching the court pursuant to the Unfair Contract Terms Directive on the basis of contacting problems in the regulated network sectors, such as energy or financial services.¹⁵⁶ Quite apart from the fact that such cases have resulted in sustained

¹⁵¹ Take *Aziz v. Catalunya Caixa*, (Case C-415/11, CJEU 14 March 2013) by way of an example. The abbreviated foreclosure procedure in case of home mortgage default might reflect the fact that banking interests were better represented in the domestic legislative process. However, it might also reflect a worthy policy objective of extending the availability of credit, including to low income households, by reducing the procedural burdens on banks claiming their security interests. More expeditious recovery procedures have been counseled by international development agencies as a way of enhancing the collateral value of the assets of low-income households to provide them easier access to credit. However, promoting this policy goal ignores the fact that accelerated foreclosure in the context of a systemic crisis hurts not only consumers, but also the banks.

¹⁵² Cristoph Schmid, “Diagonal Competence Conflicts between European Competition Law and National Regulation - A Conflict of Laws Reconstruction of the Dispute on Book Price Fixing”, *European Review of Private Law*, vol. 8, p. 155 (2000).

¹⁵³ Michael Naumann, “How Germany Keeps Amazon at Bay and Literary Culture Alive”, *The Nation* (June 18, 2012), available at www.thenation.com/article/168124/how-germany-keeps-amazon-bay-and-literary-culture-alive

¹⁵⁴ Christian Joerges and J. Neyer, “From Intergovernmental Bargaining to Deliberative Political Processes: the Constitutionalisation of Comitology” *European Law Journal*, vol. 3:3, pp. 273-299 (1997); Charles Sabel and Jonathan Zeitlin, “Learning from Difference: The New Architecture of Experimentalist Governance in the EU”, *European Law Journal*, vol. 14:3, pp. 271-327 (2008).

¹⁵⁵ Alec Stone Sweet and T. Brunell, (2013) “Trustee Courts and the Judicialization of International Regimes: The Politics of Majoritarian Activism in the ECHR, the EU, and the WTO”, *Journal of Law and Courts*, vol. 1:1, pp. 61-88 (2013) (majoritarian court activism to overcome minority opposition).

¹⁵⁶ See, eg. Hans-W. Micklitz and Norbert Reich, “The Court and Sleeping Beauty: The revival of the Unfair Contract Terms Directive (UCTD)”, *Common Market Law Review*, vol. 51:3, pp. 771–808 (2014).

attention by the CJEU to the social dimension of EU integration, Gerstenberg¹⁵⁷ has argued that the Court's jurisprudence in these cases has acquired both a regulatory and a constitutional dimension. The result is a particular style of constitutionalisation of private law reasoning through an experimentalist form of judicial review. This form of review, through the medium of proportionality analysis, both allows for a European frame for the protection of socio-economic rights, as well as for their contextualization by private actors within the setting of particular relationships or transactions.¹⁵⁸ Proportionality analysis permits a discursive process through which to strike a fair balance between simultaneous commitments to private law autonomy and to the legitimate interests of vulnerable consumers.¹⁵⁹

According to Gerstenberg, what allows the CJEU to escape the role of social engineer under such a scenario – where outcomes reflect judicial preferences – is the fact that it is not the “final decider”.¹⁶⁰ Instead, it is the national court in reaching the decision that both performs the proportionality analysis, a division of labour that transforms the CJEU and the domestic court into “mutually co-dependent interlocutors”.¹⁶¹

As I have argued elsewhere, both the “*Solange*” formula and proportionality analysis can provide judicial platforms for the integration of the various rationalities (in the sense of goal/instrument specialisations) of different legal orders.¹⁶² However, there are two (related) limits on the emergence of this experimentalist form of judicial review, whereby one court simply dislodges an existing equilibrium in the other legal order and generates experimentation so as to accommodate different normative commitments under conditions of uncertainty and mutual monitoring. One is the fact that the CJEU does not remain seized with the specific case after it gives an answer to the questions posed by the national court in the preliminary reference, unlike for example American courts that have upheld parties' destabilization rights and thereby created regimes for the reform of broken institutions such as prisons or schools.¹⁶³ Typically, this means that the CJEU does not even decide the fate of the litigant in the particular case, although it has happened that different iterations of the same case have been considered by the Court, as in the *RWE* litigation discussed below. In any event, the CJEU certainly does not supervise any regime that the decision might subsequently trigger.

A second and related limitation is the fact that courts typically do not have the infrastructure for mutual monitoring and in particular for the monitoring of the outcomes of cases over time to determine how they stack up to common normative concerns. Therefore, it is quite difficult to assess the extent to which national courts both contribute to and protect the emergence of a European understanding of contractual unfairness, or whether they upgrade domestic procedural rules and remedies to enable contracting parties to take advantage of such an understanding. This may be one reason for the introduction of a comitology updating procedure in the failed 2008 proposal for a

¹⁵⁷ Oliver Gerstenberg “Constitutional Reasoning in Private Law: The Role of the CJEU in Adjudicating Unfair Terms in Consumer Contracts”, *European Law Journal*, (forthcoming 2015).

¹⁵⁸ *Ibid.*, p. 5-6.

¹⁵⁹ *Ibid.*, p. 17.

¹⁶⁰ Oliver Gerstenberg, “The Justiciability of Socio-economic Rights, European Solidarity, and the Role of the Court of Justice of the EU”, *Yearbook of European Law*, vol. 33:1, pp. 245-276 (2014), p. 276.

¹⁶¹ Oliver Gerstenberg, “Constitutional Reasoning in Private Law”, *above.*, p. 17.

¹⁶² See Yane Svetiev, “European Regulatory Private Law: From Conflicts to Platforms”, *above.*, p. 155.

¹⁶³ Charles Sabel and William Simon, “Destabilisation Rights: How Public Law Litigation Succeeds”, *Harvard Law Review*, vol. 117:4 (2004), pp. 1015-1101; Roberto Mangabeira Unger, *False Necessity: Anti-necessitarian Social Theory in the Service of Radical Democracy*, (London, Verso Books, 1987), p. 530: “destabilization rights protect the citizen's interest in breaking open the large-scale organizations and the extended areas of social practice ... that sustain insulated hierarchies of power and advantage.”

Consumer Rights Directive, under which national court or regulatory decisions would be notified to the Commission so as to trigger a revision process.¹⁶⁴ Such a proposal reflects a recognition that courts typically lack the infrastructure and procedures for ongoing monitoring even in individual cases brought before them, let alone of broader adjustment processes that judicial decisions may trigger.

The extent to which “judicialization ‘beyond the state’” may deepen democratic solidarity by making the formulation of and implementation of broad framework commitments more pluralistic, participatory and experimentalist in the EU setting will depend upon the extent to which (i) the framework goals in secondary legislation¹⁶⁵ rigidly adhere to a market rationality and (ii) the availability of architectures for mutual monitoring and adjustment in the face of judicial destabilisation as between different actors at different policy-making levels.

Autonomy, competition and regulation in the networked services sectors

With the foregoing background, I now turn to the so-called vertical sectoral silos including electronic communications, energy and financial services, areas in which EU regulation has also had a profound – though often understudied - impact on private law. Particularly in telecommunications and energy, under the cover of the internal market programme and the primary law provisions favouring competition, successive generations of EU secondary legislation has pursued the goal of liberalization of previously publicly owned and operated vertically integrated monopoly suppliers. The goal of such interventions was to introduce greater competition in such markets, as opposed to the prior scenario of state provision and heavy regulation. This programme is typically attributed to the EU, even if the Member States did agree to this agenda, albeit gradually and progressively. One view could be that such interventions were undergirded by an internal market rationality, largely imposed on the Member States with well-functioning existing domestic arrangements. However, an alternative argument might be that the transformation of these sectors was also driven by other factors, including dissatisfaction with service provision outcomes based on political steering and planning, absence of innovation, combined with emergent technological possibilities for introducing competition and dynamism in these markets.

Schweitzer argues that “public service monopolies [in the Member States] had become detached from their original purposes and ultimately pursued self-interests and ad hoc political interests, losing user interest out of sight”¹⁶⁶. This was in part possible because there was no “monitoring of economic outcomes”, as political accountability was relied upon to discipline actors, though in the absence of monitoring and benchmarking of service outcomes electoral accountability was obviously a very limited constraint. It is such background conditions, combined with transformative pressures of transnational interdependence and technological change, that may have provided fertile ground for certain political and even intellectual¹⁶⁷ trends. As Zumbansen¹⁶⁸ explains:

¹⁶⁴ Art. 39(1) and (2) of the Proposal. See Gerstenberg, “Constitutional Reasoning in Private Law”, above, p. 4.

¹⁶⁵ Cf Hannes Unberat and Angus Johnston. “The Double-Headed Approach of the ECJ Concerning Consumer Protection” *Common Market Law Review*, vol. 44:5, pp. 1237-1284 (2007).

¹⁶⁶ Heike Schweitzer, “Services of General Economic Interest: European Law’s Impact on the Role of Markets and of Member States”, in Marise Cremona (ed.) *Market Integration and Public Services in the European Union* (Oxford, Oxford University Press, 2011), p. 60.

¹⁶⁷ Marie-Laure Djelic, “Spreading Ideas to Change the World – Inventing and Institutionalizing the Neoliberal Think Tank”, available online on SSRN http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2492010, (2014), forthcoming in Christina Garsten, Adrienne Sorbom (eds.), *Political Affairs: Bridging Markets and Politics* (Edward Elgar); cf. Dorf, above; John Dewey, *The Public and Its Problems* (1927).

¹⁶⁸ Peer Zumbansen, “Law After the Welfare State: Formalism, Functionalism, and the Ironic Turn of Reflexive Law”, *American Journal of Comparative Law*, vol.56:3, pp. 769-808 (2008), p. 780.

“The empowerment of market actors often results from a complex combination of historically evolved individualism, decentralized government and regulatory competition. The promise of private autonomy and individual freedom ... can only be understood against the background of this historically grown and continuously evolving polycontextural architecture. ... [P]rivate autonomy neither arises from nor exists in a normative or structural vacuum”

The liberalization packages were of course sold as the convergence of the internal market project and with an appetite for the benefits of competition for improving market outcomes, in terms of consumer prices, incentives to invest and innovate and, through privatization, perhaps to even shift the fiscal burden away from the State. But through provisions to bolster access to potential competitors, the agency of consumers to benefit from competitive discipline,¹⁶⁹ as well as to guarantee them universal service access, such packages reflected the intuition that markets are both social and legal constructs.¹⁷⁰

In a competitive market, the legal infrastructure for transactions and for disciplining market actors is supplied by private law (contract and tort) as well as ex post competition enforcement to control collusive behaviour and dominant positions of market power. As such, liberalisation should reduce the reliance on classic regulation, since competitive rivalry disciplines market players to deliver the various aspects of the public interests, from lower prices to improved service. In fact, in the regulated markets, EU legislation explicitly envisages regulation and competition as alternative disciplining devices on market actors. In the electronic communications package there is an explicit recognition of the aim “progressively to reduce ex-ante sector specific rules as competition in the markets develops and, ultimately, for electronic communications to be governed by competition law only”.¹⁷¹

Notwithstanding some differences in market conditions, structure and policy goals, a similar “rationality” may be detected in the energy legislative package. In the *Federutility* case, the CJEU examined the continued practice of price regulation in gas prices in Italy vis-à-vis the provisions aiming to promote competition at the expense of price regulation in the energy legislative package. AG Colomer in *Federutility* will set out the goals of the package and the remaining space for state regulation in the following way:

“Since the Single European Act, when competition was installed as the new deity on ‘the altar of political ideas’, public service has become an obstacle to be overcome in the name of a liberalisation on which all hopes were pinned. ...

The creation of an open market is the first step of this policy, but once barriers have been removed there remain certain requirements which the market alone is not able to meet. Hence the origins of public intervention, in the form of ‘services of general interest’ and ‘public service obligations’, imposed by the authorities on undertakings in liberalised sectors in order to safeguard public interests which, because they are inalienable, cannot be left to market forces to take care of. ...”¹⁷²

¹⁶⁹ Hans-W. Micklitz, “The Concept of Competitive Contract Law”, Penn. State International Law Review, vol. 23, p. 549 (2005).

¹⁷⁰ Eg. Julia Black, “Reconceiving Financial Markets: From the Economic to the Social”, Journal of Corporate Law Studies, vol. 13:2, pp. 401-442 (2013); Katharina Pistor, “A Legal Theory of Finance”, Journal of Comparative Economics, vol. 41:2, pp. 315-330 (2013).

¹⁷¹ Recital 5 of Directive 2009/140/EC of the European Parliament and of the Council of 25 November 2009 amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of electronic communications, networks and associated facilities, and 2002/20/EC on the authorisation of electronic communications networks and services, [2009] OJ L 337/37; cf Steven Vogel, *Freer markets, more rules: regulatory reform in advanced industrial countries* (Ithaca, Cornell University Press, 1996).

¹⁷² Opinion of Advocate General Ruiz-Jarabo Colomer, delivered on 20 October 2009, Case C-265/08, para. 2-3.

He will go on to add that “state involvement in the market must be limited so as not to postpone true liberalisation indefinitely, and should focus on the protection of the rights of the consumer.”¹⁷³

The decision of the CJEU followed a similar logic, in that it affirmed the continued ability of Member States to engage in price regulation for the purpose of the “general economic interest” though “for a period that is necessarily limited in time”. This was because a measure limiting the freedom to determine the gas supply price to consumers “by its very nature constitutes an obstacle to the realization of an operational internal market in gas”. On the one hand, it is true, as Gerstenberg argues,¹⁷⁴ that the CJEU decision creates a framework for discursive discipline for the different policy commitments (the internal market and social policy) to which both the EU and the MS are committed through the obligations of proportionality, transparency, non-discrimination and verifiability.¹⁷⁵ On the other hand, it does not appear to be the case that the EU law regards competition either as a sufficient disciplining force or as the sine qua non of the internal market, nor does it limit the justifications available to the Member States for price regulation.

An experimentalist architecture does require the identification of shared framework goals (even if provisional) jointly by the EU and Member States, but it also allows for lower level units to devise their own strategies about achieving such goals and allows also for the framework goals to be further specified or reformulated in light of the experiences in implementing them.¹⁷⁶ This is precisely because laws are arguably domesticated or contextualized to local circumstances and divergent policy goals through their implementation and enforcement, even more so than ex ante in their drafting. Thus, even legislative frameworks intended to be centralised and rigid can be contextualised in the face of enforcement difficulties and constraints.¹⁷⁷

There are at least a number of possible ways in which the liberalization framework goals and instruments for both electronic communications and for energy could be problematized in light of the experience of implementation in the various sectors. Some ways in which the competition/liberalisation “deities” can be contested include:

- the identification of the goal of a competitive market as coincident with the internal market;
- the idea of competition as a sufficient disciplining force on market actors both in terms of consumer market outcomes, but also in relation to other public policy goals, and not only because textbook competitive markets are unlikely to emerge in such sectors. The idea of competition being a sufficient disciplining force on market outcomes is particularly problematic when policy goals are more complex and divergent and may require some degree of coordination. For instance, in both telecoms and energy, infrastructure investment is a relevant goal that must be pursued even when infrastructure and service are not supplied by the same entity. There are also other policy goals that present challenges in a competitive environment, including network neutrality in electronic communications, the transaction costs of unbundled

¹⁷³ *Ibid.*, para. 6.

¹⁷⁴ Gerstenberg, “The Justiciability of Socio-economic Rights”, above. Incidentally, such disciplines on policy-making make energy regulation measures much more scrutable even at national level and as such may enhance national democratic debate, quite apart from structuring the mutual monitoring between the EU and Member State levels. As Gerstenberg sees it, the decision: “rather than undermining social solidarity at the national level, ... makes explicit the mutual cooperative framework within which Member States are free to pursue social policy as they see fit.” (p. 274).

¹⁷⁵ C-265/08, para. 37: “the requirement of proportionality would imply ... that [such a price intervention] be limited ... to the price component directly influenced” by an “increase in the price of petroleum products on international markets”;

¹⁷⁶ Sabel and Zeitlin, “Learning from Difference.”, above, p. 273 (“framework goals and measures for gauging their achievement are established by joint action of the Member States and EU institutions. Lower level units are given the freedom to advance these ends as they see fit.”)

¹⁷⁷ See Yane Svetiev “Networked Competition Governance in the EU: Delegation, Decentralization or Experimentalist Architecture?”, in Charles Sabel & Jonathan Zeitlin (eds.) *Experimentalist Governance in the European Union: Towards a New Architecture* (Oxford, Oxford University Press, 2010), pp. 79-120.

energy supply, as well as stability of supply and environmental/climate goals in the energy sector;

- problems in the transactional architecture for business-to-consumer relationships which are stable, yet should be subject to competitive pressure, which may reveal weaknesses both in contract law and in dispute resolution.

Apart from the problems and limits of competitive markets revealed above, local experiences with alternative models of market organization and service delivery which reveal successful outcomes would also provide a way of instrument correction and goal reformulation within an experimentalist architecture.

Thus, experimentalist market regulation would begin with the premise that there is no natural market model towards which these different sectoral regimes would converge. Therefore a mutually supportive process of error corrections (in instruments) and goal reformulation leads to a co-evolution in market construction and regulation, which is essentially never ending as markets are continuously buffeted by various transformative forces – exogenous and endogenous. The balance of the paper draws attention to further episodes in which experiences in implementing the EU legislative packages for electronic communications, energy, financial services have produced discursive disruptions that problematize the “deity on which all hopes were pinned” and trigger a search for workarounds. It remains an open question to what extent such episodes lead simply to instrument adjustments, and whether any adjustments in the habituated goals of EU-level and national actors are openly acknowledged or simply subsumed to the existing goal/mandate.¹⁷⁸

The limits of competition in forging an internal market in electronic communications

An open acknowledgment of the limits of competition in delivering both the internal market and favourable market outcomes for consumers by the EU legislator was in the Roaming Regulation,¹⁷⁹ which were subsequently acknowledged by the CJEU in the litigation that this regulation generated. The Roaming Regulation was an exercise in price regulation at EU level, capping both the wholesale and retail charges that mobile operators can charge for providing roaming services on public mobile networks for calls between Member States, promulgated under the Art. 114 internal market competence.

The EU legislator offered a number of motivations for the Regulation, including the deficiency in the regulatory instruments available at both EU and national level. The Regulation noted that the telecoms legislative package did not provide NRAs with “sufficient tools” to address the problem of excessive roaming charges (Recital 4). This was in part due to the NRAs’ limited jurisdictional reach, which did not extend to operators on the visited network in another MS (Recital 8). Moreover, limitations were also identified in the analytical tool that triggers regulation under the telecoms package (borrowed from competition law), by pointing out “the difficulty in identifying undertakings with significant market power in view of the specific circumstances of international roaming, including its cross border nature” (Recital 6).

As the cause of the high roaming costs, the Regulation identified the “high wholesale charges levied by the foreign host network operators” as well as the “high retail mark-ups” of the customer’s operator (Recital 1). While the EU legislator notes that the relationship between costs and prices is higher than would prevail in competitive markets, there is acknowledgment that relying on competition would not

¹⁷⁸ Consider, for instance, the way in which judges in many jurisdictions have subsumed more intrusive interventions in contractual relationships, so as to argue they are consistent with autonomy or freedom of contract as the normative basis of contract law. Eg, Colombi-Ciacchi, above.

¹⁷⁹ Regulation (EC) No 717/2007 of the European Parliament and of the Council of 27 June 2007 on roaming on public mobile telephone networks within the Community amending Directive 2002/21/EC.

necessarily correct that problem. This was because, even if wholesale charges were to drop, operators had no incentive to pass on reductions to retail prices, both because typically operators compete on packages of which roaming charges are a small part, but also because “the dynamics of roaming markets are complex and in the process of changing” so that the relationship between wholesale and retail charges was neither linear nor stable.¹⁸⁰

The limits of competition law and (national) regulatory instruments, together with uncertainty about the robustness of the competitive mechanism in delivering consumer outcomes was sufficient for the CJEU to affirm the proportionality of the regulation of both wholesale and retail prices at EU level. Notably, in affirming proportionality, the CJEU does stress that the “intervention is limited in time in a market that is subject to competition”. The sunset clause of the Regulation may be regarded as an experimentalist tool that triggers another round deliberation of reflection on the complex and changing market dynamics and precisely such a recursivity mechanism makes even a strong departure from market autonomy through price regulation proportionate under EU law.

One might ask at this point, whether the transnationally mobile roaming customers, Somek’s “accidental cosmopolitans” who most benefit from EU integration, are afforded more consumer protection than the less mobile who do not wish to lead mobile or competitive lives (for which the *Federutility* customers might be a proxy)? I would argue not, since in both cases price regulation is triggered by insufficient rivalry or, more to the point, ineffectiveness in the competitive disciplining mechanism due to features of the market or consumer behaviour. In both cases, price regulation is proportionate if the reasons for this restriction of autonomy are set out, the measure is limited and subject to a sunset clause, so as to allow re-examination of market dynamics and the appropriate regulatory response to changing market circumstances. The Roaming Regulation explicitly recognised the limits of competitive markets and, at the same, time promotes an important expressive value for the EU in promoting cross-border communications as an aid to the freedoms of movement.

Identification of new policy goals and priorities

Infrastructure investment and competition

Writing in 2012, William Melody, a key protagonists of telecoms liberalization both in the EU and elsewhere,¹⁸¹ perhaps somewhat surprisingly laments about the “closing of the liberalization era in European Telecommunications”.¹⁸² In particular, he argues that notwithstanding a quarter century of reforms, while the markets in different MS are more diversified compared to the national monopolies of before, there is no seamless EU-wide telecoms market, incumbent operators continue to possess market power, and there is a shortage in infrastructure investments for a digital economy broadband era. Nonetheless, he suggests that both the EU and Member States have given declining priority to market access and competition, returning to a “policy agenda based primarily on direct state intervention and government aid”. Notwithstanding the benefits that two decades of reform have brought to European communications markets, the current policy framework makes “no mention of new liberalization initiatives” or projects for expanding competition. Part of the reason he identifies is the fact that the Digital Agenda for Europe 2020 has shifted focus on “financing solutions for the investments needed to upgrade” to high speed infrastructures, which are expected to come from

¹⁸⁰ European Commission, “Impact Assessment of Policy Options in Relation to a Commission Proposal for a Regulation of the European Parliament and of the Council on Roaming on Public Mobile Networks Within the Community”, Commission Staff Working Paper, 12 07 2006, [COM (2006) 382 final], p. 48.

¹⁸¹ See eg, William Melody (ed.), *Telecoms Reform: Principles, Policies and Regulatory Practices* (Technical University of Denmark Press, Lyngby, 1997).

¹⁸² William Melody, “Viewpoint: The Closing of the Liberalization Era in European Telecommunication”, *Competition & Regulation in Network Industries*, vol. 13: 3, pp. 218-234, (2012), p. 218.

dominant incumbent operators' profits, which are thus subjected to less pressure through increasing competition or antitrust enforcement.

This illustrates the point that when policy objectives in a particular sector change, or at least are re-prioritised, this may lead to the reexamination of the instruments that have been adopted thus far. The problem of securing the investments for the digital agenda is by no means trivial, particularly in light of the fiscal pressures that have affected public finances in recent times.

Note however, that even in this respect the Member States themselves have been using innovative implementation mechanisms, which allow them to elide the distinction between *ex ante* regulation and *ex post* competition enforcement and as a method of simultaneously pursuing apparently conflicting commitments. One example comes from a joint decision of OPTA (the then telecommunications regulator) and the NMa (the then competition regulator in the Netherlands) to approve a proposed joint venture agreement between the incumbent telecom operator KPN and Reggefiber (a new entrant in the business of laying optical fibre networks) intended to exploit complementarities between the two undertakings. In particular, KPN, which had been relying on the existing copper network and facing competition from cable companies, was “to leverage its customer base and marketing expertise, whereas Reggefiber would bring in its technical expertise in rolling out optical fibre networks”.¹⁸³ The problem with the proposal was that while the joint venture would ensure investment in the rolling out of the optical fibre network, once completed KPN would control both the copper and the fibre network and would have incentives to foreclose downstream competitors from accessing the fibre network further strengthening its incumbency.

To promote both infrastructure investment and competition, the Dutch competition and communications authorities – which have since been merged into a single authority – cooperated to approve the venture, but subject it to commitments by the parties to provide access to downstream competitors to the network as well as a monitoring regime for implementation. As such, the case may be regarded as a platform for pursuing two different public policy goals, whereby “private investments in a new network can be combined with an open structure, guaranteeing reasonable access conditions for third parties”.¹⁸⁴

Vertical integration and competitive access

Turning to the energy sector, the EU Commission was not in a position to include an obligation of vertical ownership unbundling in the third energy liberalization packages as a way of stimulating competitive access in the markets of electricity and gas due to strong opposition from the Member State governments. Nonetheless, the Commission has been pursuing that goal indirectly through commencing antitrust actions against incumbent energy suppliers under the Art. 102 abuse of dominance positions.¹⁸⁵ Since 2008, the Commission in a number of commenced cases, has accepted commitments by the defendant incumbents in both electricity and gas markets, such as E.ON and ENI “to divest their transmission networks to avoid further antitrust scrutiny”¹⁸⁶, as well as divestitures of electricity generation capacity (CEZ).

¹⁸³ Dennis Hesseling, Tako Vermeulen, “Access to networks through competition law: the case of KPN – Reggefiber”, *Network Industries Quarterly*, vol. 13:1, pp. 14-16, (2011), p. 15.

¹⁸⁴ *Ibid.*

¹⁸⁵ Malgorzata Sadowska, *Committed to Reform?: Pragmatic Antitrust Enforcement in Electricity Markets* (Intersentia, Cambridge, 2014).

¹⁸⁶ Adrien de Hauteclocque, *Market Building through Antitrust: Long-term Contract Regulation in EU Electricity Markets* (Cheltenham, Edward Elgar, 2013), p. 68.

Motivated by similar policy concerns, the Commission in 2008 commenced a formal investigation against GDF France¹⁸⁷ based on an allegation of foreclosure of downstream supply markets for natural gas in France, through (i) a combination of long-term transport capacity reservations; (ii) a network of import agreements, and (iii) through underinvestment in import infrastructure.¹⁸⁸ Following the opening of the case, GDF offered to negotiate commitments with the Commission. Internally GDF identified an important goal for offering commitments to the Commission that would avoid GDF being forced to a divestiture of the network operator. Quite apart from the opposition of France, like Germany, to the introduction of ownership unbundling in the energy liberalization package, as GDF's Head of Competition and Regulatory Affairs explained within the company, from an "engineering" perspective the costs of any eventual vertical de-integration through divestiture were judged to be extremely high.¹⁸⁹

Thus, GDF offered a set of long-term commitments, including an immediate release of a large share of its long-term reservations of gas import capacity into France, amounting to about 10% of the total long-term import capacity. Further it committed to continue to reduce its share of such reservations to below 50% in a subsequent 5-year period. Finally, at the conclusion of that period, from 1 October 2014 and for a period of 10 years, GDF's capacity subscription reservation would be limited to below 50%. Finally, there was "Good faith commitment" that from 1 October 2024 to 1 October 2029, capacity reservation would be limited to less than 50 %, in all infrastructures existing as of 1 October 2014.

As the Commission recognized the commitments would "have a major structural impact on the possibility for other companies of competing on the French market, to the benefit of domestic and industrial gas consumers". Thus, the Commission considered GDF's commitments to be equivalent to structural remedies. For GDF, apart from avoiding any risk of divestiture, the commitments also offered an alternative route to cope with the capacity reductions, by for example investing in new import terminals. As the GDF official recognized, both the format and the length of the commitments will mean that the implementation of the decision is very "cumbersome", involving the work of a dedicated department within GDP in cooperation with a monitoring trustee, the French energy regulator as well as on-going communication both internally within the GDF group and with other market players (such as alternative gas suppliers who wish to take advantage of the released capacity). She suggested that the Commission intended to provide access to gas infrastructures to other gas suppliers and as such the commitments are a mechanism (alternative to divestiture) to promote the desired outcomes of liberalization, which simultaneously enables GDF to continue to reap the transaction cost efficiencies of vertical integration (presumably a key policy goal that motivated Member State opposition to vertical unbundling).

Resolving contracting problems in B2C relationships

The liberalization of the provision of services such as telecommunications and energy leads to a contractualisation of the relationship between suppliers and final consumers. However, such contracts are clearly quite different from the ordinary contract law paradigm of the one-off arms-length sale of a widget, where both parties can observe the widget and at the very least make inquiries about its

¹⁸⁷ Commission Decision of 3.12.2009 relating to a proceeding under Article 102 of the Treaty on the Functioning of the European Union and Article 54 of the EEA Agreement, Case COMP/B-1/39.316 – Gaz de France.

¹⁸⁸ Commission press release, "Antitrust: Commission opens formal proceedings against Gaz de France concerning suspected gas supply restrictions", (MEMO/08/328), 22 may 2008.

¹⁸⁹ See Paul Joskow, "Vertical Integration", in Claude Ménard, Mary M. Shirley (eds.), *Handbook of New Institutional Economics* (Springer, 2005).

characteristics and value.¹⁹⁰ Standard terms contracts concluded by a single entity with multiple consumers, who have less market knowledge, conclude far fewer similar transactions and are, thus, in a much weaker bargaining position have long been recognised to present specific issues in both negotiation, demonstrating assent and subsequent enforcement.¹⁹¹

A problematic issue in B2C gas supply contracts has been presented before the CJEU in a succession of preliminary references involving the German gas supplier RWE. These cases presented the question of how to adjust final consumer gas prices to final consumers in gas supply contracts of indeterminate length. RWE offered standard term contracts which allowed it to unilaterally vary the price paid by the final consumer, without any statement of the grounds or scope of the price variation, so long as the final consumers were informed of the price change and were free to terminate the contract. The issue was whether such a price variation term was consistent with secondary EU law, namely the Unfair Contract Terms Directive.

In light of the fact that the contracts were of indeterminate length, during which time costs and other circumstances are likely to change, the CJEU recognized that the supplier has a legitimate interest to alter the price of the service. However, it also held that a term allowing such adjustment must “meet the requirements of good faith, balance and transparency”¹⁹². In particular, the CJEU thought it of fundamental importance that the contract transparently set out “the reason for and method of the variation of the charges” so that the “consumer can foresee, on the basis of clear, intelligible criteria, the alteration that may be made to those charges” and “whether the consumers have the right to terminate” if the charges are altered.

The question of the price variation clause in a contract for energy or telecommunications presents two fundamental problems of the use of contracting in B2C relationships in these sectors. The first is a transactional or contracting problem, namely that of assenting to the terms of the contract. If the CJEU’s decision implies that a price variation clause must make price movements predictable for consumers, it is not clear that such a price variation term would provide fair balance vis-à-vis the supplier. A price indexed to inflation changes predictably for the consumer, but may not be adequate to ensure cost recovery for the supplier in cases of unpredictable cost events. A formula might be transparent, but may not be predictable for consumers, nor may it take into account significant and structural fluctuations in the market that cannot be captured by an ex ante formula.

Quite apart from the contracting assent problem, price variation clauses also highlight a regulatory problem. Namely, the energy package guarantees that consumers should have access to gas at reasonable prices, and for vulnerable consumers at affordable prices.¹⁹³ In the absence of price regulation, one issue is whether the satisfaction of such obligations vis-à-vis consumers can only be determined through ex post litigation. The fact that consumers in many situations may not even have a viable exit option since they face only one local operator make both the contracting and the regulatory problem even more challenging.

The framework provided by the Court does (per Gerstenberg) seek to balance the various interests, as well as the policy commitments of market liberalization and national private law (that grant market participants autonomy of choice and decision-making) and of the protective objectives of the unfair terms directive. However, the framework offered as such is incomplete. The fact that the final

¹⁹⁰ Hanoch Dagan and Michael Heller, “Freedom of Contracts”, Columbia Law and Economics Working Paper, No. 458, (2013).

¹⁹¹ Marc Galanter, “Why the ‘haves’ come out ahead: Speculations on the limits of legal change.” *Law and society review*, vol 9:1, pp. 95-160, (1974); Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, *Harvard Law Review* vol. 96:6, pp. 1173-1284 (1983).

¹⁹² Judgement of the Court (First Chamber) of 21 March 2013, request for a preliminary ruling from the Bundesgerichtshof - Germany) - RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen e.V. (C-92/11), par. 47.

¹⁹³ A Fair Price for Energy, *Journal of Consumer Policy* (forthcoming)

decision is left to the national court does not solve the problem of regime incompleteness, since there is no easy recipe that the local court can offer to what constitutes a fair and reasonable price variation clause. The framework is in need of what might be regarded as a “contextualizing regime”¹⁹⁴ that incorporates input from the parties and stakeholders either in the process of devising contract terms or in the process of price adjustment over time.

This problem has of course been recognized on the ground, particularly in light of national and EU litigation in the RWE case, and has triggered a number of responses by various actors. In particular, a legal practitioner who represents energy utilities has indicated that in the face of such court decisions “some experts doubt that there is a legally valid price adjustment term under German law” and neither mutual negotiation nor fixed term contracts are seen as a viable alternative in the market. Thus, from the utility suppliers’ perspective the contextualizing regime must satisfy both (i) the suppliers need to unilaterally adjust prices and (ii) the customers need to verify the scope of the price adjustment as a pre-condition to an informed decision whether to switch or not (which mere transparency requirements do not provide in a meaningful way). Summarising the perspective of the energy utilities to resolving this seemingly intractable problem, the practitioner suggested that legislative action has already taken place in Germany and that further institutional innovation may be necessary. One proposal amenable to the utilities is the creation of an “independent board” of experts or regulators who can check the range of a price adjustment through “a cost-effective process” which would be paid by the consumer if adjustment is fair and otherwise by the supplier (who would also then have the obligation to repay all consumers on that tariff). Note that this is an *ex post* mechanism that preserves the price setting autonomy of contracting parties, though a similar process could also operate *ex ante* through the involvement of various stakeholders and regulators in price setting, which would be akin to price regulation through stakeholder input.

The RWE case highlights another limitation of the contracting technology in the context of supplier-customer relationships in the energy sector. Namely, the fact that the resolution of the dispute going through various judicial stages, including first instance, appellate and preliminary reference, lasted for quite a long time.¹⁹⁵ This created problems for the consumers, who had to incur expense, be denied recovery due to the passage of limitation periods and wait for a long time to recover relatively small sums of compensation. But it also created problems for the suppliers, who were subject to uncertainty for a long period of time as to the validity of the terms and of successive price adjustments, that could eventually make them subject to substantial payouts due to the large number of consumers involved.

The dispute resolution constraints in contracting relationships in network services were examined at an earlier time by the CJEU in the context of the Italian telecommunications market in *Alassini*.¹⁹⁶ This triggered substantial efforts at devising easily accessible and affordable dispute resolution mechanisms, with participation from both suppliers and consumer organisations and also with the support of AGCOM, the Italian telecommunications authority. Not only are such ADR schemes made mandatory by the EU telecoms package, but they have more recently been subject to disciplines as to both form and substance by the EU legislator.¹⁹⁷

¹⁹⁴ Charles Sabel and William Simon. "Contextualizing regimes: Institutionalization as a response to the limits of interpretation and policy engineering." *Michigan Law Review* 110:7, pp. 1265-1308 (2012) (arguing that “generalist lawmakers and courts resort to “contextualizing regimes” by deferring decisions to institutions more embedded in the context such as administrative agencies (in public law) or trade associations (in private law)).

¹⁹⁵ Norbert Reich, 'I Want My Money Back' – Problems, Successes and Failures in the Price Regulation of the Gas Supply Market by Civil Law Remedies in Germany, EUI Department of Law Research Paper No. 2015/05.

¹⁹⁶ Judgement of the Court (Fourth Chamber) of 18 March 2010, *Rosalba Alassini v Telecom Italia SpA* (C-317/08).

¹⁹⁷ Directive 2013/11/EU on alternative dispute resolution for consumer disputes; Regulation (EU) No. 524/2013 on online dispute resolution for consumer disputes.

Adopting Member State policy innovations into EU law

The final example discloses how more intrusive policy innovations developed at national level are adopted into EU legislative packages. It comes from the field of financial services and the changing approach to financial regulation disclosed by the latest post-crisis EU legislative package (MIFIR and MIFIDII¹⁹⁸).

The previous forays of the EU legislator into the field of financial services, while not having the same liberalisation format as in telecoms or energy, were guided by a similar competition and market-enhancing logic. Namely, the EU legislator sought to allow financial institutions to establish themselves or offer their products cross-border in different Member States following the mutual recognition principle as a way of both generating inter-penetration (the ‘shallow’ view of the internal market) together with introducing greater competition in national financial markets. Moreover, from the consumer protection side, the EU legislation focused principally on strengthening disclosure and providing pre-contracting conduct of business rules intended to both help consumers take advantage of greater competition and thereby also strengthen the disciplining force of competition on suppliers.

The MIFIDII/MIFIR package was enacted in the aftermath of the financial crises, reflecting to some extent the weaknesses in financial regulation that were revealed by such crises, including

- The general weaknesses in financial supervision at national level in the Member States of financial institutions
- Failures in consumer protection in the wake of the growing retailisation of the sector, whereby both disclosure and conduct of business rules were proven to be of limited effectiveness, particularly given supervisory weaknesses
- The fact that agency problems pervade financial institutions themselves, so that the inability of the management of financial institutions to fully supervise internal staff and processes further impedes the regulatory/supervisory tasks
- That the shallow internal market, characterized by interpenetration of supply of financial services can lead to cross-border spillovers of systemic risk.

While much of the scholarly and practitioner attention on the new legislation has focused on the product intervention powers granted to EU-level authorities (a sharp regulatory limitation on party autonomy), the centre-piece of the MIFIDII regulatory scheme appear to be the product governance obligations imposed on financial services providers, which are to be overseen principally by national supervisors. As opposed to disclosure and distribution obligations at the point of sale, the product governance rules go further back in the product life cycle and on the processes through which firms manufacture and target financial products. As such, the EU legislation recognises the limits of competitive discipline in the context of complex contractual products, thus mandating internal processes of oversight of the design and targeting of products, the internally identified basis of profitability as well as continued review of their performance and effects in a changing market.

This approach of tracing throughout the product’s cycle from its very inception, similar to food safety tracing obligations that are themselves a recognition of the way in which (transnational) regulation aids competitive discipline, was in fact elaborated in a number of Member States in response to significant financial product weaknesses that revealed both regulatory short-comings and the limits of competitive discipline in the financial sector. Such problems triggered a search for new regulatory approaches and this national policy innovation took place at a time when the relevant authorities did not even have formal powers to influence the product manufacturing process. These innovations were developed by the regulatory authorities of jurisdictions such as the UK and the Netherlands, identified

¹⁹⁸ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast), OJEC 2014 L173/349.

as liberal market economies,¹⁹⁹ and are much more intrusive than the approaches followed by authorities in France or Germany.²⁰⁰ And yet, it is also not necessarily the case that product governance approaches involve a regulatory suppression of freedom of contract. With respect to financial services providers, this approach leverages the fact that agency problems in internal governance could lead to product misselling which brings short term profits, but could ultimately lead to disastrous outcomes even for firms. From the customers' perspective, product governance interventions have created monitoring regimes for product outcomes, which could lead to the elimination of products from the market, but also to improved targeting of both products and product disclosures to the intended customers.²⁰¹ Finally, the adoption of these new forms of financial supervision in the EU legislation is not done through prescriptive rules. Instead they allow Member States, their financial authorities and regulated firms substantial autonomy to devise solutions sensitive to local circumstances and policy priorities, while safeguarding customer protection and financial stability in the internal market.

Concluding remarks

In light of the above examples of how the transnational regulatory architectures created by EU law allow for the joint construction of market interventions that promote both EU level and local goals, it might be argued that the despondent tone of scholarly reflection on EU market regulation reflects two aspects of legal scholarship about the EU.

The first is that legal scholarship on EU integration typically does not consider a counterfactual, perhaps because the traditional approach in legal scholarship is to take rules and institutions as they are. This has the result of tending to ignore broader transformative drivers that influence individuals, firms, as well as States and their capacity for regulation. Ignoring broader transformative drivers may inadvertently over attribute effects, so that the phenomenon under study, such as the EU in this case, is seen as a causal factor. Where scholars do consider a counterfactual, it often tends to be an implausible one, including the EU as a non-functional or non-purposive entity or as a source of political solidarity based on a very broad generalization of the "self-understanding" of European citizens. Unlike the 19th century nation-State, violence and suppression of difference are not available to the EU to create either identity or solidarity. Otherwise, in the general EU scholarship the implicit counter-factual appears to be the nation-State absent the EU, which might both overlook deficiencies in the national policy-making and decision-making processes as well as the extent to which EU architectures have upgraded national regulatory capacities.

The second feature of legal scholarship is the tendency to focus on legislation as enacted or on the decisions of courts, such as the CJEU, as the raw material for analysis. This may produce the tendency towards broad assessments of European private law as being based on internal market logic. While looking at the process of enactment and the text of secondary legislation might occasionally suggest that, such appearances may simply reflect competence constraints and the specialization of goals and instruments that competence-allocation encourages. Once we look at a broader sample of EU interventions in private law, any rationality or "deity" seems to dissolve. Internal market building based on undistorted competition does not foreclose either EU or MS measures that put into question either the goal or the instrument of competitive markets. True it is that such interventions are subject to scrutiny by judges and by regulatory peers and that such scrutiny extends over time. But our examples suggest that such on-going scrutiny of effects should only improve both tailoring and

¹⁹⁹ Fritz Scharpf, "The Asymmetry of European Integration, or Why the EU Cannot Be a 'Social Market Economy'", *Socio-Economic Review*, vol. 8:2, pp. 211-250 (2010). At pp. 234-235.

²⁰⁰ Yane Svetiev and Annetje Ottow, "Financial Supervision in the Interstices Between Public and Private Law", *European Review of Contract Law*, vol. 10:4, pp. 496-544 (2014).

²⁰¹ *Ibid.*

efficacy of market interventions, including by Member States. As such, EU law invites policy innovation by the Member States to respond to emergent problems, though it is another matter whether this invitation is always taken up.

The assemblages of autonomy, competition and regulation in the examples discussed suggest there is no natural market model towards which different sectors can converge so as to make regulation unnecessary. Instead markets are socially constructed institutions that can be calibrated towards the achievement of different salient policy goals, particularly in response to concrete problems. Neither the EU, nor the Member States - on their own - have a comparative advantage in manufacturing socially embedded markets. The moral of the story is they are much better at this task together, within the deliberative and mutually disruptive platform supplied by EU law.

The economic efficiency rationale and European private law

*Hans-W. Micklitz*²⁰²

Clarification and the argument

Transformation, private law and competition

There is a need to clarify what I mean by ‘transformation’, ‘private law’ and ‘competition’. The overall theoretical background to the concept of ‘transformation’ is taken from the changing role and function of the nation state, for which the European could be taken as a blueprint and a laboratory.²⁰³ The drivers behind the transformation are (1) the changing economy, - the internationalization of the economy in the aftermath of the collapse of communism with the fall of the Berlin wall as the break-even point going hand in hand with the financialisation²⁰⁴ of the economy, (2) the rise of a new technology – the internet which is gradually substituting the industrial age – and (3) the borderless society in which the rights and duties of citizens are no longer bound and shaped by the nation state alone.²⁰⁵ This is not to say that the drivers are not inter-connected. The forthcoming analysis of the transformation of private law through competition will have to raise the question whether there is a fourth driver which needs to be kept separated from the others – (4) ‘crisis’ that triggers action. In our context it is the economic crisis and the Euro-crisis that sets the agenda and that has made ‘crisis’ and crisis management the permanent state of affairs of the European constitution, but also of private law, as will be shown.

First consequence: for the search of a deeper understanding of the relationship between transformation of the nation state and the drivers behind, there is a need to draw a distinction between private law in the realm of the changing economy in the aftermath of the economic and political disruptions of the late 1980s – in EU speak the Internal Market Project (1) and the impact of the economic crisis and the Euro-crisis in the aftermath of Lehman Brothers (4) – in EU speak the political decision to establish a European Banking Union. The rise and importance of the new technology is wonderfully condensed in the most recently adopted paper of the newly elected European Commission ‘A Digital Single Market Strategy for Europe’,²⁰⁶ which sets an agenda also for the future of European private law. What about the (3) the changing society then? The question leads to the role and function of the civil society, of the European civil society – provided there is one - on the making and the enforcement on statutory rules within the EU as well as self-constituted and self-enforced rules outside public law rules made by democratic organs.

²⁰² This paper is the result of many discussions we had in our project. I would like to thank the wonderful team we have built for their input, Marta Cantero, Guido Comparato, Ronan Condon, Lucila de Almeida, Irina Domurath, Betül Kas, Heikki Marjosola, Federico della Negra, Yane Svetiev, Barend van Leeuwen.

²⁰³ H.-W. Micklitz, The European Union Project, in J. Dickson/P. Eleftheriadis (eds.), *The Philosophical Foundations of European Union Law*, Yearbook of European Law, Oxford, 2013, 538-554

²⁰⁴ R. J. Shiller, *The New Financial Order, Risk in the 21st Century*, Princeton 2003, for a forceful critique J. Vogl, *Das Gespenst des Kapitals*, Diaphanes, 2010/2011.

²⁰⁵ H.-W. Micklitz/Y. Svetiev, The Transformation of Private Law, with Yane Svetiev, in Hans-W. Micklitz/Yane Svetiev/Guido Comparato (eds.), *European Regulatory Private Law – The Paradigm Tested*, EUI-ERC Law 2014/04, 69-97, in which the idea is developed.

²⁰⁶ COM (2015) 192 final, 6. May 2015 http://ec.europa.eu/priorities/digital-single-market/docs/dsm-communication_en.pdf

Private law is understood as being an integral part of economic law.²⁰⁷ This leads to the distinction between traditional private law and regulatory private law, traditional private law being understood on the European continent the grand codifications, with its congenial counterpart in common law countries. Regulatory private law can be broken down into three waves for regulation, the first going together with the rise of the regulatory state in the late 19th early 20th century, the second with the rise of the welfare state in the second half of the 20th century and the third triggered by the Single European Act, which submitted private law to the completion of the Internal Market project.²⁰⁸ The different waves have produced different set of rules, the first wave yielded labor and employment law in the early 20th century, but also regulatory means to shape markets, the second wave building on the first wave realized the political claims of the labor movement in the Sozialdemokratisierung Europas²⁰⁹ (the social democratization of Europe independent of the political party in power) but added a new layer – consumer law in reaction to the consumption society.²¹⁰ The third wave bears a different connotation and shifts the focus from the national to the European level.²¹¹ The Internal Market project gave rise to a new value paradigm which gradually but steadily penetrated from the borders into the core of private law – the anti-discrimination principle.²¹² It equally led to the liberalization and privatization of former public services, an area not commonly being understood as the field of regulated markets, telecommunication, postal services, energy (electricity and gas), transport (airlines, railways, ships and buses) – here referred to as the ‘silos’. Financial services have to be added to the regulated markets although due to the financialisation of the economy they enjoy a particular status which heavily impacts the other regulated markets.

Second consequence: there is a need to distinguish between traditional private law and regulatory private law, there is equally a need to draw a distinction between b2b and b2c relations. What really matters, however, is to understand that European private law building is following its own pathway and that only a broadening of perspective, the inclusion of regulatory private law, be it horizontal though status related labour law, anti-discrimination law and consumer law, be it vertical enshrined in silos of regulated markets allows for fully catching the change private law is undergoing since the European Union was established in 1957.

The third clarification refers to the use of ‘competition’ in relation to private law. For a German scholar the relationship between private law and competition is very much shaped by the impact on ordo-liberalism in the building of the German market and the German society after the Second World War.²¹³ The ‘*Privatrechtsgesellschaft*’ (literally private law society, however this is a term which

²⁰⁷ L. Raiser, Funktionswandel des Privatrechts, Mohr Siebeck 1971; Funktionswandel der Privatrechtsinstitutionen: Festschrift f. Ludwig Raiser zum 70. Geburtstag, Mohr Siebeck 1974 (Hg.), F. Baur, H.-D. Assmann/G. Brüggemeier/D. Hart/Ch. Joerges, Wirtschaftsrecht als Kritik des Privatrechts, Äthenäum 1980.

²⁰⁸ See with regard to the distinction H.-W. Micklitz, The Visible Hand of European Private Law, in Yearbook of European Law 2009, volume 28, P. Eeckhout/T. Tridimas (eds.), 2010, 3-60, in Italian, in Collana „Studi storici e giuridici“ diretta da Guido Alpa e Roberto Mazzei, Seminari del Consiglio Nazionale Foren-se, 2010, 125-192, in Finnish, Lakimies 3/2010, 330-356 und ins Japanische, Hokkaido Journal of New Global Law and Policy, Vol. 12, 30 July 2011, in French, La main visible du droit privé réglementaire Européen, RIDE 2014, 5-57

²⁰⁹ Scharpf, Fritz W. (1987): Sozialdemokratische Krisenpolitik in Europa. Frankfurt a. M./New York: Campus.

²¹⁰ G. Howells/th. Wilhelmsson, EC Consumer Law, Ashgate 1997; St. Weatherill, EU Consumer Law and Policy, (Cheltenham: Edward Elgar, 2005), H.-W. Micklitz, N. Reich, P. Rott and K. Tonner, European Consumer Law, (Cambridge: Intersentia, 2014).

²¹¹ For a deeper reflection of the effect of the decline of the welfare state on private law, Th. Wilhelmsson/S. Hurri (eds.), From Dissonance to Sense: Welfare State Expectations, Privatisation and Private Law, Ashgate 1999, as well as R. Brownsword/G. Howells/Th. Wilhelmsson, Welfarism in Contract Law, Dartmouth 1994.

²¹² Münch, Richard, European Governmentality, The Liberal Drift of Multilevel Governance. London: Routledge, 2010; N. Reich, General Principles of EU Civil Law, Cambridge: Intersentia 2013

²¹³ D. Gerber, Gerber, D.J. (1994). Constitutionalizing the Economy: German Neo Liberals, Competition Law and the “New” Europe. American Journal of Comparative Law, 42, 25-84.

cannot really be translated as it does not make sense²¹⁴) this is the credo of the ordo-liberals can only unfold within a competitive environment which has to be shaped via public law (competition law) and whose compliance needs to be guaranteed by national cartel authorities, to tame private power. Only if competition is secured, there is room for individual freedoms, freedoms to do business and to conclude contracts, but not only this. The ordo-liberals are promoting a particular society not only an economy, a society where the individual in the Kantian sense remains responsible for himself and where the state refrains from intervening into the economy and the society. *E.-J. Mestmäcker*²¹⁵ quite successfully succeeded in transferring the ordo-liberal to the European Union, at least in its founding period until the adoption of the Single European Act. What matters in our context is the seemingly clear distinction between private law, private autonomy, freedom of contract on the one hand and competition law on the other. This is not the place to go into the debate on whether or not this has ever been the only model in Germany or Europe²¹⁶ or whether and to what extent ordo-liberalism vanished away in the ongoing process of European integration, as documented in the various Treaty amendments.²¹⁷ For the sake of my argument I am using the distinction as a starting point of my analysis of the transformation process through European integration. The overall idea behind the paper is to demonstrate how this original distinction vanishes away over time and how regulatory intervention through the EU hand in hand with the building of regulatory private law²¹⁸ promotes an extremely instrumentalistic understanding of private law that oscillates between using private law to enhance competition in the Internal market and at the same time using private law to shut down competition for the sake of 'higher' regulatory purposes, the building of the internal market, the building of the banking union, the now envisaged building of the digital single market. So the Internal Market has two faces, competition promoting and competition restricting. The moving target of instrumentalisation leaves us with the question whether the 'political objective' is a 'means to an end' or whether the market is 'the end itself'.

Third consequence: European private law being understood as regulatory private law is per definition in conflict with competition and competition law. Following the ideology of the private law society, regulatory intervention necessarily sets limits to personal freedoms, to freedom of contract, thereby restricting competition, mostly for the sake of protecting the weaker against the stronger party. This means private law is regulating power, a domain which in ordo-liberal thinking is and should be left to competition. However, this is only half the truth. In the EU context regulation might also mean enabling competition in newly established markets, where private law is used as a tool to create competition in areas where there was none before. Here enlarged individual autonomy and competition go hand in hand.²¹⁹

²¹⁴ For a useful explanation to the non-German readers in the European context St. Grundmann, *Regulatory Competition in European Company Law – Some Different Genius?*, in: G. Ferrarini /K. Hopt /E. Wymmeersch (Hg.), *Capital Markets in the Age of the Euro – Cross-Border Transactions, Listed Companies and Regulation* (Den Haag: Kluwer), 2002, 561-595

²¹⁵ Ernst-Joachim Mestmäcker, *Auf dem Wege zu einer Ordnungspolitik für Europa*, in: E.-J. Mestmäcker/H. Möller/H.P. Schwartz (Hg.), *Eine Ordnungspolitik für Europa. Festschrift für Hans v.d. Groeben* (Baden-Baden: Nomos-Verlagsgesellschaft), 1987, 9-49

²¹⁶ M. Maduro, *We the Court, The European Court of Justice and the European Economic Constitution*, Hart Publishing, 1998.

²¹⁷ Ch. Joerges, *What is Left of the European Economic Constitution? A Melancholic Eulogy*, *European Law Review* 30 (2005), 461-489

²¹⁸ I do not intend to go through the history of the nation state, for a rough account of the development in the field of labour law and consumer law with regard to France, Germany and the United Kingdom through the last 200 years, H.-W. Micklitz, *Social justice and access justice in private law*, in H.-W. Micklitz (ed.), *The Many Faces of Social Justice in Private Law*, Elgar 2011, 3-60 = EUI Working Paper 2011/2

²¹⁹ Guido Comparato/Hans-W. Micklitz, *Regulated Autonomy between Market Freedoms and Fundamental Rights in the Case Law of the CJEU*, in *General Principles of EU Law and European Private Law* Edited by Ulf Bernitz Xavier/Groussot/Felix Schulyok, Ashgate 2013, 121-154; in same vein N. Reich, *General Principles*, op. cit.

How the argument is built

The development of European private law follows the changing policy patterns of the EU that are driving the development. The most stable policy frame is the Internal Market project that has paved the way for the development of the different forms of European private law in a rather stable fashion – the completion of the internal market through competition and regulation under the overall design of economic efficiency. The crisis in 2008/9 has added a new layer to the debate. The Banking Union project reaches dimension which come close to a revision of the European Constitution, through by and large outside the Treaty through secondary EU law. Instead of competition and efficiency, the Banking Union is driven by financial stability as the overarching principle that downgrades competition as a leading paradigm. Despite the considerable amount of rules adopted to establish the Banking Union the impact on European private law rules is yet rather difficult to grasp. It seems, however, that financial transactions – also contractual relations – are being put into an ever tighter jacket that frames the leeway for private autonomy of creditors and debtors. Last but not least the European Commission just launched its new Digital Single Market Strategy, which brings back the DCFR and CESL though in modified form. The outcome might be regulatory competition between the rules on digital transactions and rules on analog transactions. There is no clear pattern yet. A tentative conclusion will have to take the competing paradigms into account.

The Internal Market project

Competitive contract law as a starting point in 1986-2005

The first is the Internal Market project and how it impacts on the design and use of private law rules. In so far I can build on an analysis which is now exactly 10 years old and where I developed the concept of ‘competitive contract law’.²²⁰ I tried to show how the EU is designing private law relations in b2b and b2c so as to enhance competition to complete the internal market. The regulatory model behind can be broken down into seven elements: (1) instrumental protective device (the status of the party in the contractual relation, the consumer and/or SMEs), (2) the vanishing line between commercial communication and contract conclusion, (3) the distinction between competitive transparency prior to the conclusion of the contract and substantive transparency so as to submit contractual stipulations a kind of a fairness test, (4) the use of information duties so as to shape standard form contracts, (5) the instrumentalisation of fairness doctrines for the purpose of market clearance, (6) the introduction of post contractual cancellation rights so as to allow for ex-post corrections for the sake of engaging into a better contract and last but to least (7) the attempts of the EU legislator and the ECJ to ensure that the rights granted maybe effectively enforced. Constitutive for competitive private law is its submission to a higher purpose – Internal Market building and competition.

The ‘person’ required to meet these standards is the famous circumspect omnipotent consumer/SME who is constantly comparing prices and looking for a better deal, ready to use withdrawal and cancellations right to ‘reap the benefits’²²¹ of the Internal Market. The rise of the efficiency doctrine promoted in the Lisbon Summit 2000 coincides with a decrease of social distribute justice and a kind of utilitarian economy, where the price serves as the key parameter for decision. The competitive element introduced in European private law, in consumer law, in regulated markets and in distribution agreements – these were at the forefront of the analysis – follows mainly from the functionalisation of

²²⁰ The concept of competitive contract law, Penn State International Law Review, The Dickinson School of Law of the University of Pennsylvania 23 (2005), 549-586, see the critique by K. Riesenhuber, A ‘competitive’ contract law, in K. Purnhagen/P. Rott (eds.), Varieties of European Economic Regulation, Liber Amicorum Hans Micklitz, Springer 2014, 105-122

²²¹ http://europa.eu/legislation_summaries/education_training_youth/general_framework/c10241_en.htm

private law itself. Regulation is used to insert rules into private law relations that allow for the promotion of competition. Under the overall purpose of the completion of the Internal Market, private law and competition law are going hand in hand.

10 years later it seems by and large that the further development in law making and in particular in its application through the European Commission and the European Court of Justice follows the model of competitive contract law, though certainly not in a streamlined way. The most obvious confirmations of the overall hypothesis may be overserved in the ever narrower relationship of commercial communication and contract conclusion, the importance of the differences between competitive and substantive transparency, post contractual cancellation rights and the elaboration of effective legal protection.²²² Less obvious at least in consumer law is the relationship between the consumer image (the circumspet) and fairness as market clearance. In the aftermath of the financial crisis it seems as if the ECJ has turned into a regulator to protect those who suffered most from the economic crisis and the Eurocrisis from being excluded from the society.²²³ What is missing and what is not yet enshrined in the 2005 stock taking is the long term impact of the move in competition law to the more economic approach towards contract law and contract regulation.²²⁴

The continuation of the Internal Market building 2005-2015

Three major developments have changed the interrelationship between the Internal Market, competition and private law: the rise and decline of the Draft Common Frame of Reference, the move towards full harmonization very much inspired by the ideology of the more economic approach and last but not least the unprecedented development in regulated markets. In putting together the three strands I would like to hypothesize that the more recent development (2005-2015) can be caught in the language of ‘managed competition’, where the rights and duties of individual parties are subjected to a much more important goal than preserving and developing individual freedoms – that of making the EU the ‘most competitive economy of the world’.²²⁵

²²² (1) Commercial communication and contract conclusion, Perenicova (a common approach on contract terms and commercial practices, Hans-W. Micklitz, A Common Approach to the Enforcement of Unfair Commercial Practices and Unfair Contract Terms, in M. v. Boom/O. Akseli/A. Garde (eds.), *Experiencing Unfair Commercial Practices: Impact, Enforcement Strategies and National Legal Systems. Markets and the Law*, Ashgate 2014, 173-202, now ECJ, Case C-388/13 *Nemzeti Fogyasztóvédelmi Hatóság vs. UPC Magyarország Kft* (communication, by a professional to a consumer, of erroneous information, such as that at issue in the main proceedings, must be classified as a ‘misleading commercial practice’, within the meaning of that directive, even though that information concerned only one single consumer, P. Rott, *Der Durchschnittsverbraucher ein Auslaufmodell angesichts individualisierten Marketings?* *VuR* 2015, 163), (2) competitive and contractual transparency, ECJ C-92/11 *RWE* (dazu N. Reich, “I Want My Money Back” – Problems, Successes and Failures in the Price Regulation of the Gas Supply Market by Civil Law Remedies in Germany *LAW* 2015/05 Department of Law European Regulatory Private Law Project (ERC-ERPL-11) European Research Council (ERC) Grant <http://www.vzh.de/energie/369563/I%20want%20my%20money%20back.pdf>, (3) effective legal protection in particular Mohamed Aziz, H.-W. Micklitz, *Unfair Contract Terms – Public Interest Litigation before European Courts Case C-415/11 Mohamed Aziz*, in V. Colaert/E. Terry (eds.) *Landmark Cases of EU Consumer Law – in Honour of Jules Stuyck*, Intersentia, 2013, 615-634.

²²³ Hans-W. Micklitz, Norbert Reich, *The Court and the Sleeping Beauty, The revival of the Unfair Contract Terms Directive (UCTD)*, *CMLR* 51 (2014), 771-808; G. Comparato, *The rationale of financial inclusion in the changing European private law*, *ECRL* 11 (2015), 22-45.

²²⁴ There is a heated debate behind Kiran Patel / Heike Schweitzer (eds.), *Historical Foundations of EU Competition Law*, OUP 2013; D. Gerber, *Anthropology, History and the 'More Economic Approach' in European Competition Law -- A Review Essay*, 41 *International Review of Intellectual Property and Competition Law* 441 (2010) Chicago-Kent College of Law Research Paper http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2159339

²²⁵ This is the language of the Lisbon Summit : ‘If Europe is to become the world's most competitive economic area, it is also important to improve research conditions and create a more favourable climate for entrepreneurship, in particular by reducing the administrative costs associated with bureaucracy.’

DCFR and CESL

There is no need to reiterate again and again the story of the Draft Common Frame of Reference which was said to be an ‘academic project’ (2001-2008),²²⁶ turned under Commissioner *Reding* into a ‘political project’ having a short career under the heading of ‘CESL’ (the Common European Sales Law in 2011),²²⁷ before it was buried through a letter of six member states to the new commissioner *Juorová* in November 14.²²⁸ It is the design of CESL which matters in our context. CESL was drafted as the 28th legal order (side-by-side with at that time 27 national legal private law orders). CESL if adopted would have introduced serious competition between the national legal orders on the one hand and the 28th or 29th European legal order on the other.²²⁹

The access to the substantive body of common sales law rules should be guaranteed via the so-called optional instrument. This was in essence an opt-in mechanism where the parties to the contract should voluntarily decide on the applicability of CESL. Setting aside whether the OI was seriously taking into account whether consumers have been given a choice or whether the supplier chooses and makes the choice binding on the consumer,²³⁰ CESL would have opened up a new pathway in the interplay between national legal regimes and the EU regime. It would have introduced for the first time an open element of *competition* between legal orders, though it is a particular form of competition as a supranational order (CESL) but have had to compete with the Code Civil, the Codice Civile, the Wetboek, the German BGB of the recodified civil codes of the new member states. It is not clear whether the Member States – in particular the six behind the letter to the Commissioner – were afraid of the competition or whether they were more seriously concerned by the competence shift. DCFR and CESL were strongly promoted by the European Parliament as a building block for a more fully integrated European Union, being originally composed of a European Constitution and a European Civil Code.²³¹ Therefore it might very well be that those Member States which openly expressed their concern regarded their national private legal order (codified or not) as part of their national identity.²³² However, such language does not show up in the letter of the six.

The revision of the consumer acquis

The second story is equally well-known, at least to consumer lawyers. There is a direct way from the rhetoric of the Lisbon Summit in 2000 – making the EU the most competitive economy of the world –

²²⁶ Research Group on the Existing EU Private Law (Acquis Group), Principles of the Existing EU Contract Law (Acquis Principles): Contract I (2007); Ch. v. Bar et al. (eds), Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference (DCFR) (Outline Edition, 2009).

²²⁷ COM (2011) 635 final, available at

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0635:FIN:en:PDF>.

²²⁸ On file with the author. The six member states, Austria, Finland, France, Germany, Netherlands and the UK highlighted in between a number of concerns the lack of competence.

²²⁹ St. Grundmann, Kosten und Nutzen eines optionalen Europäischen Kaufrechts, AcP 212 (2012) 502-544 (Vortrag auf der Tagung der Zivilrechtslehrervereinigung vom 20./21. April 2012); in English, Costs and Benefits of an Optional European Sales Law (CESL), (2013) 50 CMLR 225-242

²³⁰ H.-W. Micklitz/N. Reich, The Commission Proposal for a “Regulation on a Common European Sales Law (CESL)” – Too Broad or Not Broad Enough, EUI Working Paper 2012/4, 1-93

²³¹ H.-W. Micklitz, Failure or Ideological Preconceptions? Thoughts on Two Grand Projects: the European Constitution and the European Civil Code, in K. Tuori and Suvi Sankari (ed.), The Many Constitutions of Europe, Ashgate 2010, 109-142 = EUI Working Paper 4/2010.

²³² It is an open question whether civil codes could be regarded as part of national identity in the way the Treaty of Lisbon intends to preserve it. In the Lisbon judgment the Federal Constitutional Court started to shape the eternal core of the German Basic Law, but did not mention the BGB, H.-W. Micklitz, German Constitutional Court (Bundesverfassungsgericht BVerfG) 2 BvE 2/08, 30.6.2009 – Organstreit proceedings between members of the German Parliament and the Federal Government, ERCL 2011, 528-546

to the promotion of full harmonization in the Consumer Policy Programme 2002-2006.²³³ Originally the European Commission intended to unite 8 consumer contract law directives into one single fully harmonized body of law. If realized this would have been the starting point for the elaboration of a European Consumer Civil Code. After Horaz ‘*Der Berg kreite und gebar eine Maus*’ – in English something like ‘an elephant went into labour and delivered a mouse’, first the ambitious project shrank down from eight directives to four (doorstep, distant selling, consumer sales and unfair terms), then – after strong resistance from the Member States and from the academic environment around Europe,²³⁴ only two remained, doorstep and distant selling, which were finally adopted under the misnomer of ‘Consumer Rights Directive 2011/83/EC’. This is a misnomer as there are many more consumer rights enshrined in other directives.

How is full harmonization related to competition? Let us assume for a moment that the EU would be able and competent to adopt a fully harmonized European Consumer Code by way of a Regulation. Let us equally assume that the rules enshrined in that body of law define a common standard for 28 member states and let us set aside all questions about possible differences in the application and enforcement within the Member States. The EU would be governed by one single set of rules as if the EU would be a state like any other EU Member State. Competition between legal orders would not exist. Harmonisation through regulation would have eliminated all potential differences between national consumer law orders. Reality is different. The EU has managed to adopt a dense body of consumer rules, most of them are based on the principle of minimum harmonization. Where they are based on full harmonization like in distant selling of financial services or more importantly in consumer credit, the scope of the fully harmonized EU rules is so small that substantial differences in the respective fields sustain despite the directives. That is why there could be – in theory – competition between the Member States on the level of consumer protection. However, neither the European Commission nor the Member States demonstrate political willingness to engage into competition over the level of protection, of which Member States provide for the best and most comprehensive protection. The reasons behind the Commission unwillingness are self-explanatory. The Member States try to promote the advantages of their national private legal orders in business circles, with little success though.²³⁵ An obvious explanation would be that businesses, in particular big businesses, prefer arbitration to litigation in (European) courts. If they opt for a particular court, they choose New York, London or Switzerland as the place of jurisdiction.²³⁶ In the choice of law perspective the remaining legal orders do not really play a role for b2b relations at least not under the aspect of competition between legal orders.

The European consumers themselves are much more sensitive than big politics. The Eurobarometer demonstrates that the degree to which consumers trust in the national legal orders to protect their rights differs considerably. The survey confirms the hearsay evidence that consumers in the northern part of Europe are better protected than in the Southern part and that this complies with the degree of

²³³ H.-W. Micklitz, *The Targeted Full Harmonisation Approach: Looking behind the Curtain*, in Howells/Schulze (eds.), *Modernising and Harmonising Consumer Contract Law*, 2009, 47-86

²³⁴ G. Howells/R. Schulze (eds.), *Modernising and Harmonising Consumer Contract Law*, 2009, 47-86; H.-W. Micklitz/Norbert Reich, *Crnica de una muerte anunciada: The Commission Proposal for a ‘Directive on Consumer Rights’*, *Common Market Law Review*, 47 (2009) 471-519

²³⁵ Smits, Jan, “Private Law 2.0 On the role of private actors in a post national society”, Inaugural Lecture, University of Maastricht, 30.11. 2010; Hague Institute for the Internationalisation of Law and Eleven International Publishing, 2011; Maastricht Faculty of Law. Available at SSRN: <http://ssrn.com/abstract=1779042>; see also Th. Wilhelmsson, *Free movement of Legal Sources: The Use of Foreign Sources in Private Law in Europe*, in K. Purnhagen/P. Rott (eds.), *Varieties of European Economic Regulation*, Liber Amicorum Hans Micklitz, Springer 2014, 185-2003.

²³⁶ S. Vogenauer and S. Weatherill (eds), *Harmonisation of European Contract Law (2006)*; G.-P. Calliess, ‘Der Richter im Zivilprozess – Sind ZPO und GVG noch zeitgem’, *Gutachten A zum 70. Deutschen Juristentag* (2014).

satisfaction.²³⁷ Comparative lawyers so far have shied away from confronting the preconceptions or prejudices with a substantiated analysis of the differences between the level of protection, let alone with a socio-legal study. This is all the more astonishing as the Consumer Law Compendium – which is regularly updated – provides for a solid ground of information. It seems as if the comparative consumer lawyers are about to miss out a field of research which might be conquered by economists and/or political scientists.²³⁸ The reluctance of lawyers to engage into such an exercise, to code consumer laws and to rank the 28 Member States according to quantitative and qualitative criteria might be explained by the *Savignyan* heritage which governs until today the relationship between national private legal orders. National private legal orders have to be treated equally. Each legal order is given the same value and the same status in international private law. By and large this philosophy is condensed in the European rules on international private law, the Brussels Regulations on jurisdiction and enforcement and the Rome regulations on contract and tort.

European regulatory private law

The story of the rise of European regulatory private law outside consumer law and outside anti-discrimination law is less-known. In the European context this has to do with the more or less total neglect of the law of regulated markets in the European Civil Code project. With the exception of consumer law and anti-discrimination law, neither the Study Group nor the Acquis Group engaged into a deeper analysis of the regulations and directives adopted in the aftermath of the Single European Act to liberalise and to privatise telecom services, energy, transport and financial services. There was a working group engaged in the analysis of services proposing a particular set of rules on services.²³⁹ However, it did not integrate these new services which account for more than 70% of Europe's gross income.²⁴⁰ The reason might be that the EU is regulating the silo top down, from the establishment of a competitive market through unbundling and third party access, supervised and monitored by sector related regulatory agencies down to the regulation of private law relations in last step. The majority of private lawyers will treat the EU rules as administrative law, outside the reach of private law. It is here where the understanding of private law as economic law ties in.

The respective EU rules in the different regulated markets are aiming at establishing competition, competition between the former incumbent and the newcomers which must be granted access to the grid or the market. Competition this is the philosophy behind should work to the benefit of the 'customers'. There is no need to discuss the intricacies of the different regulated markets. Again the focus is put on the role and function of private law in the shaping and building of these markets. The overall paradigm behind is efficiency – the Lisbon Summit. Liberalising and privatising former public services is being regarded as increasing efficiency in the relevant sector. Competition between different suppliers, this is the ideology, prevails over publicly owned companies. Private law, private regulations are just a means to an end. In so far the logic of the Internal Market project, which is the driver behind the liberalisation and privatisation policy, shines through the sector related policies.

From a private law perspective two issues dominate the discussion: in b2b relations it is third party access, in b2c relations it is switching. If third parties have no access competition cannot work. The former incumbent have used and are still using all sorts of tricks, legal or semi-legal, to render access

²³⁷ Th. Wilhelmsson, The Abuse of the "Confident Consumer" as a Justification for EC Consumer Law, *Journal of Consumer Policy* September 2004, Volume 27, Issue 3, pp 317-337.

²³⁸ R. Michaels, Comparative Law by Numbers? Legal Origins Thesis, Doing Business Reports, and the Silence of Traditional Comparative Law, *American Journal of Comparative Law* 57 (2009), 765-795

²³⁹ Service Contacts: Principles of European Law Hardcover by Maurits Barendrecht (Author), Chris Jansen (Author), Marco Loos (Author), Andrea Pinna (Author), Rui Cascao (Author), Stephanie van Gulijk (Author), Study Group on a European Civil Code (Editor), München: Sellier 2007.

²⁴⁰ Services contributed 73.5 % of the EU-28's total gross value added in 2013: Eurostat, Data from May 2014, available at http://ec.europa.eu/eurostat/statistics-explained/index.php/National_accounts_and_GDP.

difficult. Twisted into private law language the national regulatory agencies are mandated to pave the way for contractual relations where there were none before. In b2c relations the functional role of private law relations is even more evident. The ‘c’ is not the consumer in the narrow meaning of the eight consumer law directives mentioned above, but the ‘customer’ who might even be a small and medium sized company. The dominant mechanism which shall secure competition is switching. Switching requires short term contracts and easy mechanism to get out of contracts and to get into new contracts. Over time the EU has constantly strengthened the rights to switch and the necessary informational environment in which switching has to be embedded.

In both areas private law rules are functional. They have to serve a purpose. The regulation is not about freedom of contract, but about competition and choice. The new entrants as well as the new customers are instrumentalised for the purpose of market building. This comes close to the model of competitive contract law as explained above. There might be a tension between efficiency driven competitive contract law in regulated markets and the differing ‘rationalities’ of the regulated markets, though. Each of the regulated market is governed by a particular rationality, this is true for telecom, energy, transport and financial services. The rationality derives from the particular needs of the markets and the deeper cultural environment in which it is embedded.²⁴¹ The internal rationality of the respective silo might clash with the overarching efficiency paradigm.²⁴²

However, contrary to consumer law and anti-discrimination law, regulated markets are governed by regulatory agencies. These agencies are involved in the making of the sectorial rules below the level of binding laws and regulations and they are in charge of monitoring and surveying the market. The EU legislator has gradually turned these agencies into bodies which do not only have to guarantee the functioning of the market, they are ever stronger obliged to look after the collective interests of the respective customers in these markets. It is here where the threshold towards private law is trespassed. The above mentioned private law rules in regulated markets are submitted to regulatory purposes, such as third party access and switching.²⁴³

How and where does competition come in?

The overall idea of the regulatory design behind these silos is to develop uniform rules, co-ordinate them in European fora – the respective European agencies – and enforcement them throughout the EU as a whole. The regulatory means are ‘guidelines’ and ‘recommendations’ adopted by the European Commission. These guidelines and recommendations may take a quasi-binding effect. In the telecom sector they are subject to a compatibility test with EU law.²⁴⁴ Similar conflicts maybe reported from the financial services sector, within the scope of application of the MIFID and the competence of the European Commission.²⁴⁵ There should be no differences between the Member States, there should be no *regulatory arbitrage*. Agencies should not compete in the application of the EU rules. They should not engage in conflicts over who of the 28th is best promoting third party access or switching, who is the most customer friendly or the most new entrants friendly authority. In theory, however this would be possible, as the EU regulations and directives on regulated markets are regulating private law issues

²⁴¹ I refer her to system theory, more concretely to G. Teubner, who is usually avoiding the term ‘fairness’ or ‘value’ and speaks instead of ‘rationalities’, see Gunther Teubner, *Societal Constitutionalism: Alternatives to State-centered Constitutional Theory* Storrs Lectures 2003/2004, Yale Law School

²⁴² The relationship between efficiency and rationality will be subject to deeper investigated at a different occasion.

²⁴³ See H.-W. Micklitz, *Editorial The Public and the Private – European Regulatory Private Law and Financial Services* ERCL 2014; 10(4): 473–475 and the contributions from O. Cherednychenko, F. Della Negra, A. Ottow/Y. Svetiev, H. Marjosola.

²⁴⁴ The ‘Opta-Case’, see M. Cantero, *The Transformation in the Making of Private Law via Telecommunications Regulations*, paper distributed for the conference on 18/19th June 2015.

²⁴⁵ Assessment of Takis Tridimas who made this public in a conference at the EUI at the 4-5 June 2015.

in bits and pieces, sometimes via maximum harmonization rules, sometimes via minimum harmonization rules. However, the degree to which there is maximum or minimum does not play a crucial role with regard to private law issues, as there remains ample room for national private law when it comes to conflicts that reach the court level.²⁴⁶ In theory there could be competition over the level of protection and in practice there is a form of competition. It suffices to compare the UK and Germany. In the UK customers were collectively compensated for the harm they suffered from illegal telecommunication rules through AFCOM,²⁴⁷ whereas in Germany customers had to go through a highly complex litigation process which ended successfully for 50 customers who were actively involved in the litigation whereas the hundreds of thousands behind were left with empty hands.²⁴⁸ Interviews taken with public officials from different Member States in different regulated markets confirm openly or implicitly that there is regulatory arbitrage.²⁴⁹

However, what kind of competition is it? Member States are competing in their entirety, with their deeper cultures and traditions. There is no cross-border dimension that allows companies or customers to leave the national jacked behind. New entrants cannot approach Member State X to get access to the grid, if X has the reputation to be more new entrant friendly. German consumers cannot approach the UK AFCOM to get compensated for a harm they suffered from a German company. There is definitely more information needed on how regulatory arbitrage works in regulated markets, what kind of effects regulatory arbitrage produces and how it impacts private law as a tool for market building.

2005-2015 – the changing international environment and its impact on European private law

Since 2005 the overall economic, political and social environment in which the EU operates has dramatically changed. Some of the developments I am tracing started earlier than 2005, but their importance and impact reached the EU only later. They could be condensed into two major trends, the thrive for (1) competition between common law systems and continental legal systems and the (2) growing importance of behavioral economics as a test of regulatory efficiency. The first brings the divided world between the common law countries and the countries with a codified private law order to the fore. The second puts social regulation on trial. Consumer law is at the forefront of discussion. The growing pressure stems from the rise of behavioural economics in the United States and more recently also in Europe.²⁵⁰

Competition between legal orders

In 1998/2008 Raffael La Porta, Florencio Lopez-de-Silanes, Andrej Schleifer and Robert W. Vishny (LLSV)²⁵¹ published their ground breaking analysis of financial markets using legal families as a starter of comparison. The texts can be assigned to the line of research called LOT – i.e. Legal Origin

²⁴⁶ F. Della Negra is stressing this aspect in this analysis of the consumer complaints in the financial market, see F. Della Negra, 'The Private Enforcement of the MiFID Conduct of Business Rules: An Overview of the Italian and Spanish Experiences', 10 *European Review of Contract Law* 2014, p. 571.

²⁴⁷ Example taken from Hodges, Christofer, *The Reform of Class and Representative Actions in European Legal Systems. A New Framework for Collective Redress in Europe*. Oxford: Hart, 2009.

²⁴⁸ See N. Reich, 'I will my money back' op. cit.

²⁴⁹ See for the area of financial regulation A. Riles, *Managing Regulatory Arbitrage: A Conflict of Laws Approach*, *Cornell International Law Journal* 47 (2014), 63-117.

²⁵⁰ See for a deeper analysis H.-W. Micklitz, *The Politics of Behavioural Economics*, MS 2015 unpublished.

²⁵¹ Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, *Journal of Political Economy*, 106 (1998), 1113-1155; La Porta/Lopez-de-Silanes/Shleifer, *Economic Consequences of Legal Origins*, *Journal of Economic Literature* 46 (2008), 285-332, 288

Theory.²⁵² The authors' most important statement is that the historical origins of a legal system have an essential impact on the economic development and opportunities for future development. By this they claim the precise opposite of the Marxist social theory. The approach correlates with the idea of a common European legal culture. However, the crucial difference is that the *ius commune* highlights the European communities, beyond the moats of continental European and Common Law, whereas LOT declares the differences between continental European and Common Law systems to be the central parameters of analysis.

The analysis of the variables is characterised by a clear preference for the Common Law system compared to the 'French Civil Law countries' being countries with Roman legal systems. LLSV has provided the impulse for a variety of further research projects - partly with the participation of the authors - which use the same method and involve beyond business financing the ownership structures of banks, rules about market access, labour market provisions, media ownership structures, formal requirements for the judicial procedures as well as the level of independence of courts. They are listed and explained by LLS in the 2008 text. According to LOT, these examinations sharpen the original findings of 1998 and reinforce the superiority of Common Law:²⁵³ 'In all these spheres Civil Law is associated with a heavier hand of government ownership and regulation than Common Law. Many of these indicators of government ownership and regulation are associated with adverse impacts on markets, such as greater corruption, larger unofficial economy, and higher unemployment'...and further:²⁵⁴ 'in strong form (later to be supplemented by a variety of caveats) we argue that Common Law stands for a strategy of social control that seeks to support private market outcomes, whereas Civil Law seeks to replace such outcomes with state-desired allocations. In words of one legal scholar, Civil Law is 'policy implementing' while Common Law is 'dispute resolving' (Mirjan R. Damaska 1986). In the words of another commentator, French Civil Law embraces 'socially-conditioned private contracting', in contrast to Common Law's support for 'unconditional private contracting' (Katharina Pistor 2006). The path to a clear demand for the Common Law is obvious. This is the only way to organise economic growth efficiently.

Hall/Soskice' Varieties of Capitalism in 2001²⁵⁵ and the Doing Business Report of the World Bank in 2003 point into the same direction. 'Varieties of capitalism' are the response to the elimination of differences between capitalism and a state-trading system as a consequence of the collapse of the Soviet empire.²⁵⁶ In essence, it is an attempt to transfer the findings of New Institutional Economics from the micro (company level) to the macro level (national economies). The elimination of differences made it possible to examine the various forms that could be taken by a capitalistic economic order more widely than in the past, eventually with regard to possible 'recipes' which might be of help to the former socialist states going through upheaval, changes and development. At the same time these efforts, which have been going on for more than 20 years, are directly linked to the new orientation of comparative law, be it in the form of LOT (Legal Origin Theory) or with regard to the rethinking of the assignment of legal systems to legal families.

²⁵² The origins of LOT can be found in the economic analysis of law, which has its origins in the 1960s/1970s A. T.F. Lang, *The Legal Construction of Economic Rationalities?* *Journal of Law and Society*, 40 (2013), 155. For an account of the different currents of LOT with reprint of original texts, S. Deakin/K. Pistor (eds), *Legal Origin Theory* Edward Elgar 2012.

²⁵³ p. 286 left column.

²⁵⁴ p. 286 right column.

²⁵⁵ P.A. Hall/D. Soskice, *An Introduction to Varieties of Capitalism*, in: dieselben (Hg.), *Varieties of Capitalism – The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press), 2001, 1-20.

²⁵⁶ Also: D. Bohle/B. Greskovits, *Varieties of Capitalism Tout Court*, *European Journal of Sociology* 50 December 2009, pp. 355, 357, which also gives an outline of the history of comparative research and tries to explain why the approach of VoC is so successful.

If you were to follow Hall/Soskice as the thought leaders of ‘varieties of capitalism’, only two forms of appearance of comparative law would be relevant, the liberal market economy (LME) and the coordinated market economies (CME). This would amount to a clear cutting of comparative law - Bohle/Greskovitz refer to Occam’s razor²⁵⁷ - which opens up new perspectives of comparative law. Their comparative capitalism is explicitly not linked to any value judgment: ‘Although each type of capitalism has its partisans, we are not arguing here that one is superior to another’²⁵⁸. However, a direct path leads from comparative capitalism to LOT and to the report of the World Bank first published in 2003,²⁵⁹ in which the superiority not only of the Anglo-American economic model, but also of common law over the continental European legal system, is proclaimed.

The Impact on European private law

The changing environment, the pressure towards efficiency and the proclaimed superiority of the common law system over the continental one has not left the European private law unaffected. Already the DCFR and even more so the CESL came under pressure from law and economics, from authors who were questioning the gain in efficiency of a 29th legal order. The competitive element foreseen in the Optional Instrument can be traced back to the rising idea of ‘competition between legal orders’ which also gained ground in Europe.²⁶⁰ Whether competition between legal orders in the inner world of the EU will gain ground remains to be seen. For the time being it is hard to imagine. Member States are advertising the use of their private legal orders, obviously with the intention to make it attractive for business. However, these websites look more helpless and somehow touchingly, but certainly not professional. The impact of the claimed superiority of the common law system by LOT and VoC might even have promoted the withdrawal of CESL, at least this could have inspired the UK to subscribe to the letter to the Commissioner. Needless to say the claimed supremacy provoked strong reactions, in particular in France.²⁶¹

The rise of behavioral economics

Contrary to classical law and economics (*Coase, Calabresi and Posner*), behavioural economics brings reality back into economics. For economics, this comes close to a ‘revolution’ – this is at least the provocative formula used by *F. Esposito*.²⁶² BE is shifting the focus away from the market to behaviour. This is in line with the claim that the function of competition law is changing from market structure to consumer welfare.²⁶³ This shift might also explain why the US is leading the debate on

²⁵⁷ D. Bohle/B. Greskovits, *Varieties of Capitalism* Tout Court, *European Journal of Sociology* 50 December 2009, pp.355, 361.

²⁵⁸ p. 21.

²⁵⁹ Report of the World Bank World Bank Group, *Doing Business – Measuring Business Regulations*, <http://www.doingbusiness.org/>.

²⁶⁰ P. Larouche/F. Chirico (eds.) *Economic Analysis of the DCFR: The work of the Economic Impact Group within the CoPECL network of excellence*, München: Sellier, 2010.

²⁶¹ B. Fauvarque-Cosson/A.-J.Kerhué *Is Law an Economic Contest? French Reactions to the Doing Business World Bank Reports and Economic Analysis of the Law*”, [*« Le droit a-t-il des enjeux économiques ? Réactions françaises aux Rapports Doing Business de la Banque mondiale et Analyse économique du droit AJCL 57 (2009), 811-829, 821 ,violent attack’*

²⁶² *Consumer protection in the world of bounded rationality: an attempt to understand the contribution of behavioural law and economics* , MS 2014 on file with the author.

²⁶³ The catchword in competition law and competition theory is the ‘new’ economic approach. A lot has been written on this; Heike Schweitzer, *Zur Bedeutung des „more economic approach“ für die Unionsgerichte*, in: Thomas von Danwitz/Juliane Kokott (eds.), 6. *Luxemburger Expertenforum zur Entwicklung des Unionsrechts. Aktuelle Herausforderungen für den Unionsrichter*, 2013, pp. 121. Whilst the CJEU sticks to competition law as a means to preserve a competitive market structure, the EU is using its power to investigate ,dominant positions in the market under

consumer economics, despite the fact that US consumer law looks rather underdeveloped from a European perspective.²⁶⁴ Behavioural economics relates to economics and economics relates to efficiency. Here, there is a clear value system. Law is submitted to the efficiency paradigm. Research along the line of behavioural economics has amply demonstrated the need to take the real behaviour of the market participants into account, if efficiency is to be achieved. Only market efficient legal tools are legitimate and justifiable. Managing market efficient solutions cannot be achieved through modelling the economy and modelling the behaviour, but through taking due account of the varieties of human behaviour. The value paradigm, however, remains the same: market allocation.²⁶⁵

Economic efficiency as a paradigm enshrined in a liberal market economy (in the meaning and concept of Hall and Soskice), heavily supported by behavioural economics, argues in favour of a re-conceptualisation of consumer law. From this perspective, European consumer law is dysfunctional due to its unsophisticated reliance on the information paradigm, on doubtful interventions into the regulation of standard contract terms. It is counterproductive because it distorts market effects by not taking into account that consumers are biased, that they over- or underestimate their capacities to take rational decisions, and last but not least that it is exactly this behaviour which may result in re-distributional effects to the detriment of the most disadvantaged consumers.²⁶⁶

What is the broader picture here? What are the reasons behind the different concepts of consumer law – the European being closer to a co-ordinated market economy and the US to a liberal market economy? Where and how does behavioural economics fit in? What kind of role could and should behavioural economics play in two different economic and social environments? In an extremely insightful analysis J. Whitman explains the differences between US and EU consumer law through the different dominating understandings of the economy, which are deeply rooted in history, culture and tradition. US consumer law is associated with US *consumerism* and European consumer law with European *producerism*.²⁶⁷ Within the framework of this article it is not necessary to discuss whether and to what extent it is useful, feasible and justifiable to speak of ‘European Consumer Law’, despite all the differences between the Member States.²⁶⁸ From that perspective it seems fair to speak of European *producerism*.

Based on this distinction, the role and function of behavioural economics cannot but be different. The two recent publications from *Oren Bar-Gill, Omri Ben-Shahar and Carl Schneider*²⁶⁹ provide deep

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Art. 102 TFEU and the instrument of the ‘commitment decision’ as introduced in Reg. 1/2003 to shape markets along the line of the consumer welfare program. For a nuanced analysis, Yane Svetiev, *Settling or Learning: Commitment Decisions as a Competition Enforcement Paradigm*, *Yearbook of European Law* 2015, 466.

²⁶⁴ It is based on three pillars, public regulation - the FTC – the Federal Trade Commission, information disclosure in banking and finance and class actions.

²⁶⁵ Some might argue that market allocation is a prescriptive paradigm. It tells you of a technique of allocation. However, there needs to be a normative reason for preferring market allocation to other forms of allocation (read, distribution). Is it efficiency? But what does that mean? Is it regulatory distrust? Is it social Darwinism? Is it producerism?, see J. Whitman, *loc. cit.*; Is it the state-nation ideology? On the later A. Afilalo/D. Patterson/K. Purnhagen, *Statecraft, the Market State and the Development of European Legal Culture*, Genevieve Helleringer/Kai Purnhagen (eds.), *Towards a European Legal Culture*, München/Oxford/Baden-Baden, Beck/Hart/Nomos, 2014, 277.

²⁶⁶ See for an insightful overview on the current strains of discussion, F. Esposito, *Consumer protection in the world of bounded rationality: an attempt to understand the contribution of behavioural law and economics*, MS 2014, on file with the author; very helpful H. Collins, *Review of O. Bar-Gill, Seduction by Contract: Law, Economics, and Psychology in Consumer Markets*, OUP 2012, *Modern Law Review* (2014) 77, 1030, who gives an account of the current – mainly US discussion.

²⁶⁷ J. Whitman, *Consumerism Versus Producerism: A Study in Comparative Law* Yale Law School, Yale Law School Legal Scholarship Repository, 1-1-2007: A. Afilalo/D. Patterson/K. Purnhagen, *Statecraft, the Market State and the Development of European Legal Culture*, *loc. cit.*

²⁶⁸ Hans-W. Micklitz, Norbert Reich, Peter Rott and Klaus Tonner, *European Consumer Law*, Intersentia 2nd edition, 2014

²⁶⁹ *Seduction by Oren Bar-Gill Seduction by Contract*, 2012 and *Omri Ben-Shahar & Carl E. Schneider More Than You Wanted to Know: The Failure of Mandated Disclosure*. Princeton and Oxford: Princeton University Press, 2014.

insights in the investigated consumer markets and deliver an explanation for the emergence of over-complex contracts and highly sophisticated and deliberately confusing standard contract conditions.²⁷⁰ However, US consumer behavioural economics tends to promote only one regulatory solution: the – this time – correct and efficient disclosure of information. The normative design of US consumerism remains largely²⁷¹ untouched. Banning particular detrimental contract terms is not discussed as a serious option, although there are exceptions to the rule.²⁷² However, very much in line with US consumer law, BE is supporting collective redress schemes provided they meet the efficiency standards.

Impact on European consumer law

This might all sound very abstract and academic. However, the conflict over the correct design of consumer law has long reached the court fora. The big multinational companies operating from the US question the core of EU consumer protection law. Apple started the first blow in promoting the quite expensive Apple guarantee in the EU, thereby neglecting the existence of a cost free legal guarantee under Directive 99/44/EC.²⁷³ The next blow comes from Amazon. The company has inserted in its standard terms that the place of jurisdiction for all litigation is Luxemburg. The Austrian consumer organisation Verein für Konsumenteninformation has challenged the legality of the term. After referral of the Austrian Supreme Court the ECJ will have to decide over the admissibility of jurisdiction clauses and its compatibility not only with the Rome I and II regulations but also with Directive 2009/22/EC which grants the consumer organisations an action for injunction as a European minimum standard.²⁷⁴ Are such clauses simply illegal despite Article 3 Rome I – the principle of free choice of

²⁷⁰ H. Collins, Review of O. Bar-Gill, *Seduction by Contract: Law, Economics, and Psychology in Consumer Markets*, OUP 2012, *Modern Law Review* (2014) 77, 1030 at 1035.

²⁷¹ See for a notable exception, J. D. Hanson/D.A. Keysar, *Taking behaviouralism seriously: the problem of market manipulation*, *NYU Law Review* 74 (1999), 630; same authors *Taking behaviouralism seriously: some evidence of market manipulation*, *Harvard Law Review* 112 (1999), 1420.

²⁷² Ian Ayres & Alan Schwartz, *The No Reading Problem in Consumer Contract Law*, *Stanford Law Review* 2013; Y. Bakos/F. Marotta-Wurgler/D.R. Trossen, *Does Anyone Read the Fine Print? Testing a Law and Economics Approach to Standard Form Contracts*, *NYU Law and Economics Research paper No 09-40* (2009).

²⁷³ M. Djurovic, *The Apple Case: The Commencement of Pan-European Battle Against Unfair Commercial Practices*, (2013) 9 *European Review of Contract Law* 253.

²⁷⁴ *Vorabentscheidungs-Verfahren des Öst. OGH – 2 OB 204/14k – VKI v. Amazon EU S.à.r.l. Luxembourg*:

1. Ist das auf eine Unterlassungsklage im Sinne der Richtlinie 2009/22/EG des Europäischen Parlaments und des Rates vom 23. April 2009 über Unterlassungsklagen zum Schutz der Verbraucherinteressen anzuwendende Recht nach Art 4 der Verordnung (EG) 864/2007 des europäischen Parlaments und des Rates vom 11. Juli 2007 über das auf außervertragliche Schuldverhältnisse anzuwendende Recht (Rom II-VO) zu bestimmen, wenn sich die Klage gegen die Verwendung unzulässiger Vertragsklauseln durch ein in einem Mitgliedstaat ansässiges Unternehmen richtet, das im elektronischen Geschäftsverkehr Verträge mit Verbrauchern abschließt, die in anderen Mitgliedstaaten, insbesondere im Staat des angerufenen Gerichts, ansässig sind?

2. Wenn Frage 1 bejaht wird:

2.1. Ist als Staat des Schadenseintritts (Art 4 Abs 1 Rom II-VO) jeder Staat zu verstehen, auf den die Geschäftstätigkeit des beklagten Unternehmens ausgerichtet ist, sodass die beanstandeten Klauseln nach dem Recht des Gerichtsstaats zu beurteilen sind, wenn sich die klagebefugte Einrichtung gegen die Verwendung dieser Klauseln im Geschäftsverkehr mit Verbrauchern wendet, die in diesem Staat ansässig sind?

2.2. Liegt eine offensichtlich engere Verbindung (Art 4 Abs 3 Rom II-VO) zum Recht jenes Staats vor, in dem das beklagte Unternehmen seinen Sitz hat, wenn dessen Geschäftsbedingungen vorsehen, dass auf die vom Unternehmen geschlossenen Verträge das Recht dieses Staats anzuwenden ist?

2.3. Führt eine solche Rechtswahlklausel aus anderen Gründen dazu, dass die Prüfung der beanstandeten Vertragsklauseln nach dem Recht jenes Staats zu erfolgen hat, in dem das beklagte Unternehmen seinen Sitz hat?

3. Wenn Frage 1 verneint wird:

law? Can Article 6 (2) be invoked which guarantees the consumer the protection via his home country? Are Austrian courts obliged to apply Luxembourg law when they have to decide over an action for injunction that aims at protecting Austrian consumers? Or are Austrian courts entitled to apply the same law for the procedural side – the action of injunction – and the substantive side – the unfair terms regulation? For international private lawyers the case is an asset test, not only on the feasibility to apply Rome I and II which are designed for individual litigation for collective actions, but also on the potential outcome which must be in line not only with Rome I and II but with the substantive body of EU consumer law. The legal technical arguments that could be brought forward should not set aside the important political dimension behind the case. What kind of incentive should an Austrian consumer organisation have to launch an action for injunction if the standard of protection is taken from a different EU legal order which is unknown to them? What incentive should have the Luxembourgian consumer organisation – to stay with the example – to launch an action for injunction to protect Austrian consumers from a proclaimed illegal practice, or even more important the overall community of European consumers? Provided procedural and the substantive side falls apart, an overall involvement of consumer organisations, a kind of cross-border solidarity and cross border financing (?), sounds nice in European identity building, but EU law and EU politics is not yet at that level. International companies are benefiting from the prevailing differences in European consumer law, not only in terms of the substantive level of protection (minimum-maximum), but more importantly from the still unsolved issue on how transborder enforcement could be effectively organised.

It remains to be seen whether and to what extent the European Commission is ready to engage into a serious debate on the efficiency of EU consumer law regulation.²⁷⁵ This would require a hard look at the information paradigm which is so predominant in EU consumer law. It would equally require to seriously consider the introduction of the incriminated class action as a European remedy to overcome the type of ‘Amazon’ conflicts, presented above. Be that as it may the potential clash between the US efficiency paradigm and the EU (social) justice paradigm is certainly one of the most interesting phenomena to study in the years to come. It is hard to imagine that the so-called *Brussels* effect²⁷⁶ in consumer law does not belong to the TTIP agenda.

The Banking Union project

The argument is that the Banking Union changes the outlook of the European Constitution, certainly of the European Economic Constitution.²⁷⁷ It implies a paradigm shift from Internal Market –

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Wie ist das auf die Unterlassungsklage anzuwendende Recht dann zu bestimmen?

4. Unabhängig von der Antwort auf die vorstehenden Fragen:

- 4.1. Ist eine in Allgemeinen Geschäftsbedingungen enthaltene Klausel, wonach auf einen Vertrag, der im elektronischen Geschäftsverkehr zwischen einem Verbraucher und einem in einem anderen Mitgliedstaat ansässigen Unternehmer geschlossen wird, das Recht des Sitzstaats dieses Unternehmers anzuwenden ist, missbräuchlich im Sinn von Art 3 Abs 1 der Richtlinie 93/13/EWG des Rates vom 5. April 1993 über missbräuchliche Klauseln in Verbraucherverträgen?
- 4.2. Unterliegt die Verarbeitung personenbezogener Daten durch ein Unternehmen, das im elektronischen Geschäftsverkehr mit Verbrauchern, die in anderen Mitgliedstaaten ansässig sind, Verträge abschließt, nach Art 4 Abs 1 lit a der Richtlinie 95/46/EG des Europäischen Parlaments und des Rates vom 24. Oktober 1995 zum Schutz natürlicher Personen bei der Verarbeitung personenbezogener Daten und zum freien Datenverkehr unabhängig vom sonst anwendbaren Recht ausschließlich dem Recht jenes Mitgliedstaats, in dem sich die Niederlassung des Unternehmens befindet, in deren Rahmen die Verarbeitung stattfindet, oder hat das Unternehmen auch die Datenschutzvorschriften jener Mitgliedstaaten zu beachten, auf die es seine Geschäftstätigkeit ausrichtet?

²⁷⁵ A.L. Sibony/A. Alemanno, *Nudge and the Law: A European Perspective*, forthcoming.

²⁷⁶ A. Bradford, *The Brussels Effect*, 2012 Northwestern University School of Law Printed in U.S.A. Northwestern University Law Review Vol. 107, No. 1

²⁷⁷ H.-W. Micklitz, *The Internal Market Project and the Banking Union*, MS May 2015.

competition – economic efficiency to Internal Market – Banking Union – financial stability. Economic efficiency through competition is temporarily suspended by financial stability through regulation.²⁷⁸ This shift will not remain without consequence for the role and function of competition as the leading paradigm to implement the Internal Market project through competitive contract law. The claim requires a short look in the emergence of the Banking Union, which explains the paradigm shift in light of the Internal Market programme before it is possible to shed some light on the potential impact of the shift on the design of European private law.

Paradigm shift

In order to understand the importance of the shift, some facts behind the decision to establish a Banking Union need to be highlighted. There is a direct line of argument from the OMT decision in July 2012 ‘*Within our mandate, the ECB is ready to do whatever it takes to preserve the euro*’²⁷⁹ via the OMT programme announced in September 2012²⁸⁰ to the Banking Union. In that respect I rely on the reconstruction of the history of the BU by Alessandro Busca,²⁸¹ who quotes *H. Van Rompuy*, the former President of the European Council:²⁸²

“The Central Bank was only able to take this decision because of the preliminary political decision, by the EU’s Heads of State and Government to build a **banking union** (emphasis added H.-W. M.) This was the famous European Council of June 2012, so just weeks before Draghi’s statement; he himself said to me, during that Council, that this was exactly the game-changer he needed.”

The BU is built on the Single Supervisory Mechanism (SSM), the Singly Resolution Mechanism (SRM) and the still incomplete deposit guarantee scheme (DGS).²⁸³ The ground-breaking decision in favour of establishing the BU cannot be separated from the OMT declaration and the circumstances in which it was made. There is discussion of whether Draghi only implement what the European Council in June 2012 had decided, or whether Draghi went beyond the mandate of the ECB. The answer to that question is crucial for the political legitimacy of the Draghi declaration. This can be left for another discussion. What matters in our context is that from June/July 2012 on the EU is governed by a new Economic Constitution, one in which *financial stability* has become the predominant paradigm.

Financial stability is a difficult factual and normative category. It implies both a technical assessment which lies in the hands of the banking and finance experts and a value judgment on the kind of action to be taken. The overall research on risk regulation might serve as a source of inspiration to clarify the normative content of financial stability.²⁸⁴ What is needed is a sort of risk management, at the macro level via the control of systemic risks and at the micro level via the control and supervision of ‘dangerous’ financial products.²⁸⁵ Risk regulation has definitely entered banking and finance.

²⁷⁸ See H. Schweitzer, A second step of integration through constitutionalisation? From competition to Banking Union, on file with the author.

²⁷⁹ See President Draghi’s speech: <http://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html>.

²⁸⁰ ECB Press Release 6 September 2012 - Technical features of Outright Monetary Transactions.

²⁸¹ The OMT Decision and the Banking Union, Manuscript May 2015, on file with the author.

²⁸² http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/143160.pdf

²⁸³ K. Lannoo, ECB Banking Supervision and beyond, Report of Centre for European Policy Studies (CEPS) Task Force, 2014 to be downloaded for free from the website www.ceps.eu

²⁸⁴ L. Nottage, (2013). Innovating for ‘Safe Consumer Credit’: Drawing on Product Safety Regulation to Protect Consumers of Credit. In Therese Wilson (Eds.), *International Responses to Issues of Credit and Over-indebtedness in the Wake of Crisis*, (pp. 185-206). Surrey, United Kingdom: Ashgate

²⁸⁵ With regard to the latter see the EUI-ERC workshop on ‘Financial product governance in post-financial crisis Europe’, 4-5 June 2015.

Achieving financial stability means in the EU first and foremost the adoption of a new wave of regulation.

The process of establishing the Banking Union can be characterized by the following mechanisms a) the sheer quantity of rules (by now more than 1000 already), b) the outstanding use of delegation powers in regulations and directives to the European Banking Authority (EBA), c) the broad discretion which is left to the EBA in shaping the technical standards.

On the supervisory mechanism there are 2 major EU Regulations and 4 ECB Regulations, 5 major Decisions and 3 Guidelines of the ECB, 1 Recommendation of the Council, 1 Interinstitutional Agreement between the EP and the ECB, 1 MoU between the ECB and the Council and 1 MoU between the ECB and the Single Resolution Board in respect of cooperation and information exchange for a total of **450 pages** of rules and regulations directly affecting banks and interested parties.

On the resolution mechanism there are 2 major EU Regulation and 1 Intergovernmental Agreement for a total of **120 pages** of rules and regulations directly affecting banks and interested parties.

The single rulebook is made up of 1 EU Regulation and 2 Directives for a total of **595 pages** of rules and regulations directly affecting banks and interested parties. To this rules one has to add the binding technical standards for the implementation of the CRD IV package and the CRR, issued by the Commission on the proposals of the EBA. Up to 8 Implementing technical standards decisions and 17 Regulatory Technical Standards decisions have been taken.

This is not yet all. Just as in the Internal Market programme ‘technical standards’ will have to play a key role in the achievement of the Banking Union. Insiders are speaking of more than 10.000 that are needed. Under Directive 2013/36, the EBA is given the mandate to develop ‘technical standards’. These standards cover the whole field of banking and finance, as listed in Art. 8. Contrary to the technical standards adopted under the so-called New Approach to Technical Harmonization and Standards²⁸⁶ these BU technical standards can be made *binding*. Two procedures have to be kept separate: the procedure in Art. 290 TFEU – specified in Articles 10-14 of Regulation 1093/2010 – and the procedure in Art. 291 TFEU – specified in Art. 15 of Regulation 1093/2010. Needless to say there is a thin line between the two procedures. The distinction between the two is subject to intense debate between the European Commission and the European Parliament. The first draft of BTS (binding technical standards) has to be sent to the European Commission by 31.12.2015. Provided the European Commission intends to adopt the draft technical standards – what should be the rule²⁸⁷ – the European Parliament and the Council have one month to object to the adoption (Art. 149). These drafts will be based on banking and financial expertise. In particular, in the recitals to the Directive and the Regulation, constant reference is made to the particular expertise needed. Expert knowledge should normally prevail over any political reservations. In crude language: where engineers play a key role in adopting technical standards under the New Approach, economists have to fulfill this function for technical standards adopted under the BU. There is no need to go into the details of the regulations and directives. However, the often rather vague language in the EU law establishing the BU opens up space for discretion and interpretation which is filled through technical standards and expertise.

The huge machinery which is set into motion, the massive new rules, the established administrative infrastructure, the new supervisory body all these means serve one single purpose – to manage and guarantee financial stability not only on the level of systematic risks or dangerous financial products, but also at the level of private law management. Private law is deeply dug into this new spell, the doctrine of financial stability.

²⁸⁶ Council Resolution 85/C 136/01 of 7 May 1985 on a new approach to technical harmonization and standards http://europa.eu/legislation_summaries/internal_market/single_market_for_goods/technical_harmonisation/121001a_en.htm

²⁸⁷ See recital 23 Reg. 1093/2010 ‘außergewöhnliche Umstände’.

Impact on EU private law

There is a retrospective and a prospective dimension to the relationship between financial stability and private law. Retrospectively the question is how existing private law relations can be balanced against the needs of the financial stability paradigm. L. Buchheit and M. Gulati have demonstrated how bonds contracts in Cyprus were submitted to a substantial haircut based on a bold interpretation of a few contractual stipulations.²⁸⁸ The risk of financial instability prevails over *pacta sunt servanda*. Household debts are another area that attracted political, economic and judicial attention, not least due to the potential risk for de-balancing the national budget. There are thousands and thousands of Mohamed Aziz in Europe.²⁸⁹ Courts are at the forefront around Europe to strike a balance between the contractual obligation to pay the mortgages or more generally the debts, the social and political consequences of private insolvency for the economy and the society in the respective countries and the potential impact of safeguard measures on the financial stability in that country.²⁹⁰ Courts have to deal with individual cases. Help and support in individual cases may not endanger financial stability. Courts, however, may trigger a political debate in the democratic fora on how and where to strike the balance between the conflicting objectives, contractual obligations, insolvency of the individual and state default. Not least motivated by strong court judgments Greece and Iceland have introduced a moratorium by means of a parliamentary decision, which raises many questions with regard to the maintenance of financial stability, Spain takes a different position not least because the major creditor is the Caixa bank, which has been bailed out by the Spanish government.²⁹¹

Prospectively the EU is adopting new rules in the field of financial services which are meant to keep the risks of financial transactions under control. F. Della Negra²⁹² demonstrates that MIFID II and EWIR are meant to put tight boundaries to financial transactions through public/administrative regulation without interfering into contractual relations themselves. The opposite is true for derivatives as H. Marjosola²⁹³ demonstrates. Here the EU does not shy away from regulating contracts directly.

It is hard to say by now whether the rules adopted in light of financial stability will have an overarching impact on other regulated markets, thereby imposing on b2b and b2c relations a new paradigm different from the design of a competitive contract law. However, as banking and finance cuts across all economic fields it is hard to imagine that the financial stability doctrine will not affect other areas than banking and finance itself.

The Digital Single Market and the European private law

In May 2015²⁹⁴ the new European Commission launched the Digital Single Market Strategy as the overall objective of political activities throughout the forthcoming years. The Commission document

²⁸⁸ Lee C. Buchheit and Gulati, G. Mitu, *Walking Back from Cyprus* (March 18, 2013). Available at SSRN: <http://ssrn.com/abstract=2235359> or <http://dx.doi.org/10.2139/ssrn.2235359>. To understand the strong reactions the paper produced in the financial world it suffices to google the title. In that context M. Gulati and W. Mark C. Weidemaier *Sovereign Debt and the "Contracts Matter" Hypothesis*, in *Oxford Handbook of Law and Economics* (forthcoming)

²⁸⁹ See the references 000

²⁹⁰ Irina Domurath, Guido Comparato, Hans-W. Micklitz (ed.), *The Over-indebtedness of European Con-sumers – a View from six Countries* EUI Working Paper EUI-ERC 2014/08, Hans-W. Micklitz/Irina Domurath (eds.), *Consumer Debt and Social Inclusion in Europe*, Ashgate, 2015.

²⁹¹ See for more details on the situation in these three countries, references in fn. 88.

²⁹² *The transformation of the governance of financial transactions: drivers and effects*, MS 2015 (ERPL IV Conference 18-19 June 2015).

²⁹³ *Global Derivatives Reform Through the Lenses of the Financial Trilemma: The (False?) Promise of Coordination* MS 2015 (ERPL IV Conference 18-19 June 2015).

²⁹⁴ COM (2015) 192 final 6 May 2015-

does not even mention ‘financial stability’ but refers to competition and ‘fair competition’ several times as a means to promote ‘jobs and growth’. Priority no. 2 reads as follows:

“I believe that we must make much better use of the great opportunities offered by digital technologies, which know no borders. To do so, we will need to have the courage to break down national silos in telecoms regulation, in copyright and data protection legislation, in the management of radio waves and in the application of competition law...”

There is a lot of trust in the strategy paper in the positive role and function of competition law in the telecommunication market. So it seems as if the competition paradigm is back on the agenda. But how does the new strategy on the Digital Single Market relate to private law in general and contract law in particular? The European Commission seems ready to transform the DCFR and the CESL into a Regulation on Sales Contracts for b2b and b2c.

Under 2.1. of the DSM Strategy paper²⁹⁵ the following reference can be found. It is quoted in full as it enshrines the logic from which the European Commission starts:

2.1. Cross-border e-commerce rules that consumers and business can trust

One of the reasons why consumers and smaller companies do not engage more in cross-border e-commerce is because the rules that apply to these transactions can be complex, unclear and may differ between Member States. Having 28 different national consumer protection and contract laws discourages companies from cross-border trading and prevents consumers from benefitting from the most competitive offers and from the full range of online offers. EU consumers could save EUR 11.7 billion each year if they could choose from a full range of EU goods and services when shopping online. 61% of EU consumers feel confident about purchasing via the Internet from a retailer located in their own Member State while only 38% feel confident about purchasing from another EU Member State. Only 7% of SMEs in the EU sell cross-border.

In a Single Market, companies should be able to manage their sales under a common set of rules. Some aspects of consumer and contract law have already been fully harmonised for online sales (such as the information that should be provided to consumers before they enter into a contract or the rules governing their right to withdraw from the deal if they have second thoughts). However, other aspects of the contract (such as what remedies are available if tangible goods are not in conformity with the contract of sale) are only subject to EU rules providing minimum harmonisation, with the possibility for Member States to go further. When it comes to remedies for defective digital content purchased online (such as e-books) no specific EU rules exist at all, and only few national ones.

Simplified and modern rules for online and digital cross-border purchases will encourage more businesses to sell online across borders and increase consumer confidence in cross-border e-commerce. If the same rules for e-commerce were applied in all EU Member States, 57% of companies say they would either start or increase their online sales to other EU Member States.

To deliver the right conditions to enable cross-border e-commerce to flourish, the Commission, as announced in its Work Programme for 2015, will make an amended legislative proposal² to allow sellers to rely on their national laws, further harmonising the main rights and obligations of the parties to a sales contract. This will be done notably by providing remedies for non-performance and the appropriate periods for the right to a legal guarantee. The purpose is to ensure that traders in the internal market are not deterred from cross-border trading by differences in mandatory national consumer contract laws, or to differences arising from product specific rules such as labelling.

However, just having a common set of rules is not enough. There is also a need for more rapid, agile and consistent enforcement of consumer rules for online and digital purchases to make them fully effective. The Commission will submit a proposal to review the Regulation on Consumer Protection Cooperation

²⁹⁵ COM (2015) 192 final 6 May 2015 http://ec.europa.eu/priorities/digital-single-market/docs/dsm-communication_en.pdf

that will clarify and develop the powers of enforcement authorities and improve the coordination of their market monitoring activities and alert mechanisms to detect infringements faster. Furthermore, the Commission will establish in 2016 an EU-wide online dispute resolution platform.

The Commission will make an amended proposal before the end of 2015 (i) covering harmonised EU rules for online purchases of digital content, and (ii) allowing traders to rely on their national laws based on a focused set of key mandatory EU contractual rights for domestic and cross-border online sales of tangible goods.

The Commission will submit a proposal for a review of the Regulation on Consumer Protection Cooperation in order to develop more efficient cooperation mechanisms.”

Without further ado the European Commission is promoting the development of rules that promote the digital distribution channel over other forms of distribution.²⁹⁶ There is no discussion on the potential impact of the one sided support of digital sales over analog sales, on the impact on the society at large. The history of the privatization of public services and its impact on the society should serve as a reminder.²⁹⁷ One might wonder where the European Commission takes the legitimacy from. Does the plea for jobs and growth suffice? In legal terms it means that the EU is obviously giving up the idea of having a European Sales Law that governs all forms of transactions independent of the means of communication by which they have been negotiated. Favoring digital sales over analog sales means that the ‘new digital’ rules will compete with the ‘old analog’ rules. This is in fact a new form of open competition, new forms of contracting via the internet against old forms of contracting via the old means of communication, language and letters.

The EU has developed a dense body of digital rules on e-commerce (b2b and b2c), on distant selling (under the Consumer Rights Directive b2c), on distant selling for financial services (b2c). These rules are mainly dealing with the modalities of contract conclusion. The envisaged new regulation could easily mean that the European Commission is trying to unite too suspended initiatives: the revision of the consumer acquis and the common European sales law (for b2b and b2c). It would have to do so, however, in facing the question whether the price can remain the only parameter for governing the competition between the two distribution channels. The key to the understanding of the changes in the economy and the society is ‘net neutrality’. The US Federal Communication Commission has most recently taken a landmark decision confirming the neutrality of the net. The net neutrality debate suggests a far reaching way of thinking about all kinds of online services and business models, from Amazon, to Uber and Airbnb.²⁹⁸ It reopens the old debate on what the appropriate parameters for competition shall be. The EU will not be able to escape that debate.

Conclusions – are there conclusions?

There are three different projects that guide European Integration – the Internal Market, the Banking Union and now the Digital Single Market. Each of the three is governed by a different competition paradigm, even more complicated each of three demonstrate different competition paradigms depending on what kind of private law we are talking about, traditional private law, regulatory private law, b2b and b2c relations. On top of this the three projects are standing side by side and they will continue to stand side by side. So in a way one might even raise the question whether there is

²⁹⁶ This is not really new. The Directive on Distant Selling was adopted as early as 1997. At that time the Directive was perceived as an appropriate means to handle a new phenomenon. Today, this phenomenon is structuring the society.

²⁹⁷ W. Sauter, *Public Services in EU Law*, CUP 2015; see the various contributions in M. Cremona (ed.), *Market Integration and Public Services*, OUP, 2011, which also look into the societal impact of liberalization and privatization of public services.

²⁹⁸ See K. S. Rahman, *Curbing the New Corporate Power*, *Boston Review*, Monday May 4 2015 <http://bostonreview.net/forum/k-sabeel-rahman-curbing-new-corporate-power>

competition between the three projects, which is the one that ‘wins’ and how does this impact private law relations.

There is no clear answer to the future of private law in this new triangle. Much will depend on the future of European integration. The standard answer to the future of the EU is the reference to understand European constitution building as a process or Europe as laboratory for the post nation state. This perspective, however, leads us to the conclusion that the observed transformations are taking place quite independently of the future of the EU. In so far the EU is indeed a wonderful subject of research.

SECTION II. SPECIFIC FIELDS

Long-term upstream supply contracts and EU energy law: Regulating contracts in the times of security of supply crisis

Lucila de Almeida

“Go on. Quickly, hurry, keep thinking and keep looking beyond the purely necessary, even when you have the feeling that there is no more, no more to think, that it’s all been thought, that there’s no more to see, that’s all been seen.”

Javier Mariás, *Your Face Tomorrow: Fever and Spear*

Introduction

How have contracts been regulated in the energy sector since the EU has pursued the creation of integrated and competitive gas and electricity markets in the late 1990s?²⁹⁹ Has the EU multilevel system of law cast its net toward private ordering,³⁰⁰ and then reshaped the parties’ free and informed consent by restricting the default rules domain? To answer these questions, we might take a leaf from Javier Mariás’s book: *Keep thinking and keep looking beyond the purely necessary, even when you have the feeling that that’s all been thought or seen*. Some scholars still argue that the EU lacks the competence to encroach on the boundaries of contract law, which are still embedded in national legal systems. By contrast, European regulatory private law goes beyond this textual interpretation by claiming that, while lacking competence in the Treaties, the EU may intervene in national contract law through public ordering by the Community in the fields of competition and industrial policy.³⁰¹ Taking the latter realistic approach to law, instead of the formalistic one, as a primary assumption, we might pause to ask how regulatory instrumentalism, which is highly prevalent in the activities of the Community, could to some extent regulate contracts by either establishing hard mandatory rules or by softly affecting the parties’ reasonable expectations. Following what Javier Mariás suggests, my thesis is dedicated in the first place to investigating whether, and if so how, the EU has interfered through hard or soft means in the private ordering governance of contract law in energy markets. To test this paradigm, instead of starting by looking into the substantive law customarily referred to as EU energy law, which consists of a series of directives and regulations that have continuously approved advanced modes of sectoral governance, I will take contracts as my primary subject and starting point.

Historically, European energy-supply chains have always been organized into a mixed governance system that operates not only through a network of vertically integrated firms but also through contracts, even early on when the Community emerged as simply a coal-and-steel integrated market. Of course, this governance system has not always kept its balance over the years. Whereas energy undertakings mostly relied on networks of integrated firms at the beginning of energy market

²⁹⁹ Although the First Energy Package [Directive 1996/92/EC and Directive 1998/30/E] was approved in the second half of the 1990s, it was preceded at the EU level by some first steps toward integrated and competitive energy markets. These were the Transit Directives on Electricity [Directive 1990/547/ECC] and Gas [Directive 1991/296/ECC] and the Price Transparency Directive [1990/377/ECC].

³⁰⁰ Here I have in mind the three ideal-typical models of ordering societies defined by Roger Brownsword: private order, public order, and *ordre public*. Roger Brownsword, *The Theoretical Foundations of European Private Law: A Time to Stand and Stare* (2011), pp. 160–61.

³⁰¹ That is the original claim that motivated the European Regulatory Private Law Project. Hans-W Micklitz, “The Visible Hand of European Regulatory Private Law: The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation” (2008), EUI Working Paper 2008/14.

consolidation, the distribution of weight since liberalization has increasingly shifted towards relational contracts. Contracts have always been among the governance models used to firm up relationships, especially at the upstream level of energy markets. For example, contracts have always tied parties that hold the right to explore natural gas resources and buyers that lack this natural competitive advantage, or those that own intellectual property rights in new forms of electricity generation and those that pay usage rights. However, contracts were scarcer as energy goods moved along the supply chain to downstream levels. Many energy undertakings usually ran activities from transmission to the supply of end-users through a single firm or through its subsidiaries. As the governance of the energy sector has increasingly tended toward de-verticalization of integrated firms for economic and legal reasons, contracts have become a cornerstone of energy supply-chain governance. Aside from upstream agreements, there are transmission-service contracts between energy suppliers and TSOs (transmission system operators), lease contracts between pipeline owners and DSOs (distribution system operators), storage contracts, wholesale contracts, and consumer contracts. Obviously, it is far from my intention, and even far from feasible, to make an exhaustive list of the contracts now being used in energy markets, but illustrating the complexity of contractual relations along energy-supply chains is crucial in justifying my methodological choice to select a single contract model. By focusing on a single type of contract, I will be able, in the first place, to trace how the parties' consent on default rules in one type of transaction subsequently turned into commercial practices recognized as customary clauses. Once the contractual model is described, the second step will be to inquire whether the EU has in any way interfered in this existing private ordering by legislating on contracts—thereby directly imposing mandatory rules, in virtue of the EU public order having precedence over private ordering—or by interpreting EU legal provisions which are primarily competition and industry policies but which could wind up setting standards when contractual relations are under dispute.

For the purposes of this article, I will make my discussion shorter by focusing on a single contract model: that of long-term upstream supply (LUS) contracts. LUS contracts are agreements between a gas producer (or promisor) on one side, typically a state-owned firm owned and incorporated in non-Member States with large natural gas reserves, and European undertakings as buyers and importers (the promisee), on the other. This contractual model has traditionally been a backbone for the purchase of natural gas in Europe since the 1960s, when gas markets were first taking shape, and it later consolidated into an indispensable good and a public service obligation. From the 1960s to late 1990s, while the EU remained indifferent to energy markets, LUS contracts were formed and performed under freely agreed conditions and also under national private laws. Their clauses followed certain paths. Long-term clauses, take-or-pay clauses, destination restrictions, profit-sharing, and oil-price indexation were often found in LUS contracts before the sector was liberalized. Since the late 1990s, when the EU began to move toward creating an integrated and competitive energy market, sector-regulation and competition law have been the two possible means by which LUS contracts have been regulated.

Since the late 1990s, the EU has shifted toward common rules for internal gas markets by approving three gas packages: the first in 1998, the second in 2003, and the third in 2009. By taking into consideration the provision of law involving B2B (business-to-business) relations that could potentially affect LUS contracts, directives and regulations have established rules for (i) ensuring the security of supply, (ii) creating a governance system to regulate third party access (TPA) in transmission and distribution systems, and (iii) enforcing unbundling obligations that gave rise to management, legal, and subsequent ownership unbundling of TSOs and DSOs. Despite the broad scope of the three gas packages, none of their substantive rules regulated LUS contracts. *Au contraire*, the first thing EU sector regulation did was to bring into being a governance system for managing capacity in pipelines so as to make possible the full performance of LUS contracts. Moreover, even the unbundling of ownership does not regulate LUS contracts directly, even if it affects the corporate governance of the parties involved in LUS contracts. Consequently, we could preliminarily conclude that EU substantive law has never affected the private order of LUS contracts, either by establishing mandatory rules or by enforcing industrial policies. But, again, Javier Marias is worth going back to

when he insists that we *keep looking*. *When we have the feeling everything has been seen or thought*, the gas supply crisis in 2009 laid the first stone toward a new paradigm. Disputes involving Russians and Ukrainians led to the shutdown of gas flow from Ukraine to the EU for about twenty days. If this crisis scared European leaders and consumers, it also has served as a political argument for the European Commission to support the introduction of mandatory rules in LUS contracts, and this plan has since been put into effect. While in 2010 the European Parliament and Council approved regulation of security of supply with timid provisions on “supply standards,” which are in fact a set of mandatory rules for preventing and managing future crises, in 2015 the Energy Union’s Communication goes further. Here the Commission has recently called for more regulation of upstream supply contracts, which can be understood as a way to steer toward mandatory rules and a sector-oriented European contract law.

We can then answer the question asked at the outset and say that, yes, the EU multilevel system of law making *has* cast its net toward private ordering in the energy sector by taking LUS contracts into account.

Long-Term Upstream Supply Contracts on the Groningen Model

Apart from the Netherlands, the UK, and Denmark,³⁰² that is, the countries that have held sufficient gas resources to satisfy domestic consumption at different times and for differing durations, European Member States have long been known to be dependent on gas imports to supply demand. In the 1980s, the domestic production of gas in Italy and Germany accounted for only 8.6% and 5% of final consumption, respectively,³⁰³ and these circumstances have remained to date the same. As gas buyers rather than producers, the EU natural gas markets have been led to take different governance paths from those of electricity markets. Whereas, before liberalization, electricity supply chains were mostly enclosed within national boundaries and were carried by vertical integrated state-owned firms from production to supply, EU natural gas markets have always rested their upstream governance on relational contracts. In spite of operating through intra-firm governance as electricity industries, the vast majority of European states have first been compelled to purchase gas from net exporters, since gas has overwhelmingly replaced coal in cookers, heaters, and power plants. Moreover, this lack of a natural advantage left European states without alternatives for growing its international relations toward large gas producers owned by the non-European Member States Russia, Norway, and Algeria.³⁰⁴ Those countries are geographically located within a distance that enabled gas transmission through a network system of pipelines, the only feasible way of transporting gas in the early ages of market consolidation.³⁰⁵

³⁰² Natural gas has played an important role in the Netherlands since the discovery of the Groningen gas fields in 1959, the largest non-associated gas field in Europe, whose volume of total production is still accounting for the Netherlands’s status as a net exporter. On the other hand, the production of gas in the UK portion of the North Sea in the Southern Gas Basin and the Continental Shelf has progressively decreased over the years, and most recently it has shifted Member Status to the status of net importer. IEA, *Oil and Gas Security: Emergence Response of IEA Countries: Netherlands* (2012), p. 17–18; *Oil and Gas Security: Emergence Response of IEA Countries: United Kingdom* (2010), p. 15.

³⁰³ Terence Daintith and Leigh Hancher, *Energy Strategy in Europe: The Legal Framework* (Berlin and New York: Walter de Gruyter, 1986), p. 60–64.

³⁰⁴ “More than three quarters (76.8%) of the EU-28’s imports of natural gas in 2012 came from Russia, Norway or Algeria.” Eurostat, *Energy Production and Imports*, March and May 2014, http://ec.europa.eu/eurostat/statistics-explained/index.php/Energy_production_and_imports#Further_Eurostat_information.

³⁰⁵ Although gas is imported through pipelines and LNG terminals, the LNG industry in the EU represented an irrelevant market until the early 1990s and has gained market share only in the early of twenty-first century. Yichen Du and Sergey Paltsev, “International Trade in Natural Gas: Golden Age of LNG?” (2014), MIT Joint Program on the Science and Policy of Global Change, Report No. 271, p. XX. http://globalchange.mit.edu/files/document/MITJPSPGC_Rpt271.pdf.

The lack of natural gas reserves hindered the chance to replicate the intra-firm governance model in the EU gas market at the upstream level. However, since gas became an essential utility, contracts have been the alternative solution for tying up relationships between producers and EU importers. From there on out, the LUS (Long-term upstream supply) contractual model played a key role in the EU gas market, and that is the reason why I have made it the subject of this investigation. To understand how LUS contracts have evolved from isolated supply agreements to a contractual model considered as a benchmarking tool, we need first to look at the history of how and why LUS contracts were first used, and then consider how their default rules became embedded in commercial practices until it was broadly recognized as standard contract model.

Although there have three optimal contract portfolios in all commodity markets (long-term, short-term, and spot),³⁰⁶ the dominant practice of relying on long-term contracts as the tool of choice for purchasing gas has generally been grounded in economic and political reasons.³⁰⁷ If we think broadly about the legal framework in the second half of the 20th century, we can see that there were obvious economic reasons for parties to choose LUS contracts as their preferred contractual governance model. On the producer's side (that of the promisor), long-term agreements were the imperative model with which to ensure the ability to recoup the extremely high upfront costs involved: not only the costs of gas exploration, drilling, and refinement, but also the investment in infrastructure for the pipelines needed to transport gas from the reserves to the outer reaches of its own territory, which are named exit points. On the importer's side (that of the promisee), which before liberalization was mostly made up of national and local firms simultaneously running distribution and supply operations, there were also investments in infrastructure to develop the national pipeline network from entry points at their boundaries to the end-user. Furthermore, either producers or importers, whether working with third parties or not, were allied in putting up the investment for cross-border transmission pipelines. These transnational network operations often cut through the territory of Member and non-Member States or take offshore courses to reach the territory of the end-users. For instance, the Yamal-Europe pipeline, built from Russia to Germany in the early 1990s, crosses Belarus and Poland over two thousand kilometres. Thus, to provide the net exporter with a substitute for *security of demand*, and the importer with *security of supply*, LUS contracts became the main vehicle in these deals that involve high-sunk investments by averting opportunistic behavior. This contractual governance choice is thus aligned with theories developed in law and economics and in relational contracts.³⁰⁸

In the EU, LUS contracts have traditionally been used as the cornerstone of the purchase of natural gas since the 1960s, when contracts were originally designed for export from the large reserve discovered in 1959 in the Groningen gas field in the Netherlands. So it is not a coincidence that the kind of governance adopted by LUS contracts is also known as the Groningen model.³⁰⁹ Although the Netherlands is among the founding members of the EU, their LUS contract model has since served as a point of reference for most gas imports in continental Europe irrespective of whether the producer was located within the Community or without. But there is more. The Groningen model persisted as a benchmark over the next four decades. Here are some examples that can illustrate the spillover of this contractual governance into the EU. Russians used the Dutch LUS model to export to Germany,

³⁰⁶ Karsten Neuhoff and Christian von Hirschhausen, "Long-Term vs. Short-Term Contract: A European Perspective on Natural Gas" (2005), University of Cambridge Working Paper, <https://www.repository.cam.ac.uk/bitstream/handle/1810/131595/eprg0505.pdf?sequence=1>, p. 3.

³⁰⁷ Karsten Neuhoff and Christian von Hirschhausen, "Long-Term vs. Short-Term Contract: A European Perspective on Natural Gas" (2005), op. cit., p. 3–5.

³⁰⁸ Benjamin Klein, Robert G. Crawford, and Armen A. Alchian, "Vertical Integration, Appropriable Rents, and the Competitive Contracting Process," *Journal of Law and Economics*, vol. 1, no. 2 (1978): p. 297–326; and Oliver E. Williamson, "Credible Commitments: Using Hostages to Support Exchange," *The American Economic Review*, vol. 73, no. 4 (1983): p. 519–40.

³⁰⁹ Aad Correljé, Coby van der Linde, and Theo Westerwoudt, *Natural and Gas in the Netherlands: From Cooperation to Competition?* (Amsterdam and Zuidoost: Oranje-Nassau Groep, 2003).

Austria, France, and Italy in the early 1970s, and this was replicated in the early 1980s under the SGE IV project. Over the same period, Algerians reproduced the standing formula to export to Italy via pipelines, as well as to France, Belgium, Greece, and Spain through LNG (liquefied natural gas), and it was again used in the early 1990s to export to Spain and Portugal via the Maghreb pipeline. Most recently, the Norwegians started to export gas from the large Troll gas field to Germany, the Netherlands, Belgium, France, Austria, and Spain in the 1990s by adopting the LUS contracts based on the Groningen model.³¹⁰

Although some scholars had predicted the change in contractual governance in the early 21st century, the market share of LUS contracts fell significantly: this meant an increase in spot and short-term contracts, and their predictions therefore turned out to be wrong in relation to the EU.³¹¹ LUS contracts have so far been the dominant contractual governance for importing gas into the EU. While 100% of gas imports consisted of trade through LUS contracts in the 1990s, this model to date still accounts for 85% of trade volume.³¹² This shift is far from being considered a large loss of market share, and it accordingly underpins my methodological choice of picking LUS contracts in studying how contracts have been regulating the upstream level of the gas market.

Bearing in mind that the original Groningen model for LUS contracts has long framed the contractual governance of the entire upstream gas market in Europe, more needs to be said about the default rules inherent in this model. Specifically, we need to consider the conditions and time clauses written into LUS contracts on the basis of the customary practices adopted by gas market players. The most recurrent conditions, some of them still in use, were take-and-pay clauses, destination and/or use restrictions, and profit-share and price-indexing clauses. But before turning to these conditions, let me begin with the most obvious one: the long-term time clause.

The Long-Term Time Clause

As noted, the reason why the parties chose long-term time clauses was to ensure a return on the high upfront-cost investments on either side of the contract. In the EU, the typical duration of LUS contracts in 1985 was about 15 or 25 years.³¹³ While LUS contracts in the 20th century were discharged by performance,³¹⁴ the negotiation for renewal has wound up narrowing the time clause to about 8 and 15 years, especially after 1998.³¹⁵ The reasons for curtailing time clauses are economic and legal. Economically, asset recovery from infrastructure investment commonly took place while performing the first LUS contracts. Afterwards, in the second negotiation, there was less of an

³¹⁰ This is certainly not an exhaustive list of LUS contracts in EU history but a mere illustration of the extent to which the major EU gas suppliers took up the Groningen model. Energy Charter Secretariat, *Putting a Price on Energy: International Pricing Mechanisms for Oil and Gas* (2007), p. 143.

³¹¹ Peter Hartley and Dagobert Brito, *New Energy Technology in the Natural Gas Sector* (Houston, Texas: The James A. Baker III Institute for Public Policy, 2001).

³¹² International Energy Agency, *Security of Gas Supply in Open Markets – LNG and Power at a Turning Point* (Paris: OECD, 2004).

³¹³ For a quantitative analysis, see Anne Neumann and Christian von Hirschhausen, “Less Long-Term Gas to Europe? A Quantitative Analysis of European Long-Term Gas Supply Contracts,” *Zeitschrift für Energiewirtschaft*, vol. 28, no. 3 (2004): p. 177. https://tu-dresden.de/die_tu_dresden/fakultaeten/fakultaet_wirtschaftswissenschaften/bwl/ee2/dateien/ordner_publicationen/wp_gg_07_hirschhausen_neumann.pdf; and Jonathan Stern, *Security of European Natural Gas Supplies* (London: The Royal Institute of International Affairs, 2002), p. 9.

³¹⁴ *Solvere dicimus eum, qui fecit quod facere promisit*: “We say that someone who does what he has promised performs.” Ulp. D. 50, 16, 176 cited by Reinhard Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Oxford University Press, 1996).

³¹⁵ For a quantitative analysis, see Neumann and von Hirschhausen, “Less Long-Term Gas to Europe?” op. cit., p. 180.

incentive to renew these agreements for over 15 years.³¹⁶ In addition to economic considerations, LUS contract parties seeking to operate transmission and distribution systems have been precluded from doing so under provisions of EU secondary law enforcing different degrees of unbundling, a subject that will be discussed at greater length in Section 2. Apart from the investments or divestments made in pipelines, LNG terminals have increasingly been built onshore in countries across the world, and this has opened up new markets for net exporters and net importers alike seeking new buyers and suppliers beyond the range of the pipelines' geographical constraints. Natural gas produced in the US could thus cross the oceans and reach European consumers, but Russian gas could also be reallocated to South American countries.

The Take-or-Pay Clause

In addition to making the long-term time clause standard, the Groningen model played a pioneering role in its use of the take-or-pay clause, which it introduced from the US, and which would subsequently also become standard in LUS contracts in the EU. This is why it is an established custom to refer to LUS contracts with take-or-pay (ToP) clauses as take-and-pay contracts, which therefore become a species under the genus of LUS contracts. Before 1960 in the US, gas producers ignored seasonal fluctuations in gas demand, surging in winter and declining in summer. This was a source of financial hardship for them at the time. Gas purchasers were also pipeline owners at the time, and winter forced them to acquire extra capacity. To protect their interests, these buyers insisted on pre-empting and exclusively reserving rights to the seller's gas-production capacity, but with no obligation to buy if supply outstripped demand. As a result, when buyers acquired smaller volumes of gas in the summer, producers were unable to sell the remaining volume to third parties, for they were prevented from doing so under the exclusive-dedication clause, and so they would lose revenue from the sale of gas. Hence, the take-or-pay clause was designed to safeguard the interests of producers. The provision requires the buyer to purchase a minimum volume of gas for each period based on daily rates of production. So, even if the buyer takes less than the minimum quantity of gas, that buyer is still a contractual obligation to pay that quantity in full.³¹⁷ A typical take-or-pay clause resembles the text below:³¹⁸

Buyer agrees to purchase and receive from seller or to pay for it if available but not taken, a quantity of gas equal to the Sum of the Daily Contract Quantities herein specified [...]. The Daily contract quantity shall be the daily rate of production equal to seventy-five percent (75% of the delivery capacity of each well).

As much as the take-and-pay clause was first introduced into LUS contracts to protect the producer from any opportunistic behaviour by buyers, it ended up benefiting both parties as global demand for gas increased. On the producer's side, the take-or-pay condition shields them by assuring certain minimum revenues regardless of their offtake. The importer, on the other hand, boosts its security of supply. It is noteworthy that since the 1970s, when the Dutch model took hold, take-or-pay clauses have been written into all long-term LUS contracts (including those currently in force) for gas exported from Russia (then the Soviet Union). According to a recent study on reducing European gas dependence on Russian gas, LUS contracts originally provided for a take-or-pay level of 85% of the

³¹⁶ The trend toward decreasing LUS contract durations to 8–15 years does not mean that agreements of over 15 years vanished from the EU gas market. The 25-year contracts between European importers and Azerbaijan in 2013 shows that when guarantees are needed to finance large infrastructural projects, the duration of LUS contracts can still be very long. See Luca Franza, "Long-Term Gas Import Contracts in Europe: The Evolution in Pricing Mechanisms," Clingendael International Energy Programme, CEIP Paper 2014/08, p. 18.

³¹⁷ J. Michael Medina, "The Take-or-Pay Wars: A Cautionary Analysis for the Future," *Tulsa Law Review*, vol. 27, no. 2 (1991): p. 288.

³¹⁸ J. Michel Medina, "Take-or-Pay Oklahoma Style," *The Oklahoma Bar Journal*, vol. 60, no. 12 (1989): p. 705.

delivery capacity of each well, while post-2008, that level in many of these contracts dropped to 70%.³¹⁹

The Destination Restriction Clause: Territorial and use

As is the case with the take-or-pay clause, the vast majority of LUS contracts in the EU contain clauses setting forth a destination restriction, which can fall into either of two categories: territorial restrictions and use restrictions. The territorial restriction clause was designed to prohibit buyers from reselling gas to other countries or regions beyond the restricted territory for which it was originally destined.³²⁰ Irrespective of whether the demand was lower than the minimum volume of gas contracted under the take-or-pay clause, territorial restrictions precluded gas flow from the negotiated entry point to areas beyond the virtual zones previously sought in the contract. First used by the Dutch firms in the EU gas market in the 1970s, the territorial restriction ensured that when gas destined for remote markets like Italy was sold at a low price at the exit point within Dutch borders, it could not be used to undercut higher-priced gas in other markets like Germany.³²¹ Consequently, by foreclosing the ability to resell gas, the producer remained in control of the prices of gas traded in the downstream side of gas markets in different territorial destinations.³²² For four decades promisors and promisees managed in their arrangements to override territorial restrictions in the gas market; this is surprising if we consider that the practice patently violated the principle of free movement of goods. But in any event the territorial restriction clause vanished from LUS contracts in the early 2000s. The approval of the First Gas Package gave a green light to the European Commissioner for Competition to declare war on territorial clauses in upstream gas markets using competition law as the weapon.

In parallel to territorial restrictions, as mentioned, some LUS contracts also contained clauses restricting the use destination. While the former are barriers designed to preclude the reselling of gas to different Members States, the latter place restrictions, not on territory, but on market players. If the parties to a LUS contract agree that the promisee, such as a downstream gas supplier, may resell gas exclusively to industrial customers and consumers, the promisee would fall into a breach of contract by reselling it on spot markets or to gas power plants.

The Profit-Sharing Clause

Once territorial destination clauses in LUS contracts came under the close scrutiny of the Commission, profit-sharing mechanisms (PSMs) began to be used as an alternative in gas markets. Whereas the former is a hardcore restriction on reselling gas outside of a defined geographic area, the profit-sharing clause employs a much softer private regulatory mechanism that makes resale economically less attractive. Its provision obliges the buyer to share a certain share of the profit with the producer if the gas is resold to an undertaking outside the agreed territory, as well as if the resale targets a customer

³¹⁹ Ralf Dickel, Elham Hassanzadeh, James Henderson, Anouk Honoré, Laura El-Katiri, Simon Pirani, Howard Rogers, Jonathan Stern, and Katja Yafimava, “Reducing European Dependence on Russian Gas: Distinguishing Natural Gas Security from Geopolitics” (2014), Oxford Institute for Energy Studies, OIES Paper: NG 92, pp. 4–5. Although the study is conclusive in regard to the change in contractual governance, the data does not say in what way this reshaping in fact reduced the take-or-pay level from 85% to 70%, so we don’t know whether the governance was reshaped when the contracts came up for renewal or whether they were renegotiated while still in force. In addition, the authors include the disclaimer that long-term gas contracts are subject to commercial confidentiality, which makes it difficult to be categorical about their terms.

³²⁰ Kim Talus, *Vertical Natural Gas Transportation Capacity, Upstream Commodity Contracts and EU Competition Law* (Wolters Kluwer Law & Business, 2011), p. 159.

³²¹ Correljé, van der Linde, and Westerwoudt, *Natural and Gas in the Netherlands* (2003), op. cit., pp. 68–69.

³²² Anthony J. Meeling, *Natural Gas Pricing and Its Future: Europe as the Battleground* (Carnegie Endowment for International Peace, 2010), p. 69.

using the gas for a purpose other than the one agreed upon.³²³ This means that the profit-sharing mechanism has served as a substitute for either territorial restriction clauses or clauses restricting use destination. Moreover, the profit-sharing clause is typically written in such a way as to provide for a 50/50 split of the additional profits between promisor and promisee, even though the question of what the additional profit is and how it is to be calculated is contentious.³²⁴

By comparison with the previously discussed clauses like take-and-pay, whose customary use in the gas market lasted for at least four decades, the profit-sharing mechanism is a recent development in LUS contracts, particularly in contracts involving gas supplied via LNG. LUS contracts based on the use of pipelines precisely state the location of exit and entry points, and the same happens with LUS contracts based on the use of LNG: the parties agree ahead of time on the port of shipment and the port of destination for a long-term contract. However, pipelines are heavy immovable structures attached to the land, while LNG ships (carriers) are not. Therefore, like any other international freight, they can be diverted to a different port of destination, meant as a different LNG terminal. The profit-sharing mechanism has thus been written into these LUS contracts to split the additional profit made by the buyer if the destination of the LNG carriers is reallocated to a different LNG terminal not provided for in the agreement. Such a request to redirect the ship could take place when gas prices in the market served by the port of destination falls below the price in other locations served by a different LNG terminal. The buyer thus has the freedom to change the port of destination so long as it shares the additional profits with the producer.³²⁵

In the early 2000s, taking the same path as that of territorial-restriction clauses, the European Commissioner for Competition also raised concerns about the incompatibility of profit-sharing clauses with provisions of the EU Treaties. However, while it is to a certain extent easy to claim that territorial destination clauses in the gas market are unlawful, considering the well-established precedents the CJEU has set in relation to different markets,³²⁶ the same reasoning cannot transfer without controversy to profit-sharing clauses. In the latter case, the Commission neatly distinguished profit-sharing mechanisms in LUS contracts via LNG under the FOB (free on board), DES (delivered ex-ship), and CIF (cost, insurance, and freight) contractual regimes, which are internationally recognized commercial terms established by the ICC (International Chamber of Commerce).

The Price Indexation Clause: From oil-based to hubs

Last, but certainly not least in importance, LUS contracts in the EU also inherited the gas pricing clause from the Groningen model. Going back to the 1960s, the EU gas market was not effectively launched until the discovery of the Groningen field, which was a large onshore reserve with low development and production costs. In order to maximize revenue for the Netherlands by charging royalties on gas exports, the Dutch Minister of Economic Affairs approved the Dutch gas policy in 1962, a domestic public law that, among other conditions, included the gas price mechanism by paradoxically naming it the market value principle.³²⁷ In spite of using a cost-plus pricing approach—

³²³ An example would be if the buyer resells gas to power plants instead of to consumers. Eleonora Wäktare, “Territorial Restrictions and Profit Sharing Mechanisms in the Gas Sector: The Algerian Case,” *Competition Policy Newsletter*, no. 3 (2007): pp. 19–20.

³²⁴ Harold Nyssens and Iain Osborne, “Profit Splitting Mechanisms in a Liberalised Gas Market: The Devil Lies in the Detail,” *Competition Policy Newsletter*, no. 1 (2005).

³²⁵ *Ibid.*, p. 26–27.

³²⁶ Case 56/65, *Société Technique Minière (L.T.M.) v Maschinenbau Ulm GmbH (M.B.U)* [1966] ECR 389.

³²⁷ Here it is worth taking into account the historical research done by Aad Correljé, Coby van der Linde, and Theo Westerwoudt. The authors dug up official documents to reconstruct how the negotiation between the Netherlands minister and the oil and gas firms Shell, Exxon and DSM put an end to the market value principle. “Thus, three years after the discovery of the large Groningen gas field in 1959, the Minister of Economic Affairs, de Pous, established the main principles of the Dutch gas policy in the *Nota inzake het aardgas* (‘Nota

which means pricing goods according to the production cost added by a reasonable *surplus value*—the national government made a public choice to weigh the gas price with other fuels, principally fossil fuels. As a justification, the Netherlands government argued that gas was by nature a good that would compete with oil and coal for home heating and power generation.³²⁸ While oil-indexation-pricing schemes were first used in LUS contracts by Dutch firms in compliance with a national mandatory rule, the adoption of this contractual governance mechanism by non-Dutch gas producers in continental Europe was made on a voluntary basis, which substituted the clause for its original one and rearranged it as a default rule. On the Dutch model, the vast majority of LUS contracts in the EU gas market endorsed the indexation of gas prices to oil products, mainly crude oil and gasoline, with periodic price reviews usually every three years.³²⁹ Notwithstanding the predominance of oil-indexed price in LUS contracts, this pricing mechanism has dramatically changed since 2008 and, if we are to briefly introduce its cause and effect, the narrative needs to go back to the late 1990s.

With the liberalization of the UK gas market, the NBP (national balancing point) was created as a trading hub in 1996, but the heavy dependence on long-term contracts lead gas prices in this spot market to converge with the flows of oil-based pricing. However, this path was first changed in 2008 when the financial crisis hit, driving down the demand for gas in the EU, at which point trade in gas in hubs began to move away from the pricing scheme based on oil indexation. Gas demand in the EU had already dropped by 5.7% in 2009, and then by 11% in 2013. The 2008 financial crisis, coupled with the loss of market share of growth in the consumption of renewables, led to a problem of production surplus, and in response to that problem gas producers reallocated the surplus gas to hubs. The consequence was an unprecedented liquidity increase in the EU spot market, and that set the stage for decoupling the hub price from the oil-indexation price in LUS contracts.³³⁰ Graphics comparing gas prices between LUS contracts and spot markets began to show a large divergence. Then, furthermore, once the line-of-gas price in hubs dropped and created a significant gap relative to gas trade on long-term bases, buyers began to request that LUS contracts be renegotiated or that they no longer be renewed with the oil-indexation clause. Between wholesalers and their buyers, hub prices—notably the NBP for the United Kingdom and TTF (title transfer facility) for continental Europe—had already become benchmarks in the north-western European market, but the same outcome cannot be said to have applied in the same way to LUS contracts between gas producers and their importers.³³¹ At this top upstream level, producers resisted renegotiating LUS contracts, while the Brent crude prices remained at their peak, and this situation unleashed disputes that wound up being taken to courts of arbitration.³³² More recently, the abrupt fall in oil prices in the second half of 2014 has surely rebalanced the interests at stake and prompted more and more renegotiation. Although the shift from oil-indexed prices to hubs is still in process, it is today a universally accepted reality that hub indexation has made major inroads into LUS contracts in Europe.³³³

(Contd.)

de Pous’ – MEZ 1962). In order to generate maximum revenue for the State and the holder of the concession, NAM, the Minister introduced the ‘market-value’ principle as the basis on which the gas should be produced. The price of gas was linked to the price of alternative fuels that were most likely to be substituted by the different types of consumers (e.g., gas oil for small-scale users and fuel oil for large-scale users). Accordingly, consumers would never have to pay *more* for gas than for alternative fuels, but the market-value principle also ensured that they would not pay *less*.” Correljé, van der Linde, and Westerwoudt, *Natural and Gas in the Netherlands* (2003), op. cit., p. 34.

³²⁸ Negil Harris, *Should Natural Gas Prices in Europe and Asia be De-linked from Oil?* (2013) The Oxford Princeton Programme, www.oxfordprinceton.com/news/latest-news/338-should-natural-gas-prices-in-europe-and-asia-be-de-linked-from-oil.html.

³²⁹ Jonathan Stern and Howard V. Rogers, “The Dynamics of a Liberalised European Gas Market: Key Determinants of Hub Prices, and Roles and Risks of Major Players” (2014), The Oxford Institute for Energy Studies, OIES Paper: NG 94, p. 2.

³³⁰ *Ibid.*, p. 5.

³³¹ Franza, “Long-Term Gas Import Contracts in Europe” (2014), op. cit., p. 12.

³³² *Gazprom v. RWE*

³³³ Franza, “Long-Term Gas Import Contracts in Europe” (2014), op. cit., p. 11.

Bearing in mind the standard clauses written into LUS contracts in the EU gas market, we now have to shift focus from a description of contractual governance based on default rules, in which a major principle is that of the parties' autonomy, to a discussion analyzing whether, and if so how, EU energy law has directly or indirectly regulated contractual governance in LUS contracts.

EU Energy law: Balancing security of supply and the interest of third parties in not regulating long-term upstream supply contracts

By reading the standard LUS contract, someone could intuitively enquire to what extent clauses like territorial restriction have infringed not only competition rules, but also the most fundamental values of the Treaties. Territorial restriction clauses preclude the flow of gas from Member States geographically located close to the producers' borders to further Neighborhood State within the Union and, therefore, this contractual barrier could be contested as an infringement of the free movement of goods. Moreover, Member States that refuse to resell the surplus of gas to others that face a shortfall in their supply, basing their arguments on the same territorial restriction clause, could be accused of violating the principle of solidarity. Thirdly, the gas producer's behavior of charging different prices for the same good could be argued to be also a transgression of the non-discrimination principle. Altogether, the principles of the EU Treaties – freedom of goods, solidarity, and non-discrimination – could be addressed as a doctrinal argument against the validity of these LUS contracts. Of course, the development of this legal reasoning would lead the discussion to a conceptual level about the balance of private law principles - legitimacy expectation and legal certainty - with the principles laid out in EU primary law. Yet, it could also bring us to a second discussion on the external effects of EU law considering the gas producers (or promisors) of the LUS contracts have never signed the EU Treaties, being aliens of the European Union. Notwithstanding the relevance of these discussions at the conceptual level, they are far removed from the scope of this chapter. Here, we are still committed to the empirical legal studies on how contracts have in fact been regulated directly through provisions of law, or indirectly through interpretations of these provisions by the Court of Justice of the European Union. Therefore, let's then move on to what the provisions of the EU secondary law on energy have stated about LUS contracts.

Although the LUS contracts have been the dominant contractual governance system used by the EU to purchase gas from producers inside and outside the Union boundaries, the European bureaucrats had not moved the spot light onto the gas sector nor the electricity sector before the late 1980s. In fact, scholars³³⁴ were those who first raised their voices in favor of bringing European energy markets towards the internal market program and, hence, against the supremacy of the *Sacchi doctrine*,³³⁵ which had held back the enforcement of the freedoms of the Treaties in utilities sectors.³³⁶

Leaving behind its inertia and following the scholars, the EU's first shift towards the gas market was the approval of the Transit Directive of Natural Gas of 21 May 1991, which was the first attempt to

³³⁴ It is worth of attention the work of Terence Daintith and Leigh Hancher in 1980s as part of series of works within the framework of research at the European University Institute, whose introduction is remarkable for beginning with a strong statement. "Not many people, we would guess, could be found to say that the energy sector offered a good example of positive and effective European integration. The general consensus, in which senior community officials participate no less than outside observers, is that the Community performance in this field has been inadequate". Terence Daintith and Leigh Hancher, *Energy Strategy in Europe: the legal framework* (1986), Berlin and New York: Walter de Gruyter, p. 1.

³³⁵ The landmark cases C-6/64, *Costa vs Enel* [1964] ECR 1253, in which ENEL's electricity monopoly was supported as legal; and C-155/73 *Sacchi* [1974] ECR 1291, when the Court reinforced the *Costa vs. Enel* case by confirming the public interest of a non-economic nature justified RAI's broadcasting monopoly and exclusive right could even be extended to *Sacchi's* public display.

³³⁶ Jacques Pelkmans, *Making EU Network Markets Competitive* (2001) Oxford Review of Economic Policy, vol. 17, No. 3, p. 433-444.

monitor transit contracts.³³⁷ Transit contracts were bilateral or multilateral transnational agreements in which firms enrolled in a transmission system or even the sovereign states themselves agreed with the transportation of gas through their territory, regardless of being part of the EU or not. It is a standard agreement where one party commits to pay transit fees insofar as the other party grants exclusive rights to pipelines in order to ensure the cross-boundaries of natural gas without interruption.³³⁸ To clarify the purpose of transit contracts, this is the model applied by Russian, Belarusian, and Polish actors to ensure that Russian gas reaches German borders via Yamal-Europe and Jamal pipelines, as well as between Russians and Ukrainians for the safe delivery of gas to Slovakia and then Austria through Brotherhood and Transgas pipelines. Through this, we can come to understand that Transit contracts are obviously not LUS contracts. The object of the former is about rights to access transmission capacity combined with service provision, while the latter is about sales of natural gas between producers and buyers in the long-term. However, the Transit Directive matters here because it represents the first movement of the EU towards the regulation of gas markets at the Union level, which indeed set the scene for further Directives and also opened the Commission's eyes to LUS contracts. Already in the preamble of the Transit Directive, the Council approved a text calling for the development of a Community energy strategy on security of supply.³³⁹ Secondly, the directive stated that transit contracts, pursuant to the rules of the treaties, should comply with the non-discrimination principle, should not include unfair clauses or unjustified restriction to access pipelines and, most importantly, should not endanger security of supply.³⁴⁰ Thirdly and lastly, the sector-regulation demanded the Member States to take measures to TSOs (transmission system operators) and to notify the Commission and the national authorities concerning any request to transit³⁴¹. Considering these three different propositions, someone could argue that, on one hand, the transit directive never challenged the contractual governance of LUS contracts, nor did it shackle the market structure *status quo*. On the other hand, the transit directive established two guidelines in 1991 that slightly affected LUS contracts. First, it granted to the Commission the right to access general data about transit requests, which were in fact mostly motivated by the performance of LUS contracts. Thus, the Commission became aware of their terms and conditions. Secondly and most importantly, the transit directive foreshadowed the EU position which concerns the balance between security of supply and TPA (third party access) when upstream gas supply agreements are under scrutiny.³⁴² In this regard, Article 3(2) clearly weighted the security of supply value over the non-discrimination principle, the cornerstone of TPA rights, by aligning the Treaties' principle with the specific-sector value. Hence, the transit contracts should be non-discriminatory insofar as they do not erode security of supply within the community. From there on, the EU has always stuck to this position whenever the importation of gas into the EU has been at stake.

³³⁷ Council Directive 1991/148/EEC of 18 March 1991 revoking directive 1975/404/ECC, OJ L 75, 21.03.1991.

³³⁸ ACER, *Transit Contracts in EU Member States: Final results of ACER inquiry* (2013), http://www.acer.europa.eu/Official_documents/Acts_of_the_Agency/Publication/ACER_Report_Inquiry_on_Transit_Contracts_9_April_2013.pdf.

³³⁹ "Whereas the completion of the internal market in energy in general, and more particular in the natural gas sector, requires the development of Community energy strategy that will be equal to the challenge of: security of supply, and environment protection". Council Directive 1991/148/ECC of 18 March 1991, preamble 1.

³⁴⁰ "The condition of transit shall, pursuant on the rules of the Treaty, be non-discriminatory, fair for all parties concerned, shall not include unfair clauses or unjustified restrictions and, not endanger security of supply nor quality of service (...)". Council Directive 1991/148/ECC of 18 March 1991, Article 3 (2).

³⁴¹ Council Directive 1991/148/ECC of 18 March 1991, Article 3 (3).

³⁴² On these two faces of the Transit Directive, Kim Talus argues that the Transit Directive was "nothing more than a face-saving exercise on the part of the Commission, designed to give the impression of taking action. However, the directives may also be seen as initial steps in a dynamic process whereby a transit obligation on reasonable terms is gradually imposed on network operators (the infant form of a negotiated TPA). Using the mechanism contained in the Directives, the Commission has opened a window into the negotiations between transit operators and transit customers". Kim Talus, *EU Energy Law and Policy: A Critical Account* (2013), Oxford: Oxford University Press p. 46.

First, Second and Third Gas Packages: weighting security of supply to not regulate long-term upstream contracts

From the Transit Directive in 1991 to the approval of the first gas package in 1998, there were a temporal gap of seven years filled with intense discussion about settling what we could call a check and balance between EU and Member States which concerns the limits of harmonization within the EU legal system. Some who were optimistic about the EU expected the approval of provisions of law materializing via a visible European hand holding a brush and repainting contractual governance structure in business-to-business relations, similar to the Unfair Contractual Terms Directive in business-to-consumer contracts.³⁴³ However, those EU optimists certainly underrated the economic and political complexity involving LUS contracts and the issues of security of supply in gas markets, which has been a dilemma handled by the EU from the first gas directive hitherto. Unlike long-term reservation of capacity contracts, LUS contracts have not been regulated through the propositions of law in EU sector-specific regulation. Rather, whenever the provisions of law in the three gas packages mentioned LUS contracts, they explicitly recognized their great value for the sake of security of supply, in particular those including take-and-pay clause, hereafter called take-and-pay contracts as the EU legislator has referred to them.

Already in February 1992, the Commission formally released the first proposal for stand-alone harmonization through a Council Directive concerning common rules for the internal market in natural gas.³⁴⁴ It was founded on three policy goals.³⁴⁵ First, Member States would grant a transparent and non-discriminatory licensing system for building or operating LNG facilities, as well as for transmission and distribution pipelines.³⁴⁶ Secondly, vertical integrated natural gas companies would separate their managerial functions into as many divisions as there were activities. The operations of natural monopolies, such as transmission and distribution systems, would be unbundled from other ordinary commercial activities like gas importation or wholesale, which have conventionally been called *management unbundling*. Thirdly, transmission and distribution operators would not discriminate against system users *except* to ensure security of supply.³⁴⁷ Again, like the Transit Directive, the Commission established in 1992 the balance between non-discrimination and security of supply values. However, unlike the Transit Directive, this proposal would encompass not a single transaction, the transit contracts, but the entire EU gas market. Additional to the substantive law written into the proposal for the first gas Directive, the Commission also attached a long general explanatory memorandum accounting for the sector-related policies. There, the rule-maker dedicated an entire section to delineate a caveat about existing take-or-pay contracts,³⁴⁸ even though there was just a short note in the preamble of the proposed Directive about this type of LUS contract.³⁴⁹ Unwrapping the explanatory memorandum and preamble, the Commission upheld the position that take-or-pay obligations would need to be taken into account when liberalizing the natural gas market in order not to endanger the economic viability of its promisees. For them, since take-and pay clauses oblige importers to pay for a prefixed annual gas volume irrespective of their taking it, the compliance with non-discriminatory principles could engender the squeeze of the capacity in pipelines reserved for the performance of the take-or-pay contracts. Therefore, it could lead European importers to an insolvency situation by paying for the gas but not taking it. What interests us about the first

³⁴³ Council Directive 93/13/ECC of 5 April 1993 on Unfair Terms in Consumer Contracts, OJ L 95, 21.4.1993.

³⁴⁴ COM/91/548 Final, SYN 384, 21 February 1992.

³⁴⁵ COM/91/548 Final, SYN 384, 21 February 1992, Article 4(2).

³⁴⁶ Kim Talus, *EU Energy Law and Policy: A Critical Account* (2013), op. cit., p. 59.

³⁴⁷ COM/91/548 Final, SYN 384, 21 February 1992, Article 11(6) and Article 18(6).

³⁴⁸ COM/91/548 Final, SYN 384, 21 February 1992, p. 27. 40.

³⁴⁹ COM/91/548 Final, SYN 384, 21 February 1992, Preamble. “Whereas specific provisions must be made for safeguard in case natural gas undertaking being in economic difficult because of the impossibility to respect take-off volumes which are part of Take or Pay obligations”.

Commission proposal is the EU argument to support take-and-pay contracts. Notwithstanding that the draft of the directive exempted TSOs and DSOs (Distribution System Operators) from compliance with non-discriminatory rules insofar as it would ensure security of supply, on the earlier occasion the Commission took a position in favour of the performance of existing take-or-pay contracts, basing its arguments not on security of supply, but on granting economic stability to promisees. This was the exact point redrafted in the approved version of the First gas Directive.

First Gas Package

Although the commission put forward the First Gas Directive in 1992, the European Parliament and Council approved it far later, in June 1998, with some changes to the original text.³⁵⁰ On one hand, the three policy goals remained unchanged in general terms: a non-discriminatory license system³⁵¹, non-discriminatory access to networks³⁵², and management unbundling³⁵³. On the other hand, the EU legislator made the choice to shift the Commission's concern about how the non-discriminatory principle could affect performance of take-or-pay contracts from the explanatory memorandum to the substantive provisions, and not only that. Despite justifying the derogation of network access to take-or-pay contracts for safeguarding the economic viability of gas importers, as the Commission originally did, the EU legislator raised security of supply as a supplementary reason to support the public regulation. This conclusion can be drawn from a simple reading the preamble, as well as Articles 17 and 25 of the First gas package. Already in the preamble, the Directive entrusted the Member States with monitoring functions of take-or-pay contracts "in order to keep up the date with the situation on supply"³⁵⁴ and also acknowledged that "take-or-pay contracts are a market reality for securing Member States security of supply"³⁵⁵. Besides the clear statement in the preamble about the connection between take-or-pay contracts and security of supply, rule-makers also inserted provisions into the substantive law of the gas Directive that clearly establish the right to derogate from access to networks if it jeopardizes the performance of take-or-pay contracts. If a pipeline has committed all or part of its capacity to the performance of take-or-pay contracts, TSOs and DSOs could refuse access to a third party based on existing take-or-pay commitments with undertakings. When there is no available capacity to third parties for this reason, it is considered a contractual congestion of network capacity.³⁵⁶ However, the right to derogation, of course, has been not unrestricted. The network operator could refuse access insofar as providing access would engender serious economic and financial difficulties to the gas importer, the promisees in the take-or-pay contract.³⁵⁷ Furthermore, any derogation has to be informed to the Commission by Member States or National Regulatory Authorities (NRAs), which in turn holds the rights to request withdrawal of or amendments to the decision that granted derogation.³⁵⁸ This multi-level assessment of the derogation is to ensure that this refusal of access would not undermine the objective to construct an integrated and competitive gas market.³⁵⁹

³⁵⁰ Directive 98/30/EC of the European Parliament and of the Council of 22 June 1998 concerning common rules for the internal gas market, OJL 204, 21.7.1998.

³⁵¹ Directive 98/30/EC of 22 June 1998, Article 4(2).

³⁵² Directive 98/30/EC of 22 June 1998, Article 14, 15, 16.

³⁵³ Directive 98/30/EC of 22 June 1998, Article 4(2).

³⁵⁴ Directive 98/30/EC of 22 June 1998, Preamble 13.

³⁵⁵ Directive 98/30/EC of 22 June 1998, Preamble 30.

³⁵⁶ About contractual congestion in Europe, see Sergio Asccari, *An American Model for the EU gas Market?* (2011), EUI Working Papers, Robert Schuman for Advanced Studies, RSCAS 2011/39, p. 21.

³⁵⁷ Directive 98/30/EC of 22 June 1998, Article 17(1) and Article 25(1).

³⁵⁸ Directive 98/30/EC of 22 June 1998, Article 25(2).

³⁵⁹ Directive 98/30/EC of 22 June 1998, Article 25(3)(a) and also Preamble 30.

Taking into account the First gas Directive of 1998, and the prior discussion put forward by the Commission, we could reach some preliminary conclusions about the early EU understanding of LUS contracts. First, whereas the Commission's explanatory memorandum claimed the need to protect the performance of take-or-pay for the sake of promisees' financial stability, the Directive of 1998 twisted the commission's original argument and justified the derogation from the non-discriminatory principle on security of supply reasoning. Thus, risking the financial stability of promisees has been written not as a justification to refuse access, but as a prior condition to it. Secondly, the approval of the Directive settled the position of the EU legislator when it is balancing the non-discriminatory principle with security of supply regarding take-and-pay contracts in gas markets. Thirdly, although some could see the right of restricting access as a way of regulating take-and-pay contracts, in fact it is the opposite. The Directive established governance mechanisms for managing congestion in transmission and distribution capacity systems that have indeed granted the full performance of take-and-pay agreements. No mandatory rules have been approved to reshape clauses of LUS contacts so far.

The first gas directive made a significant contribution by setting up controversial policies against legal monopolies and exclusive rights. However, there was a certain common understanding that it was not effective in reshaping markets *status quo ante* towards the internal market.³⁶⁰ After nearly two years, the Council called upon the Commission to speed up liberalization to fully achieve the internal market. As a speedy response, the European Parliament first approved the Second gas Directive concerning common rules for the internal market in June of 2003³⁶¹, which repealed the first directive, and later approved the Regulation on conditions for access to the natural gas transmission networks in September 2005.³⁶²

The Second Gas Package

Together, Second Gas Directive 2003/55/EC and Regulation 1175/2005 have been conventionally called the Second Gas Package, although the Regulation is innocuous to LUS Contracts.³⁶³ Therefore, let's give more attention to the Second gas Directive. Although parts of the first Directive were essentially taken over by its successor, there were in general significant changes in the content towards more interventionism which concerns TPA,³⁶⁴ unbundling,³⁶⁵ and the need for independent regulatory authority³⁶⁶. Specifically in relation to LUS contracts, the same premise can be applied. Already, the Preamble of the second directive played a constructive role by recognizing not only take-or-pay contracts as important to security of supply, but extended this statement to general Long-term contracts, which obviously covered LUS contracts.³⁶⁷

“(25) Long-term contracts will continue to be an important part of gas supply of Member States and should be maintained as an option for gas supply undertaking in so far as they do not undermine the

³⁶⁰ For Peter Cameron, the energy first packages were ineffective for having been rendered obsolete by events. Considering the negotiation took long seven years from its proposal to approval, the provisions of the Directive were out of date in order to follow the changes in European integration led by the Treaty of Maastricht and later by the Treaty of Amsterdam. Peter D. Cameron, *Competition in Energy Market: Law and Regulation in European Union* (2007). New York City: Oxford University Press, p. 40.

³⁶¹ 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, OJ L 176, 15.07.2003.

³⁶² Regulation 1775/2005 of the European Parliament and of the Council of 28 September 2005 on conditions for access to the natural gas transmission networks, L 289/1, 31.11.2005.

³⁶³ Regulation 1775/2005 of.

³⁶⁴ Directive 2003/55/EC of 26 June 2003, Article 18.

³⁶⁵ Directive 2003/55/EC of 26 June 2003, Articles 9 and 13.

³⁶⁶ Directive 2003/55/EC of 26 June 2003, Article 25.

³⁶⁷ Directive 2003/55/EC of 26 June 2003, Preamble 25.

objectives of this Directive and are compatible with the Treaty, including the competition rules. It is therefore necessary to take into account long-term contracts in the planning of supply and transport capacity of natural gas undertaking.”

Whereas the first gas directive asserted the importance of take-or-pay contracts to the security of supply in gas market, the second stretched the same statement to any LUS contract that has pumped gas through the borders of the Member States. Furthermore, besides the assumption in the preamble, the EU legislator reinforced the compatibility of LUS contracts in a broad sense with the non-discrimination rules for access to networks in Article 18. While the system of regulated tariffs were first established and enforced for TSOs, DSOs and storages facilities under the section of TPA rights, the Directive clarified how the EU stands in relation to long-term contracts by adding the provisions stating that it should “not prevent the conclusion of long-term contracts in so far as they comply with Community competition rules”.³⁶⁸ Observe that, at this point, the EU legislator upheld long-term contracts in general as far as they do not blunt competition. This means this statement covered not only upstream supply contracts, but also capacity contracts directly dealing with transmission service.

Different to the first package, the second gas directive positively acknowledged the importance of LUS contracts for security of supply and, beforehand, refused an unchecked position against any long-term contracts when TPA is under scrutiny. But identical to the first package, the Directive of 2003 repeated the provisions concerning derogation of TPA to existing take-or-pay contracts.³⁶⁹ If providing access to transmission, distribution and storage systems in favour of third parties over this LUS contract would provoke serious economic and financial damage to the promisee, the operator could refuse access. Moreover, the proceedings for the assessment of the derogation remained the same, which retained the authority of the Commission and NRAs to assess the reasons for the refusal of access requests.

Besides the provisions that openly made reference to LUS contracts, there was another rule introduced by the second package that affected them, however this cannot be inferred through textual interpretation of the second gas directive. This was a large step towards the *legal unbundling* of TSOs and DSOs. To understand how this is linked to LUS contracts, there is a need to contextualize how this public regulation affected contractual governance in gas markets. Since the early years of the liberalization, there has been a common understanding that non-discriminatory access to networks would depend on having independent TSOs and DSOs, whose decisions could not be interfered with by those who operate competitive markets. This premise has had obvious grounds. If undertakings operating vertically could interfere in the decision making of networks, which are natural monopolies, they would tend to restrict access to pipelines for new entrants and, therefore, keep their market share in the downstream side of gas sector.³⁷⁰ Since the first directive, the EU has approved regulatory provisions with the aim of tackling this issue. Already in the first directive, the EU required the *management unbundling* of vertical integrated firms, which required them to separate decision-making power about transmission and distribution operations from any other ordinary economic activity. This was a rule that merely affected the corporate governance of vertically integrated firms. By separating the decision-making power within the same legal entity, the rule-maker expected to solve the issue of conflict of interest. Departments carrying the natural monopoly operation would not suffer the interference of another department operating in competitive operations. Of course, as we could expect, the means were not appropriate to achieve the ends, and the compliance with TPA was insignificant.³⁷¹ As an alternative, the second gas directive went one step further and approved the

³⁶⁸ Directive 2003/55/EC of 26 June 2003, Article 18(3). The system of regulated tariffs for TSOs, DSOs, and storage facilities will be developed in the part II of this thesis since it does not target LUS contracts, but capacity contracts.

³⁶⁹ Directive 2003/55/EC of 26 June 2003, Articles 18, 21(1), and 27(1).

³⁷⁰ COM/91/548 Final, SYN 384, 21 February 1992.

³⁷¹ Philip Lowe, Ingirda Pucinskaite, William Webster and Patrick Lindeberg, *Effective Unbundling of Energy Transmission Networks, lessons from the Energy Sector Inquiry* (2007), Competition Policy Newsletter, Summer 1, Spring 2007, p. 24.

legal unbundling.³⁷² Instead of keeping natural monopoly operations together with competitive operations within the same legal entity, vertically integrated firms were forced to reallocate transmission and distribution operations to independent legal entities. An undertaking that imported gas, owned and operated pipelines, and also supplied the gas to end-users had to create a new legal entity to take over the operation of the pipelines. Moreover, this new legal entity should be independent also in terms of organization and decision-making, although there was no need to unbundle ownership. Vertically integrated firms could then keep holding shares of the legal entity in charge of providing services of transmission and distribution insofar as they did not interfere in the decision making involving operations. Furthermore, they could still hold the real property of physical pipelines as long as they complied with the same conditions. This means network operators could be subsidiaries of firms acting in competitive markets, but they could not join these operations into a single legal entity from then on.

After describing how EU energy law evolved from unbundling management to legal unbundling, I still need to explain how the latter affected LUS contracts. As mentioned earlier in this chapter, one of the reasons that the LUS contracts were originally signed with long-term time clauses was to ensure the recovery of upfront investments for building pipelines. In the second-half of the last century, vertically integrated firms imported gas through LUS contracts and resold it into their domestic markets for a price that enabled the earning back of gas prices paid to producers, and also investments in building pipelines. Of course, promisees had long signed LUS contracts by taking into account their absolute control over the system's operation. However, through a top-down approach, the EU legislator has imposed a more effective governance system that substantially removed this control from promisees' hands for the sake of creating competition. Thereafter, to access transmissions promisees have to pay regulated tariffs to legal entities operating pipelines, even if they were their own subsidiary. The regulated tariff has been based on daily operational costs, and the need to build new pipelines. Even considering that the second gas directive preserved the right to derogation of TPA for the passage of take-or-pay contracts, we must admit that legal unbundling has affected the interests of parties while negotiating LUS contracts. Although the EU has not directly regulated the LUS contract through establishing mandatory rules, it has imposed restrictions upon the governance of vertically integrated firms, the promisees, and has indirectly affected bargains usually involved in the negotiation of LUS contracts.

By analysing the provisions of the First and Second Directive, there is an undeniable shift towards strengthening the importance of LUS contracts for security of supply. While the first directive brought forward this statement through a timid reference in the preamble, the second gave prominence to the importance of LUS contracts by explicitly restating the EU's prior position. To reinforce this point besides the second gas package, the EU also approved a Council Directive in 26 April 2004 concerning measures to safeguard security of natural gas supply.³⁷³ In the introduction, the rule-maker reproduced the same provisions of the second package, which were written down in the 25th paragraph of the preamble, about the importance of LUS to security of supply in the long-term, and the need for companies using these contracts in their overall supply portfolio.³⁷⁴ Beyond the restatement of what was already said, the 2004 Council Directive established monitoring obligations for both Member States and the Commission. While the Member States should report upon existing LUS contracts by which the promisee is established into their territory concerning time duration and the degree of liquidity of its gas markets,³⁷⁵ the Commission should keep track of new LUS contracts with third

³⁷² Directive 2003/55/EC of 26 June 2003, Articles 9 and 13.

³⁷³ Council Directive 2004/67/EC of 26 April 2004 concerning measures to safeguard security of natural gas, Preamble 1 and 11.

³⁷⁴ Council Directive 2004/67/EC of 26 April 2004, Preamble 11.

³⁷⁵ Council Directive 2004/67/EC of 26 April 2004, Article 5(1)(c)

countries.³⁷⁶ Observe that the Transit Directive of 1991 requested Member States to report Transit contracts, which were mostly agreements in which the state was a party or acquiescent, whereas the 2004 the Council Directive demanded Member States to report data concerning LUS contracts, which were mostly agreements between private parties. Since information has flowed from indoor private negotiations to state level bureaucrats and therefore to the EU, the Commission has awoken to the issue of increasing reliance on the importation of gas by expressing its concerns in the Communication released first in March 2006³⁷⁷ and again in January of 2007³⁷⁸. There they called for stronger solidarity ties between Member States in the event of energy crises caused by the interruption of gas supply, which kicked the ball toward the Third Gas Package.

The Third Gas Package

The Third Gas Package came out in 2009 and encompassed several regulations and directives at EU level. For the gas market, the European Parliament and Council approved the Third gas Directive³⁷⁹ concerning common rules and repealing the prior second directive, establishing Regulation 713/2009 creating the ACER (Agency for the Cooperation of Energy Regulator)³⁸⁰, and Regulation 715/2009 on conditions for access to the natural gas transmission networks, and repealing Regulation 1775/2005.³⁸¹ Similar to the second gas package, whilst the third directive has readdressed the issue of security of supply and LUS contracts, the two regulations have looked at transmissions systems and their operations especially when it is dealing with the cross-border flow of gas, which has still been a barrier for consolidation of the internal market programme in some Member States. When the matter is buy-sell agreements between an EU undertaking and gas producers, which are increasingly composed of third states, the Directive is still the source of ground rules at EU level.

Those who expected at last a heavy visible hand regulating LUS contracts at EU level, thus giving consideration to the Commission Communication of 2007, might have been astonished its absence. Concerning the LUS contracts, the Third Gas Directive has been a repetition of what the Second Directive had already ensured seven years earlier, except for two changes. Similar to prior directives, the provision on the importance of long-term contracts to EU security of supply has been copied and pasted from the second directive, which means that the wording is exactly the same.³⁸² Moreover, concerning non-discriminatory access, the right to derogation of TPA for the performance of take-or-pay contracts remained unchanged in its two dimensions: the substantive legal dimension of the right to derogation, and the procedural dimension of the competence to assess the lawfulness of derogations at state and EU level.³⁸³ However, two changes have been introduced in the Third Gas Directive. One had already been in the preamble, where the EU rule-maker has made a clear reference to the EU dependence on gas produced and imported from third countries, therefore drawing the attention of

³⁷⁶ Council Directive 2004/67/EC of 26 April 2004, Article 6(1)(b).

³⁷⁷ COM(2006) 105 final, Green Paper: A European Strategy for Sustainable, Competitive and security Energy, 8 March 2006, p. 8-9.

³⁷⁸ “Reliance on imports of gas is expected to increase from 57% to 84% by 2030 (...). In addition, mechanism to ensure solidarity between Member States in the event of an energy crisis are not yet in place and several Member States are largely or completely dependent on a single gas supplier”. COM(2007) 1 Final, An energy Policy for Europe, 10 January 2007, p. 3-4.

³⁷⁹ Directive 2009/73/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC, OJ L 211, 14.08.2009.

³⁸⁰ Regulation (EC) No 713/2009 of the European Parliament and of the Council of 13 July 2009 establishing and Agency for the Cooperation of Energy Regulators, OJ L 211, 14.08.2009.

³⁸¹ Regulation (EC) No 715/2009 of the European Parliament and of the Council of 13 July 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No. 1775/2005, OJ L 211, 14.08.2009.

³⁸² Directive 2009/73/EC of 13 July 2009, Preamble 42.

³⁸³ Directive 2009/73/EC of 13 July 2009, Article XX

Community law to the characteristics of natural gas markets, such as the concentration of supplies, LUS contracts and the lack of downstream liquidity. The other change has been in the unbundling rules. Whereas the first and second directives established respectively *management unbundling* and *legal unbundling*, the third directive took another step further by enforcing *ownership unbundling*.³⁸⁴ Recalling the Second Gas Directive, the legal unbundling required vertically integrated firms to separate transmission, distribution and storage operation into different legal entities from those carrying out activities in competitive markets. Within these terms, vertically integrated firms were allowed to keep shares in firms operating natural monopolies as long as they would not interfere in decision-making power, such as defining which firm should or should not have access to networks. To safeguard even further the independence of firms operating natural monopolies, the Third Gas Directive has excluded the option of TSOs and DSOs being subsidiaries of firms operating in competitive markets. Thereon, vertically integrated firms have had to divest their shares from legal entities operating natural monopolies. Nevertheless, despite the divestment in operators, vertically integrated firms could continue to own the tangible property of pipelines or storages facilities insofar as the operations are assigned to a third party, for example through lease agreements. Although the ownership unbundling is indeed a rule that regulates the corporative governance model of vertically integrated firms by restricting their intangible *status* as shareholders in network operators, it does not directly regulate LUS contracts. The argument addressed above about legal unbundling is still valid to ownership unbundling. It does not regulate LUS contracts straightforwardly, albeit it affects the conditions that have originally influenced the formation of LUS contracts.³⁸⁵

Having in mind the evolution of EU Energy Law from the early 1990s to the last broad reform with the Third Energy Package, which concerns how it affects directly and indirectly LUS contracts, we could come to a negative preliminary conclusion. Neither the three gas packages, nor the Regulation of 2004 devoted to security of supply in gas markets, have ever regulated LUS contracts. No single mandatory rule has been established to regulate terms or clauses of LUS contracts through a top-down approach. *Au contraire*, what the EU sector-regulation has first done is to bring into being a governance system of capacity management in pipelines that has allowed TSOs and DSOs to derogate from TPA obligations in order to grant the full performance of take-or-pay contracts. In spite of regulating the contractual terms, the EU legislator has in fact removed by law barriers that could preclude the full performance of LUS contracts by creating an exclusive right allowing non-compliance with TPA rights. Secondly, the evolution of the unbundling obligation from management to ownership disrupted the corporate governance structure of most of the promisees in LUS contracts. By coercing vertically integrated firms to divest their asset from network and storage operators, the law has not regulated LUS contracts. Instead, it has reshaped the interests of parties entering into LUS agreements ahead of the negotiations. While promisees had originally signed LUS contract to cover investments in network infrastructure owned and operated by promisees, this side of the bargain has vanished from negotiations through command-and-control regulation at EU level.³⁸⁶ Lastly, and most obviously, while the Second and Third Gas Directive inserted the provision on the importance of LUS contracts to security of supply, the EU legislator is neither regulating terms or clauses, nor creating rights and obligations. It is merely revealing the position of the Union, which might be taken into consideration by Member States for the sake of the integrity of the law.

³⁸⁴ Directive 2009/73/EC of 13 July 2009, Article 26.

³⁸⁵ Se Silvester van Koten, *Legal Unbundling and Auctions in Vertically Integrated (Utility) Markets* (2011), *European Journal of Law and Economics*.

³⁸⁶ If LUS contract brings forward privately funded investment in interconnectors by one or both parties, there is only a way to grant exclusive rights to access it. First, the operation should be lease to a complete independent third party and require an exception of TPA to NRAs, which will decide whether the project fulfill a strict technically and economically criteria listed in the second and third package.

The Gas Supply Crisis of 2009: security of supply as an argument to regulate Long-Term Upstream Supply Contracts

From the First Package in 1998 to the Third in 2009, EU energy Law was extremely prudent in gas markets while LUS contracts were subject to its provisions. The laws either emphasized the importance of LUS contracts to security of supply, or created a governance mechanism to reserve pipeline capacity for their full performance. However, establishing mandatory rules to LUS contracts had never fit into the scope of EU Energy Law. Perhaps the reasons why can be find in the peculiarity regarding the parties to LUS contracts of promisors located in third states committing with promisees incorporated within the boundaries of the Union. Alternatively, the reasons could lie in the historical stability of gas supply, though the increasingly dependence upon gas produced by third states had held EU bureaucrats back from interfering in the conditions of LUS contracts. Finding reasons to justify why the EU legislator had not looked into the clauses of LUS contracts until the third energy package requires deeper research that goes through understanding the political dimensions of upstream agreements in gas markets, the European Foreign Policy before the Lisbon Treaty, and most importantly, the absence of EU legislative competence in the field of private law. Discussing these factors is far from the aim of this chapter; however, there have been ongoing changes in the EU Energy Law approach to LUS contracts since 2010, and this matters to the empirical legal study conducted at this stage. However, to understand these changes, there is a need to narrate international disputes beyond the EU boundaries, which brings us back to 2005 and 2006.

First in March 2006³⁸⁷ and later in January 2007³⁸⁸, the Commission and energy experts alerted the European Parliament and Council about the risks of interruption of gas supply. Taking into consideration the increasing dependence for gas supply on a few producers in third country, the Commission's wariness was clearly based on the consequences of protracted disputes between Ukraine and Russia in 2006. Although disputes between Ukrainians and Russians concerning gas debts and non-payment by Ukrainians appeared immediately after the collapse of the Soviet Union, the consequences of the frequent disputes had never affected third states before 2006, when, for the first time, Ukrainians diverted Russian gas transiting to the EU. This cut-off of gas in 2006 was motivated by the dispute between the state owned companies, the Russian Gazprom and Ukrainian Naftohaz, during 2005 on the negotiations over gas transit fees paid to Ukrainians and gas prices produced in Russia for 2006. The failure in the negotiations over the gas price delivered to the Ukrainian domestic market led Gazprom to reduce the pressure in pipelines from Russia to Ukraine in 1st January 2006. As more than 80% of the gas supply from Russia to Europe transited through Ukrainian territory,³⁸⁹ Ukraine made the decision to compensate the loss of domestic supply by diverting gas flowing to European Member States, which obviously faced a reduction of gas supply in the middle of the winter season.³⁹⁰ Under immediate pressure from the EU, Member States, and the international community³⁹¹, Gazprom reacted by pumping an additional 95 million cubic meters

³⁸⁷ COM(2006) 105 final, Green Paper: A European Strategy for Sustainable, Competitive and security Energy, 8 March 2006, p. 8-9.

³⁸⁸ COM(2007) 1 Final, An energy Policy for Europe, 10 January 2007, p. 3-4.

³⁸⁹ Chow, Edward C, Bocair, Jennifer L. *The European Gas Crisis* (2009), Center for Strategic and International Studies (CSIS), p.

³⁹⁰ "The fall in volumes delivered to European Union countries caused an outcry all over Europe. By January 2, Hungary was reported to have lost up to 40% of its Russian supplies; Austrian, Slovakian and Romania supplies were said to be down by one third, France 25-30% and Poland by 14% Italy reported having lost 32 million cubic metres, around 25% of deliveries, during January 1-3. German deliveries were also affected but no further details are known". Jonathan Stern, *The Russian-Ukrainian gas crisis of January 2006* (2006), Oxford Institute for Energy Studies, p. 8-9 <http://www.oxfordenergy.org/wpcms/wp-content/uploads/2011/01/Jan2006-RussiaUkraineGasCrisis-JonathanStern.pdf>.

³⁹¹ World Trade Organization, European Commission DG Energy Communication

volume of gas per day into the Ukrainian network on 2nd January. The gas flow to Europe was then re-established on 4th January after an urgent agreement signed between the Ukrainians and Russians.³⁹²

Diverting gas intended originally for Europe for a couple of hours did not seriously resound through the downstream side of gas markets. End-users such as consumers still had gas being pumped into their cookers or heating systems. However, it gave a red alert to the European Commission. Jonathan Stern perfectly framed the dilemma that the EU had just started to deal with in his statement in the aftermath of the crisis: “it is not clear whether the major European gas security problem is that not enough gas will be available at some date in the future, or that gas providers will prove to be unreliable”.³⁹³ Stern was right to point his finger at the issue of reliance on third countries as gas suppliers or transit territory. This was also the assumption adopted by the Commission in the aforementioned Communications of 8th March 2006 and 10th January 2007, though neither the Green Paper nor the White Paper acknowledged the bridge of the transit contract with the Ukrainians. Anyhow, the European Commission called, first, for enhancement of the security of supply in the internal market through strengthening solidarity between Member States and, second, for a rethink in the EU approach to the emergence of gas stocks and prevention of disruptions. The former requires regulation that compels gas firms in one Member State to rescue another suffering from gas interruption by quick releasing its gas through interconnectors. Gas supplied by Norwegians and delivered to Germany via the North Sea could be quickly pumped to Hungarians if other disputes lead to successive interruptions of gas transiting through Ukrainian. The latter communication demands more investments in gas storage infrastructure. Bearing in mind the Commission’s recommendations, we can reach the conclusion that the regulation of LUS contracts at EU level was not in the toolbox of possible solutions. This was the early position endorsed by the European Parliament and Council during the two years of discussion that culminated in the approval of the Third Gas Package in July 2009. Reiterating what was said earlier, the EU legislator has not given the required attention to LUS contracts which concern security of supply. As the Parliament usually does not respond immediately to crises, the Third Directive approved in July of 2009 was already obsolete and did not give answers to the contractual dimensions of the most serious Gas Supply crisis in Europe which started on 1st January 2009.

The very short-term interruption of gas flow in 2006 was a forewarning of what would happen in 2009. Similar to the occurrences in 2005, Russians and Ukrainians once again failed to reach an agreement on gas prices for 2009 and, in addition, on the repayment of an accumulated debt with Gazprom. Like a *déjà vu*, Russians reduced again the pressure of pipelines connecting to Ukraine. But, differently to 2006, the reduction was dramatically higher. 90 million cubic meters of natural gas per day were halted completely on 1st January 2009, approximately 30% of the volume export to Europe through Ukraine. Immediately, the lack of gas was detected by Member States, but the tensions between Russian and Ukraine led to a far more serious crisis.³⁹⁴ On 7th January, the entire gas supply

³⁹² To have a detailed description of the dispute between Russians and Ukrainians and their agreements, see Jonathan Stern, *The Russian-Ukrainian gas crisis of January 2006* (2006), *op. cit.*, p. 8-13. Also Eric Pardo Sauvageot, *The Second Energy Crisis in Ukraine in 2009: Russo-Ukrainian Negotiations up to 2010 and the Role of European Union, Analysis of a Challenge to the EU Diplomacy* (2010), European Consortium for Political Research, <http://www.jhubc.it/ecpr-porto/virtualpaperroom/033.pdf>

³⁹³ Jonathan Stern. 2006 Natural Gas Security Problems in Europe: The 2006 Russian-Ukrainian Crisis of 2006, (2206) Asia-Pacif Review, vol. 13, no.1, p. 33.

³⁹⁴ “One quarter of all energy consumed in the EU is gas. 58% of this gas is imported. Of this, 42% comes from Russia, and around 80% of EU imports of gas from Russia pass via Ukraine. Among the 8 new eastern European Member States, dependence on Russian imports averages 77%. In practical terms, some 300-350 million cubic metres per day (mcm/day) of gas passes through Ukraine towards the EU, around one fifth of total gas demand in the EU. Ukraine transits the same quantity of gas on behalf of the EU as it consumes in its national market (around 300 mcm/day in winter)”. COM(2009) 363 of 16 July 2009, Commission Staff Working Document on The January 2009 Gas Supply Disruption to the EU (an Assessment), accompanying document to the Proposal

travelling through Ukraine was cut off and the state of shock overwhelmed the whole of Europe, from political leaders at EU and state level to simple householder consumers. Ukrainians and Russians accused each other of shutting down the flow of gas. From the contractual dimension, either Russians could have breached their LUS contracts with European promisees by shutting the gas supply down into European territories, or Ukrainians could also have breached the transit contract by diverting the gas initially directed towards the EU. Although the mutual accusation ended in a settlement that hid the identity of the guilty party, this second dispute between Russians and Ukrainian resulted in the drop of gas supply in most of the Member States, as an avalanche beginning from the east and tirelessly devastating the west. Hungary, Czech Republic, Germany, Italy, France, Romania, Poland, Bulgaria, and Greece reported very low gas in its entry points; even the UK announced entry of its gas reserves. Extreme situations were reported in eastern regions such as east Hungary, where citizens had been deprived of heating in the winter season as the region received only 20% of the normal volume supplied.³⁹⁵ Despite the several appeals for clemency by the international community, Russians and Ukrainians only reached a settlement on 19th January, and on 20th January the gas started to flow again into the EU.

What started as a terrifying experience for European Member States served as a reason for the Commission to mobilize efforts and release, on 16th July 2009, a proposal for a Regulation concerning the security of supply thus repealing the Directive of 2004. Unlike the prior Communications, the Commission obviously and openly recognized the risks of security supply, and forewarned a third gas supply crisis from similar or different causes. The exposure to a third gas supply crisis brought about the EU Regulation³⁹⁶ on security of supply, thus introducing several mechanism that has represented a large step towards the regulation of LUS contracts at EU level. Whereas the First, Second and Third Gas Packages have never imposed rules intrinsically regulating LUS contracts, Regulation 994/2010 has devoted the entirety of its Article 8, curiously entitled “Supply Standard”, to the issue. Already in the preamble, the EU rule makers gave the reasons for their unusual intrusion into the field of contract law. For them, “sufficiently *harmonized* security of supply standards covering at least the situations that occurred in January 2009”, should be established. Moreover, it states that those “standards should be stable, so as to provide the necessary legal certainty, should be clearly defined, and should not impose unreasonable and disproportionate burdens on natural gas undertakings, including new entrants and small undertakings”.³⁹⁷ Stability, Clarity, Reasonableness and Proportionality are material rules that certainly have a vague linguistic meaning. They need construction in order to create subsidiary rules that translate the semantic content into legal content.³⁹⁸ This is what the legislator tried to implement in Article 8. EU law has designated to the *Competent Authority*³⁹⁹ the obligation to identify the gas undertakings that are promisees in upstream supply contracts, without distinguishing short or long-term thereof. Hence, this Competent Authority should “require these natural gas undertakings to take measures to ensure gas supply to protected costumers of the Members States in the following cases”:⁴⁰⁰

(Contd.) _____

for a Regulation of the European Parliament and of the Council concerning measures to safeguard of gas supply and repealing Directive 2004/67/EC, p. 2.

³⁹⁵ COM(2209) 363, op. cit. p. 4.

³⁹⁶ Regulation 994/2010 of European Parliament and of the Council of 20 October 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 204/67/EC.

³⁹⁷ Regulation 994/2010 of 20 October 2010, Preamble 26.

³⁹⁸ Regulation 994/2010 of 20 October 2010, Preamble 26.

³⁹⁹ Competent Authorities are not necessarily NRAs. The legislator made the decision to give the Member States autonomy to choose another institution to be responsible for the activities involving security of supply. Regulation 994/2010 of 20 October 2010, Preamble 4(1).

⁴⁰⁰ Here I have as assumption the clear distinction between interpretation and construction, where the former solved ambiguity and the later vagueness. Lawrence Solemn, *The Interpretation-Construction Distinction*, 27 Constitutional Commentary 95 (2010).

1. Extreme temperatures during a 7-day peak period occurring with a statistical probability of once in 20 years;
2. any period of at least 30 days of exceptionally high gas demand, occurring with a statistical probability of once in 20 years; and
3. for a period of at least 30 days in case of the disruption of the single largest gas infrastructure under average winter conditions.

Observe that the European Parliament and Council for the first time have established mandatory rules for general upstream supply contracts. By speed-reading the norms in the provisions, one could have the impression that the regulation *a priori* loads European gas undertakings. The promisees seem to be the party who has to ensure supply covers demand for a minimum period of time as much as it increases in case of extreme temperatures, exceptionally high demand, or disruption of the single largest gas infrastructure. However, the promisee could never comply with the EU rules if they don't transpose these obligations to promisors through upstream supply contracts, which obviously includes LUS Contracts. Since promisees are not under the control of production or, in other words, how much volume of gas is extracted from the natural gas reserves, the way to comply with the new approach in EU law is to replace this obligation with the promisor though including this mandatory rule in the contractual governance. Yet, being LUS contracts, the major instrument to import gas into Europe, shifting these obligations to the promisor is even more crucial as long as the volume of daily gas trade is defined ahead in the take-or-pay clauses. In addition to the exhaustive list of supply standards, the second paragraph has inserted a provision insofar as obligations go beyond the 30-day period referred to in points (b) and (c) or relating to any other obligations imposed for reasons of security of supply. If an extra commitment is incorporated to supply standards, it has to be based on the risk assessment written down in the Regulation, in conformity with the Preventive Action Plan, and it must not unduly distort competition or hamper the functioning of internal gas markets.⁴⁰¹

In 2010, the provision on supply standards, which is in fact a clear regulation of contractual relationships in the upstream supply agreements, was approved as a response to the scandalous crisis of gas supply in 2009. These rules fit exactly into the understanding of preventing crisis through contracts. The European Parliament and Council would hardly have voted in favor of the supply standards if there were not the Ukrainian-Russian disputes that culminated with the shutoff of gas to EU Members States for almost fifteen days during wintertime. If this assumption is correct, we can assume that the shift provided by the Regulation of 2010 fits in which the new institutionalism calls *transitional rupture*. The political and economic crisis of security of supply in 2009 created an abrupt change in the quality of the community resilience and, therefore, broke open a positive pathway for changes to *path dependence*.⁴⁰² In this case, the EU legal system, which had been resilient to expanding its shadow toward private law, hitherto *locked-in* to national legal system, seems to have begun to weaken the walls restricting EU legislature competence to public law.

Someone could argue, however, that Regulation 994/2010 on gas supply is an isolated circumstance prompted by a crisis and, therefore, deny that the EU is expanding towards the field of contract law. However, the most recent Commission Communication on the Energy Union released in February 2015⁴⁰³, can confirm that there is a trend towards harmonizing contractual rules of LUS agreements through sector-regulation. The European Commission transparently addressed its ambitions in the bottom of the communication, where they defined the Energy Union in 15 actions points. The 3rd point

⁴⁰¹ Regulation 994/2010 of 20 October 2010, Article 2(b).

⁴⁰² Douglas North and new institutionalisms approach.

⁴⁰³ COM(2015) 80 final, Energy Union Package: Communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee, the Committee of Regions and The European Investment Bank: A framework strategy for Resilient Energy Union with a Forward-Looking Climate Change Policy, 25 February 2015.

states “the Commission will propose a revision of the Decision on Intergovernmental Agreements [Transit Contracts] in 2016 to ensure compatibility with EU legislation before agreements are negotiated, involve the Commission in such negotiations, develop standards clauses covering EU rules and make commercial contracts more transparent.”⁴⁰⁴

⁴⁰⁴ COM(2015) 80 final of 25 February 2015, p. 19.

The transformation in the making of private law via telecommunications regulation

Marta Cantero Gamito

Introduction

This paper focuses on the transformations operating in the *making* of private law through the regulation of a particular market; telecommunications. Following the liberalization of formerly public monopolies in the field of utilities, telecommunications have been regulated at EU level in a comprehensive way. This inclusive approach reaches up to the private law relations that take place among participants in telecommunications markets. Particularly, the overarching principles for the telecoms sector, such as (non-discriminatory) and universal access, heavily impact not only on the nature of private law but also imply a transformation in the contractual relations arising from transactions within the sector.

The shift of telecommunications from the public to the private sphere as a result of the liberalization of the sector has entailed not only substantive but also institutional transformations. Internal Market harmonization has been the driver for the rise of “European supervisory powers” in order to ensure the proper implementation of EU law in many fields covered by EU competences. In the telecommunications sector, the amplitude of these, largely European, control mechanisms overseeing compliance with sector-specific policy goals interferes with other spheres traditionally belonging to the Member States, such as private relationships.

The development of the telecoms sector has triggered a visible transformation that concerns private law and contract law in such a way that it is also used as a tool to achieve higher policy goals, mainly the creation of a Digital Single Market (Connected Continent), while promoting competition and protecting users at the same time, or even as part of such a harmonization programme. In so doing, the EU is following a *functionalist approach* (Internal Market as a *finalité* and as an objective) that also touches upon contract/consumer law (integration through private law⁴⁰⁵). This *makeover* has been noticeable in the EU Regulatory Framework for Electronic Communications, which has evolved over time. So far, there have been three different packages of rules. Their evolution is characterized by an initial liberalization goal, but later on, the objectives were more focused on harmonization of the internal market and consumer protection.

Furthermore, the transformation of private law via telecommunications regulation does not take place in an isolated manner; rather it occurs at three different (and interlinked) levels, giving rise to three different layers of transformation. These transformation processes in private law take place at the level of decision-making, substantive law, and enforcement and, hence, they alter the making, the substance, and the enforcement of private law when it comes to the private law contained in the legal regime of the so-called regulated sectors. Against this background, this paper focuses on the first transformation (transformation in decision-making) as the epitome of a transformation from legislative rule-making to *specialized* delegated powers under a networked decentralized structure which, in practice, works hierarchically under *sector-specific* supervisory mechanisms.

⁴⁰⁵ Caruso, D. (2006) ‘Private Law and State-Making in the Age of Globalization’, *New York University Journal of International Law and Politics*, 39, pp. 1–74.

To understand this claim, one may have to start from the assumption that “European Union private law is different”.⁴⁰⁶ The EU is not (and it will not be) a State, but its ambitions reach all economically relevant sectors.⁴⁰⁷ In so doing, according to its nature as a non-state actor, the European Union organizes its *action* in networks.⁴⁰⁸ We find that the Internal Market rationale and the promotion and preservation of competition underpin economic (and social) regulation. This process is “disintegrating” the classical core of private law and its systemic character undermining “the coherence of private law as a whole”.⁴⁰⁹ (Transformed) private law now serves “instrumentalist” purposes.⁴¹⁰ This surrender to the achievement of the overarching objective of the market-building project results in the emergence of different legal frameworks (one for each sector) that encompasses public and private law elements, weakening the *clear-cut* distinction of public/private law.⁴¹¹

The incorporation of private law provisions in telecommunications has certainly implied a shift in the *traditional approach* of law-making in private law. On the one hand, the role of National Regulatory Authorities (NRAs) has spread to the field of private law.⁴¹² The EU regulatory framework for telecoms has vested NRAs with competences that have an effect on private law, e.g. price setting in B2B relationships.⁴¹³ On the other hand, the Nation-State has a more modest role in terms of law-making. The EU’s lack of specific competences in the field of private law is overcome via the incorporation of national supervisory actors (in this case, the NRAs). There is no (formal) hierarchy between the EU and the national levels or any transfer of powers; rather, it is a type of “multi-layered institutional structure”.⁴¹⁴ However, in order to guarantee that NRAs exert their powers in the EU interest, the EU Regulatory Framework sets up a system of supervision, giving the European Commission policing powers to achieve the intended policy goals.⁴¹⁵ Accordingly, this *networked* institutional setting aims to create a governance network that, by regulating certain aspects concerning private law relationships, becomes a new private law-maker.

Against this background, even though the legislator has opted for a system of co-regulation, the effectiveness of EU soft-law is increasing. The system has evolved through different interactional

⁴⁰⁶ Micklitz, H.-W. and Patterson, D. (2012), “From the Nation State to the Market: The Evolution of EU Private Law”, *EUI Working Papers LAW* no 2012/15., at 11.

⁴⁰⁷ *Ibid.*

⁴⁰⁸ Joerges, C. (2006). “Deliberative Political Processes’ Revisited: What Have we Learnt About the Legitimacy of Supranational Decision-Making”, *JCMS: Journal of Common Market Studies*, 44(4), 779-802.

⁴⁰⁹ Zimmermann, R. (2008) ‘Comparative Law and the Europeanization of Private Law’ in Reimann, M. and Zimmermann, R. (eds.), *The Oxford Handbook of Comparative Law*, Oxford University Press, 539–78.

⁴¹⁰ Michaels, R. (2011), ‘Of Islands and the Ocean: The Two Rationalities of European Private Law’ in R. Brownsword, H.-W. Micklitz, L. Niglia and S. Weatherill (eds.), *The Foundations of European Private Law*, Hart Publishing, 139–158. See also Davies, G.T. (2015), “Democracy and Legitimacy in the Shadow of Purposive Competence”, *European Law Journal*, 21(1), 2-22; and Schmid, C. (2005), “The Instrumentalist Conception of the *Acquis Communautaire* in Consumer Law and its Implications on a European Contract Law Code”, *European Review of Contract Law*, 1(2), 211-227.

⁴¹¹ If there was ever one, see Kennedy, D. (1981), “Stages of the Decline of the Public/Private Distinction”, *University of Pennsylvania Law Review*, 130, p. 1982.

⁴¹² Taggart, M. (2005), “From ‘Parliamentary Powers’ to Privatization: The Chequered History of Delegated Legislation in the Twentieth Century”, *University of Toronto Law Journal*, 55, pp. 575-627.

⁴¹³ For particular examples see Ottow, A. (2012), “Intrusion of public law into contract law: the case of network sectors”, *The Europa Institute Working Paper* 03/12.

⁴¹⁴ Svetiev, Y. (2012), “W(h)ither Private Law in the face of the Regulatory Deluge”, in Micklitz, H.-W. and Svetiev, Y. (eds.), *A Self-Sufficient European Private Law - A Viable Concept?*, *EUI Working Papers Series Law* No. 2012/31, 26-44. See also Hancher, L. and Larouche, P., (2011), “The Coming of Age of EU Regulation of Network Industries and Services of General Economic Interest”, in G. de B. P. Craig, ed. *The Evolution of EU Law*. Oxford University Press, 743-779.

⁴¹⁵ Ottow, A. (2012, “Europeanization of the Supervision of Competitive Markets”, *European Public Law*, 18(1), 191–221.

(networked) levels aimed at a chief purpose: harmonization of the Internal Market. Accordingly, it is crucial to analyze these new regulatory structures, which seem to contrast with those belonging to traditional spheres of private law. In addition to this, the normative design displaces the border of private law and triggers confusion in the definition of what is private and what is regulatory within telecommunications regulation.

By exploring a real case on the implementation of the European legal framework in the field of telecommunications, this paper provides an answer to the question of to what extent the new model of decision-making implies a shift with regard to traditional methods of law-making in private law.

The (internal) market-building project and the transformed role of private law-making in telecoms

The law-making procedure is a decisive factor in the content and quality of the legal provisions that are produced.⁴¹⁶ A potential transformation of private law therefore calls for examination of the institutional choice and design, particularly where the process of rulemaking is understood “as a dynamic process, in which rules are not simply the result of a single legislative procedure but the outcome of continuing interaction between legal, political, and economic institutions”.⁴¹⁷ This is particularly the case in the making of European Private Law.

Within the internal market, the four fundamental freedoms are a new foundation for private relationships, meaning that European legal integration takes place (also) via private law.⁴¹⁸ In this evolution, the “private law society” has turned into a “market society”⁴¹⁹ and so has the State, by turning into a Market-State.⁴²⁰ Yet, while the creation of the Internal Market project has implied the extension of private autonomy beyond national markets, the role of the State as a law-maker has been undermined. Private law has been de-nationalised. Thus, alongside Globalization –in Europe, *Europeanization*–, the role of private law has decreased and it has been *instrumentalized*,⁴²¹ giving rise to a less clear-cut distinction between public and private law. Not only has the role of the State been weakened, but also the role of the law itself.⁴²²

In the European arena, this process of internationalization of markets has been cherished as an opportunity to enlarge national markets by way of diversifying into a bigger and supranational market: the (EU) internal market. The management of a single market calls for intervention aimed at market integration, be it via positive or negative integration.⁴²³ The combination of positive and negative techniques of integration enlarges the array of regulatory options. This means that new regulatory

⁴¹⁶ Cafaggi, F. (2006). *The Institutional framework of European private law*. Oxford University Press.

⁴¹⁷ Ibid.

⁴¹⁸ See Caruso supra n 1; and Davies, G. T. (2013), ‘Freedom of Contract and the Horizontal Effect of Free Movement Law’, in Leczykiewicz, D. And Weatherill, S. (eds), *The Involvement of EU Law in Private Law Relationships* (Studies of the Oxford Institute of European and Comparative Law), Hart Publishing.

⁴¹⁹ Polanyi, K. (1944). *The great transformation: The political and economic origins of our time*. Beacon Press.

⁴²⁰ Micklitz and Patterson, supra n 2.

⁴²¹ Micklitz, H.-W. (2009), “The Visible Hand of European Regulatory Private Law--The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation”, *Yearbook of European Law*, 28(1) 3-59.

⁴²² Smits, J. (2013), ‘Private law in a post-national society: from ex post to ex ante governance’ in Maduro, M., Tuori, K. and Sunkari, S. (eds.), *Transnational Law: Rethinking European Law and Legal Thinking*, Cambridge University Press.

⁴²³ Majone, G. (2009). *Dilemmas of European integration: the ambiguities and pitfalls of integration by stealth*. Oxford University Press.

techniques do not find accommodation within the traditional legal taxonomy. Thus, the emergence of new actors has deeply transformed the distribution of (legislative) powers within the State.⁴²⁴

On the other hand, the “New Social State” has also triggered the transformation (redistribution) of powers *within* the State.⁴²⁵ The inevitable delegation derives from the fact that the State cannot be responsible for everything.⁴²⁶ *Complexity* and *technicality* have also driven the internal redistribution of powers inside the State.⁴²⁷ This, together with the phenomenon of Globalization –in Europe, Europeanization–, has given rise to a process of *functional differentiation*.⁴²⁸ Thus, oversight functions have increasingly been displaced from the Congress to specialized government agencies and the private sector.⁴²⁹ The emergence of specialized agencies implies a sort of compartmentalization of the law according to policy concerns and expertise.⁴³⁰ The “law machine” (State) becomes an instrument to achieve policy aims. Regulatory intervention is giving rise to heavily regulated sectors. The telecommunications sector in the European Union is *overregulated* and it pursues different policy objectives ranging from liberalization, competition, and harmonization of the Internal Market, or even consumer protection; i.e. it pursues economic and social goals. In addition, the telecommunications sector in the European Union is configured under a regulatory *network-like approach* of different sector-related National Regulatory Authorities for telecommunications. This, in turn, gives rise to a new set of relationships of interconnection and interaction among the actors involved in the legislative development.

The commissioning of NRAs responds to a strategy aimed at securing the liberalization process via institutional design. With a similar object, a process of network-building for cooperation in regulatory matters can be identified as part of the development of the mandate of NRAs. These new modes of governance in the EU are an example of legal transformation.⁴³¹ As pointed out by Majone, the delegated functions of rule-making lead to paradoxes of privatization, sub-delegation, and issues and problems related to quasi-legislation.⁴³² In a decentralized model, diagonal conflicts are inevitable as they are inherent to the EU Multi-level system of governance.⁴³³ These diagonal conflicts, and the way

⁴²⁴ Dehousse, R. (2002). ‘Misfits: EU law and the transformation of European Governance’, in Joerges, C., Dehousse, R. (Eds.) *Good Governance in Europe’s Integrated Market*, Oxford University Press.

⁴²⁵ Sassen, S. (2006) *Territory, Authority, Rights: From Medieval to Global Assemblages*. Princeton, N.J: Princeton University Press (Chapter 4) and Taggart, M. (2005), ‘From ‘Parliamentary Powers’ to Privatization: The Chequered History of Delegated Legislation in the Twentieth Century’, *University of Toronto Law Journal*, 55, 575-627.

⁴²⁶ Taggart supra n 8, at 585-586.

⁴²⁷ Sassen supra n 21, at 171.

⁴²⁸ Teubner, G. (2004). ‘Societal Constitutionalism: Alternatives to State-Centered Constitutional Theory?’ *Storrs Lectures 2003/04 Yale Law School*.

⁴²⁹ Sassen supra n 21.

⁴³⁰ In telecommunications, the development of technology has greatly contributed to the emergence of niches of expertise, which strongly contribute to the formation of sector-related expertise organized institutions. Hence, in the telecommunications sector, we find different (sector-related) organizations that, to some extent, feature some regulatory powers. At the national level, the most representative example are National Regulatory Authorities responsible for telecommunications markets nationally, which were originally created to oversee the process of liberalization of the telecommunications markets, but whose involvement in the sector has increased over time. The emphasis on the achievement of a, initially, harmonized telecommunications market and the creation of a Digital Single Market, on a later stage, have meant the blooming of sector-related supranational organizations dealing with telecommunications issues. Only at European level we find the Body for European Regulators of Electronic Communications (BEREC), the Independent Regulators Group (IRG), the European Standardization Standards Institute (ETSI) or the Communications Committee (Cocom), inter alia.

⁴³¹ Dawson, M. (2011), *New Governance and the Transformation of European Law: Coordinating EU social law and policy*. Studies in European law and policy. Cambridge University Press.

⁴³² See also Taggart supra n 8.

⁴³³ Joerges supra n 4.

they are resolved under the established regulatory structure, suggest a significant erosion of national sovereignty.⁴³⁴

A case of (empirical) evidence: the implementation of termination rates in the Netherlands

First of all, it is important to recall here that, in Europe, National Regulatory Authorities in telecommunications are required to perform their regulatory duties in line with the policy objectives contained in Article 8 of the Framework Directive, namely: promotion of competition, contribution to the development of the Internal Market, and promotion of the interests of the citizens of the European Union.⁴³⁵ The European framework requires NRAs (in the case at issue, OPTA, the former Dutch NRA, now ACM⁴³⁶), among other regulatory duties, to investigate market termination and to impose regulatory obligations upon operators enjoying Significant Market Power (SMP).⁴³⁷ Among the different regulatory obligations, price control is a regulatory intervention required in order to prevent excessive pricing and margin squeeze. To that end, the European framework enables NRAs to impose cost accounting obligations.⁴³⁸ Under such obligations, NRAs may compel SMP operators to structure their cost accounting system (CAS) and pricing system under a certain methodology to meet the regulatory requirements in order to support price controls, grouping activities in specified accounts and applying particular rules for the allocation of costs to different services in order to prevent unfair cross-subsidies, excessive or predatory prices, with the aim of preventing margin squeeze as well as promoting sustainable competition and efficiency for the benefit of the user.⁴³⁹ Accordingly, NRAs must impose obligations to implement the CAS at the national level. This regulatory system was transposed in the Netherlands into national law⁴⁴⁰ and in particular, regarding the imposition of regulatory remedies, the national framework provided that regulatory obligations shall be appropriate if they are based on the nature of the problem identified in the market concerned and are proportionate and justified in the light of the objectives of Article 1(3) of the Dutch Telecommunications Act.⁴⁴¹

⁴³⁴ Richardson, J., and Mazey, S. (Eds.). (2015), *European Union: power and policy-making*, Routledge. See also Dawson, *supra* n 27.

⁴³⁵ 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'), as amended by Directive 2009/140/EC of the European Parliament and of the Council of 25 November 2009 amending Directives 2002/21/EC on a common regulatory framework for electronic communications networks and services, 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities, and 2002/20/EC on the authorisation of electronic communications networks and services.

⁴³⁶ OPTA (*Onafhankelijke Post en Telecommunicatie Autoriteit*, "Independent Post and Telecommunications Authority", in English) has been replaced by a single "super watchdog" body: the Netherlands Authority for Consumers and Markets ('ACM') after the merger of the Netherlands Competition Authority (NMa), the Netherlands Consumer Authority, and the Independent Post and Telecommunications Authority of the Netherlands (OPTA). ACM became operational as of 1st April 2013.

⁴³⁷ Article 15 of the Framework Directive and Commission Recommendation 2007/879/EC on Relevant Markets.

⁴³⁸ 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'); Article 13.

⁴³⁹ Article 13(2) Access Directive.

⁴⁴⁰ Law of 19 October 1998, containing rules on Telecommunications, Telecommunications Act (Wet van 19 oktober 1998, houdende regels inzake de telecommunicatie, Telecommunicatiewet); hereinafter 'Dutch Telecommunications Act'. Chapter 6a. *Obligations of Undertakings with Significant Market Power*.

⁴⁴¹ Article 6a.2(3). Such objectives are a mere transposition of those contained in Article 8 of the Framework Directive, namely: a. promoting competition in the provision of electronic communications networks, electronic communications services, or associated facilities, including by encouraging efficient investment in the field of infrastructure and supporting innovation; b. the development of the internal market; c. promoting the interests of end-users as regards choice, price, and quality.

In order to harmonize pricing control measures in Europe, in 2009 the European Commission issued a Recommendation on termination rates.⁴⁴² Without much elaboration on the technical details, termination rates are the rates which telecoms networks charge each other to deliver calls between their respective networks; i.e. how much mobile phone operators can charge to connect calls on each other's networks. These costs are ultimately included in call prices paid by consumers and businesses. The 2009 Commission Recommendation establishes that termination rates (fixed and mobile) should be calculated on the basis of the costs effectively incurred by an efficient operator using the *pure* Bottom-up Long Run Incremental Cost (BULRIC) methodology for its calculation. This method imposes a stricter costs measurement method than the previous one operating in The Netherlands, BULRIC+. The BULRIC+ model not only assumes the costs that are incremental to providing termination, but also applies a mark-up to non-incremental fixed costs. Thus, unlike BULRIC+, under the *pure* BULRIC methodology some of the costs are not considered for the calculation of the price cap.⁴⁴³

On the 7th July 2010, OPTA (now ACM), as part of its regulatory duties,⁴⁴⁴ published its market analysis including a decision in relation to: (a) the review of the wholesale market for voice call termination on individual public telephone networks provided at a fixed location; and (b) the review of the wholesale market for voice call termination on individual mobile networks in the Netherlands.⁴⁴⁵ This decision included conditions establishing price control for mobile and fixed termination rates in line with Article 13 of the so-called Access Directive.⁴⁴⁶ The methodology used by OPTA (now ACM) in that decision, consistent with the Commission's Recommendation on terminations rates, was based on the *pure* BULRIC cost standard. The national regulator, in issuing that regulatory decision, considered that the establishment of the *pure* BULRIC costing methodology was the best way to regulate for the "highest consumer welfare", provided that lower termination rates in the wholesale markets would be translated in lower retail prices.⁴⁴⁷

The above-mentioned regulatory decision gave rise to a judicial procedure before the Dutch Trade and Industry Appeals Tribunal (*College van Beroep voor het bedrijfsleven*, hereinafter CBB) following the appeal of a number of telecommunications operators in the Netherlands.⁴⁴⁸ The appeals raised several issues, including the regulator's decision to set the price controls on the basis of the *pure* BULRIC cost standard. Telecommunications operators contended that the cost-price method based on *pure* BULRIC was not an appropriate price obligation within the meaning of Article 6a.2(3) of the Dutch Telecommunications Act, as they considered that this obligation would go beyond what was strictly necessary to rectify the potential competition problems by implying that operators were no longer allowed to include certain costs in their tariffs.⁴⁴⁹ In particular, they argued that applying a cost-price method based on BULRIC+ could also offset the competition problem of excessively high prices. The

⁴⁴²Commission Recommendation (2009/396/EC) of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (OJ L 20.5.2009, pp. 67-74).

⁴⁴³Interview with an Economic Expert at OPTA, Florence 18.10.2012.

⁴⁴⁴Pursuant to Chapter 6(a) of the Dutch Telecommunication Act.

⁴⁴⁵Decision of 7 July 2010, OPTA/AM/2010/201951.

⁴⁴⁶Directive 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).

⁴⁴⁷Interview with an Economic Expert at OPTA, Florence 18.10.2012.

⁴⁴⁸T-Mobile Netherland B.V., Vodafone Libertel B.V., Koninklijke KPN N.B., KPN B.V., Telfort B.V., and Lycamobile Netherlands B.V.

⁴⁴⁹Interview with an Economic Expert from OPTA, Florence 18.10.2012: "When we take a decision, we have to formally consult the draft decision and, then, they (the operators) react to it and said: 'we don't agree with it'. That's what they're always saying and then that there should be lower prices, because there are lower costs. Then, you as a company you're not happy, it is logical and [...] So, there is a consultation phase and after that we have a final decision and, then, they have, of course, the right of defense [...] and they have a right to go to the Court and fight the decision and they did that successfully".

economic consequences of the case provide an overview of the influence of regulatory measures on the (private) relationships amongst operators. In monetary terms, the difference between *pure* BULRIC and BULRIC+ is only about 1 Euro cent. However, that cent, translated into a market where millions of transactions take place every day involves important sums. As stated in the CBB's judgment, ACM estimates a loss of revenue suffered by mobile providers to the order of €21 million to €219 million; the estimates produced by mobile providers themselves were even higher.⁴⁵⁰ The question to be answered by the national court was whether the adoption of the new costing methodology (*pure* BULRIC) could be considered *appropriate* in light of the observed competition problem within the meaning of the Dutch Telecommunications Act.⁴⁵¹

The CBB's Judgment was released on 31st August 2011, rendering judgment in the first and sole instance. In very broad terms, and leaving aside further competition concerns and issues of market analysis that were also objects of the plea, the Court, upholding the appeal, argued that despite the Commission's Recommendation on termination rates, conditions remained unchanged and, therefore, there was no reason to adjust the methodology for cost calculation from *plus* to *pure* BULRIC. The Court grounded its reasoning on the requirement of proportionality and justification as to the objectives of the Dutch Telecommunications Act (Article 1(3)) when imposing price control obligations such as the one in question.⁴⁵² Whereas the authority's aim is to neutralize consequences of market inefficiencies, likely margin squeezes, and excessive retail prices by way of imposing a price control obligation, the action "goes beyond what is strictly necessary to correct the identified competitive problem"; the national judge therefore casted doubt on the *proportionality* of the measure.⁴⁵³ Essentially, the court concluded that the inefficiencies in retail pricing cannot be resolved by imposing a "more invasive measure" at wholesale level, given that the retail mobile market was already considered competitive.⁴⁵⁴ As a result, the Court established new cap prices for termination rates and compelled the regulator to take a new decision setting the relevant rates on the basis of BULRIC+ methodology.⁴⁵⁵

Under the EU Regulatory Framework for Electronic Communications, there is a procedure for the consistent application of remedies. This procedure – the so-called "Article 7a procedure" as it is enshrined in Article 7a of the Framework Directive– establishes a supervisory mechanism that involves a notification procedure of the draft regulatory measure to the European Commission by the NRA concerned (Phase I). This Phase may take up to 1 month during which other NRAs and the BEREC may provide comments on the proposed measure, as well as the European Commission which may agree (providing comments or not), or instead raise "serious doubts".

In the case at stake, in January 2012, OPTA (now ACM) notified the European Commission of the new decision compliant with the court's judgment and the setting of the rate following the BULRIC+ methodology. Since this measure departs from the 2009 Commission Recommendation on termination rates, the regulator justified this deviation on the basis of the order by the CBB, as the highest appeal body in the Netherlands, to take a new regulatory decision regarding both the price caps for fixed

⁴⁵⁰ CBB Judgment of 31st August 2011, 4.8.3.1. See also Case C-424/07, *Commission v. Germany*, 3 December [2009] ECR I-11431, See, in particular, paragraphs 90-92.

⁴⁵¹ In particular within the meaning of its Article 6a.2(3)., that is, proportional and justified in light of Article 1.3 objectives.

⁴⁵² CBB Judgment of 31st August 2011, 4.8.3.1.

⁴⁵³ Ibid: "Pure BULRIC is a more stringent form of price regulation than BULRIC+ - there is no mark-up for non-incremental fixed costs - and the text of Article 6a.7(2) of the TA does provides no support for an interpretation to the effect that a form of price regulation might be imposed which goes beyond a price measure that can already be considered cost-oriented".

⁴⁵⁴ CBB Judgment of 31st August 2011, 4.8.3.4.

⁴⁵⁵ In fact, the CBB itself even set the price cap for Mobile Termination Rates at 0.056 €/min as of 7 July 2010, 0.042 €/min as of 1 January 2011, 0.027 €/min as of 1 September 2011, and 0.024 €/min as of 1 September 2012 on the basis of the BULRIC+ methodology and OPTA's own calculations.

termination rates and for direct interconnection rates following a BULRIC+ cost accounting methodology.⁴⁵⁶ During Phase I of the notification procedure, the European Commission raised concerns about the newly adopted regulatory measure and sent a *serious doubts letter* to ACM on the 13th February 2012, thus opening the Phase II investigation.⁴⁵⁷ The Phase II investigation opens a “Regulatory Dialogue” that may take up to 3 months preventing the adoption of the draft measure (the standstill period).⁴⁵⁸ In the *serious doubts letter*, the European Commission expressed reservations concerning the compatibility of the measure with the European Regulatory Framework and provided reasons why it believed that the draft measure would not only create a barrier to the internal market, but would also involve an increase in the retail prices leading to a decline in consumer welfare.⁴⁵⁹ In particular, the Commission considered that the measure did not comply with the requirements of Article 16(4) of the Framework Directive and Article 8(4) of the Access Directive in conjunction with Article 8 of the Framework Directive. In that regard, the European Commission acknowledges that NRAs are allowed to deviate from the Commission’s Recommendation but, in such event, the deviation must be *duly justified* in light of the policy objectives and regulatory principles of the Regulatory Framework. In the eyes of the European Commission, ACM did not provide any economic justification for the departure from the *pure* BULRIC methodology guaranteeing that the *plus* BULRIC methodology would equally promote efficiency and sustainable competition, as well as maximize consumer benefit in the Dutch market.⁴⁶⁰ In addition, the European Commission considered that it would create barriers to the Internal Market because mobile termination rates set via the *pure* BULRIC level would contribute to a level playing field at EU level by eliminating competition distortions between fixed and mobile networks.⁴⁶¹

Within the first six weeks of the Regulatory Dialogue, the BEREC –the umbrella group of European telecommunications regulators– may intervene in the procedure by issuing an Opinion expressing its views on the Commission’s serious doubts. In such case, there is a process of cooperation between the actors involved; i.e. the BEREC, the Commission, and the NRA. This stage may end in 3 different ways: a) the NRA withdraws its proposal; b) the NRA amends its proposal taking utmost account of the Commission’s serious doubts and BEREC’s Opinion; or c) the NRA maintain its proposal. In the case concerned, BEREC was required to issue an Opinion on the serious doubts letter indicating its position. To this end, and following the mandate enshrined in Article 7a(3) of the Framework Directive, a specific Expert Working Group (EWG) within the BEREC was established.⁴⁶² After several meetings, a final Opinion was adopted by the majority of the Board of Regulators.⁴⁶³ In that

⁴⁵⁶ CBB Judgment of 31st August 2011, 4.10.4 and 5 (‘The Judgement’).

⁴⁵⁷ SG-Greffe (2012) D/2859. Brussels 13.02.2012, C(2012) 1038. Interview with an Economic Expert at OPTA, Florence 18.10.2012: “The process of notification requires that you have to notify again to the Commission. So, we came with the Commission and said: “ok, we are going to do this, we have a Court decision, we cannot do anything else than this, so this is what we are going to do”. And, then, the Commission got very annoyed, because they had serious doubts about what we were doing there with regard to the economic analysis underlying the regulator’s decision”.

⁴⁵⁸ Article 7a(1) of the Framework Directive as introduced by the Directive 2009/140/EC (Better Regulation Directive).

⁴⁵⁹ Commission Recommendation of 13 June 2012, in accordance with Article 7a of 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”) in Case NL/2012/1284: call termination on individual public telephone networks provided at a fixed location in the Netherlands and in Case NL/2012/1285: voice call termination on individual mobile networks in the Netherlands; C(2012) 3770.

⁴⁶⁰ SG-Greffe (2012) D/2859. Brussels 13.02.2012, C(2012) 1038. European Commission serious doubts letter.

⁴⁶¹ Ibid.

⁴⁶² The EWG was charged with the task of drafting an opinion containing a summary of the notification and the serious doubts, the experts’ analysis, and clear conclusions concerning the compatibility of the proposed regulatory measure with the EU Regulatory Framework, as well as the provision of possible alternative proposals (if any).

⁴⁶³ BEREC Opinion in Phase II investigation pursuant to Article 7a of Directive 2002/21/EC as amended by Directive 2009/140/EC Case NL/2012/1284 – Call termination on individual public telephone networks provided at a fixed location

decision, the BEREC found that the serious doubts raised by the European Commission were *justified* and it agreed that: 1) The regulator had not provided an economic justification for the use of the BULRIC+ methodology as the appropriate measure “to promote efficiency and sustainable competition and maximize consumer benefits set out in Recital 20 to the Access Directive”; and 2) the proposed measure may have created a barrier to the Internal Market. Nonetheless, regarding the position on whether the measures should be amended or withdrawn, BEREC did not consider it appropriate to impose on the regulator any particular way to proceed due to the legally binding nature of the Judgment by the CbB.⁴⁶⁴

The procedure at hand concludes with a final notification by which, within 1 month after the Commission’s position, the national regulator has to inform the Commission and the BEREC about the final measures taken, and when it does not follow the Commission, the NRA must provide a reasoned justification. In our particular example, ACM deviated from the Commission on the basis that, under national law, the CbB’s judgment overturned the original regulatory measure.

Two years after the original decision that gave rise to the case at hand, the national regulator decided to attempt once more to set the *pure* BULRIC costing methodology.⁴⁶⁵ This second regulatory decision following the Recommendation was again appealed in front of the CbB. During the process of judicial review, after the initial unwillingness of the national court to refer the case to the Court of Justice of the European Union on the most problematic issues at stake –i.e. the legal effect of the Recommendation–, the national judge has finally decided to suspend the proceedings and request a preliminary reference from the Court of Justice of the European Union (CJEU) under Article 267 TFEU.⁴⁶⁶ The preliminary questions submitted for reference (and their implications) are examined below.

The private law dimension

Implementation of the EU regulatory framework for telecoms and private law

To begin with the implementation of the EU regulatory framework, a potential solution to this case might well have been the opening of infringement procedures. Yet, an infringement procedure is against the Member State infringing EU law provisions and it is necessary to recall here that National Regulatory Authorities are claimed to be *independent*.⁴⁶⁷ Accordingly, given that the NRAs are independent and also that there was no problem of incompatibility of the national law with the European provisions, in an infringement context this case would have raised the question: Infringement by whom? The Netherlands or the Dutch regulator?⁴⁶⁸

In addition to the foregoing, the *sector-specific* consultation procedure carried out in this case touches upon the competences and powers of the regulator, and involves the participation of the regulators’ umbrella group (BEREC), the European Commission, groups of interests, and the national judiciary. Therefore, some issues concerning implementation and decision-making are the subject matter of the

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in the Netherlands Case NL/2012/1285 – Voice call termination on individual mobile networks in the Netherlands, BoR(12)23.

⁴⁶⁴ Ibid.: “BEREC therefore considers that the Commission’s serious doubts, as narrowly expressed in its letter to OPTA of 13 February 2012 (i.e. without explicitly addressing the legally binding nature of the CbB’s judgment for OPTA), are justified”.

⁴⁶⁵ Effective as of 1st September 2013.

⁴⁶⁶ Case C-28/15, *Koninklijke KPN and Others Autoriteit Consument en Markt (ACM)* [in progress].

⁴⁶⁷ Article 3(2) Framework Directive. See Lavrijssen, S. and Ottow, A. (2012) ‘Independent Supervisory Authorities: A Fragile Concept’, *Legal Issues of Economic Integration*, 39(4), pp. 419–446.

⁴⁶⁸ Article 258 TFEU.

forthcoming analysis: How are regulatory decisions made? What criteria are taken into account? Who intervenes in decision-making processes? What is the role of the judiciary? Whose interests are taken into account? What is the actual effect of a European Recommendation (soft-law)? Provided that the case is related to the use of Article 7a of the Framework Directive ('Procedure for the consistent application of remedies') by the European Commission, it turns to be a very good example of the interplay between the national and the EU level, and the role of the European Union in the decision-making processes for issues touching upon private law matters.

In the field of private law, a problematic matter is represented by the delegation of substantive competence to "specialized institutions".⁴⁶⁹ The establishment of NRAs in the telecoms sector is a clear example of the partial integration or integration by sectors that Pescatore speaks about.⁴⁷⁰ But in order to get a clear understanding on this, it is necessary to look at the functional competence of such institutions as well as the interplay between the EU, the Member States, and the established administrative structures. A closer look to the implementation of the EU Regulatory Framework for Electronic Communications reveals a subtle increasing power of the EU Commission's role at the functional level when it comes to the achievement of the regulatory goals; i.e. consistent application of the legal framework and harmonization of the Internal Market. This might be the result of the nature of the prerogatives reserved to the European Commission with regard to the control mechanisms which grant it certain powers aimed at the adjustment of national measures; e.g. via consultation procedures.⁴⁷¹ The rationale of such procedures responds to the political and legal imperatives set out at EU level.⁴⁷²

The case at stake concerns the implementation of the Commission's Recommendation on the methodology employed for the calculation of termination rates costs.⁴⁷³ When it comes to contracts between telecoms operators, NRAs exert price control over the prices that the incumbent charges to alternative operators for the use of the network (termination rates).⁴⁷⁴ Therefore, this case is a good example for illustrating the implementation process of EU decisions by the Member States with implications for private law (price control in B2B contracts). This regulatory pricing control prerogative arises in the context of regulatory obligations that might be imposed by the national regulator over operators in wholesale markets. In particular, the concerned price control arises from cost accounting obligations. Article 13 of the Access Directive compels SMP operators to structure their cost accounting system (CAS) and pricing system under a certain methodology to meet the regulatory requirements in order to support price controls, grouping activities in specified accounts and with particular rules for the allocation of costs to different services in order to prevent unfair cross-subsidies, excessive or predatory prices, and to prevent margin squeeze as well as to promote sustainable competition and efficiency for the benefit of the user.⁴⁷⁵ In the case at hand, the disputed regulatory decision establishes a cap for termination rates so that it can avoid excessive tariffs or margin squeeze practices.

The economic consequences of the case provide an overview of the influence of regulatory measures on the (private) relationships among operators. In economic terms, the difference between *pure* BULRIC and BULRIC+ is only about 1 cent of Euro. Yet, the multiplied effect of such price alteration

⁴⁶⁹ Pescatore, P. (1974). *The law of integration*, Sijthoff, at p. 27.

⁴⁷⁰ *Ibid.*

⁴⁷¹ Article 7 and 7a of the Framework Directive. In this regard, see also Curtin (2009), *Executive Power of the European Union. Law, Practices and the Living Constitution*, Oxford University Press.

⁴⁷² Pescatore *supra* n 65, at 45.

⁴⁷³ Commission Recommendation (2009/396/EC) of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (OJ L 20.5.2009, pp. 67-74).

⁴⁷⁴ In accordance with Article 13(1) of the Access Directive.

⁴⁷⁵ Article 13(2) Access Directive.

amounts to millions of Euros.⁴⁷⁶ As stated in the CBB's judgment, ACM estimates a loss of revenue suffered by mobile providers that would be of the order of €21 million to €219 million, whereas mobile providers themselves have produced even higher estimates.⁴⁷⁷

Without entering into all the economic, competitive and regulatory consequences of the case, it will suffice to examine here the interplay among the actors involved in the implementation of the European Regulatory Framework for telecoms. This alone gives rise to governance problems.

Multi-level (network) governance conflicts

Essentially, the case is about the principle of national procedural autonomy. As mentioned above, the implementation and enforcement of the EU Regulatory Framework for Electronic Communications follows a decentralized approach. Under this scheme, we can identify three types of conflicts:

Vertical conflicts

NRAs are required to perform their regulatory duties in accordance with the regulatory objectives of the specific Directives.⁴⁷⁸ In principle, the national regulator enjoys a certain degree of autonomy when carrying out its regulatory tasks. However, the European Commission also enjoys a certain degree of control by virtue of Articles 7 and 7a procedures and Article 19 of the Framework Directive.

The vertical conflict arises in relation to the divergence between the European mandate and the disputed national decision that occurs as a consequence of the national ruling. This is a very common situation that the consultation procedures that are in place attempt to palliate. The internal market rationale takes precedence over the national legal regime as has been long established by the case law of the European Court.⁴⁷⁹

Horizontal conflicts of jurisdictions

The horizontal conflict is epitomized by the discrepancy between two different national jurisdictions. A conflict in the field of telecommunications could take place between civil or contract law rules –i.e. general contract law– vis-à-vis telecommunications regulation. Another example would be a potential inconsistency between telecommunications regulation and administrative law. Such incompatibilities might well be solved by rules of conflict and the maxim *lex specialis derogate generalis*. However, jurisdictional conflicts shall be recalled here. In the case at stake, the national regulator maintains the application of sector-specific regulation whereas for the national judge major principles such as legality and the administrative principle of legal certainty prevail.⁴⁸⁰

⁴⁷⁶ CBB Judgment of 31st August 2011, 4.8.3.1. See also Case C-424/07, *Commission v. Germany*, 3 December [2009] ECR I-11431, See, in particular, paragraphs 90-92.

⁴⁷⁷ *Ibid.*

⁴⁷⁸ Article 8(1) Framework Directive.

⁴⁷⁹ Inter alia: Case C-6/64 *Flaminio Costa v ENEL* [1964] ECR 585, Case C-26/62, *NV Algemene Transporten Expeditie Onderneming van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECR 1, and C-106/89 *Marleasing SA v La Comercial Internacional de Alimentación SA* [1991] ECR I-7321.

⁴⁸⁰ On the decay of the legality principle see Lavrijssen, S. and Ottow, A. (2011), 'The Legality of Independent Regulatory Authorities', in L. Besselink, F. Pennings and A. Prechal (eds.), *The Eclipse of Legality*, Kluwer Law International.

(Multi) diagonal conflicts

The literature has thoroughly addressed diagonal conflicts in issues of European governance.⁴⁸¹ Diagonal conflicts arise particularly in issues of decentralized enforcement, such as the one that concerns us here. It epitomizes a multi-dimensional interplay that brings together the national regulator, the European Commission, the umbrella organization BEREC (in a more modest way) and the national judiciary. The latter steps into the framework of the procedure through the judicial scrutiny of regulatory decisions conferred under the right of appeal against such decisions.⁴⁸²

The (potential) diagonal conflict emerges in particular with regard to the sought optimization of the market versus the proportionality of the (contested) intervention. As aforementioned in the background of the case, the regulator and the judiciary hold divergent views about the suitability of the measure. In turn, the judicial conclusion and the subsequent new regulatory decision restoring the BULRIC+ methodology triggered the opening of an Article 7a procedure starting a turf war involving three parties – the European Commission, the national regulator and the national judiciary.

On the one hand, the regulator argues that adopting a costing methodology in line with the European Recommendation would imply lower costs and, therefore, would be translated into lower consumer prices. In the eyes of the European Commission, in re-establishing the former methodology as required by the national court, ACM did not provide any economic justification for the departure from the *pure* BULRIC methodology that guarantees that the BULRIC+ methodology would equally promote efficiency and sustainable competition, as well as maximizing consumer benefit in the Dutch market.⁴⁸³ In addition, the European Commission considered that this would create barriers to the Internal Market because mobile termination rates set via the *pure* BULRIC level would contribute to a level playing field at EU level by eliminating competition distortions between fixed and mobile networks.⁴⁸⁴

On the other hand, the national court holds the view that the intervention of wholesale markets under conditions of inefficiency to resolve retail market prices are disproportionate, provided that NRAs cannot intervene in a market that already has been deemed competitive and that, therefore, is not subject to *ex-ante* regulation.⁴⁸⁵ Retail and wholesale markets are different markets operating at different –and not interlinked– levels. The Recommendation is about the wholesale market. The court reasoning concludes that the regulator –together with the Commission– cannot come up with a justification from a different market (i.e. it cannot use the retail market to say something about the functioning of the wholesale level).

Compatibility of the regulatory decision with EU law and institutional conflicts

Drawing on the empirical analysis consisting of interviews with staff related to this particular case, this brief case comment tries to call attention to issues that need consideration when it comes to the implications of European telecommunications regulation for private law relationships. Although ACM sought to follow the Commission's Recommendation on termination rates, it was not possible not to comply with the CBB's judgment.⁴⁸⁶ Formally, the case –including the Commission's investigation

⁴⁸¹ The most representative works on diagonal conflicts comes from Professor Joerges. See Joerges, C. (1997), "The impact of European integration on private law: Reductionist perceptions, true conflicts and a new constitutional perspective" *European Law Journal* 3(4), pp. 378-406, and Joerges supra n 4; amongst others.

⁴⁸² Article 4 Framework Directive.

⁴⁸³ SG-Greffe (2012) D/2859. Brussels 13.02.2012, C(2012) 1038. European Commission serious doubts letter.

⁴⁸⁴ Ibid.

⁴⁸⁵ CBB Judgment of 31st August 2011, 4.8.3.1.

⁴⁸⁶ Interview with an Economic Expert from OPTA, Florence 18.10.2012: "there was only one outcome possible and it was to follow the Court!".

procedure— gave rise to a complex situation because ACM has to apply the court’s decision. As such, the national court adopted the role of the regulator by overturning the new price caps resulting from the recommended new cost accounting model and restoring the previous methodology, and requiring the regulator to issue a new regulatory decision as from the 1st January 2012 pursuant to the judicial reasoning.⁴⁸⁷ The court here performed the role of a *de facto* regulator.⁴⁸⁸

Furthermore, this case was not, in principle, a problem of compatibility of Dutch law (the Dutch Telecommunications Act) with EU Law, because the concerned provision (its former Article 6) existed from 2004. The European Commission never raised questions concerning the law, but only about the specific reasoning of the Court.⁴⁸⁹ This means that the Commission was not arguing about a lack of compliance of the Dutch Telecommunications Act with EU law, but was only questioning the regulatory decision issued as a consequence of the court’s ruling which set the price cap on the basis of the BULRIC+ costing methodology, and to the contrary of the cost model suggested by the Commission’s Recommendation.

This situation perfectly reflects a clear decoupling of the CbB’s Judgment and the EU understanding, which places a debate on the nature of EU soft-law—in particular concerning the binding effect of the 2009 Commission Recommendation on termination rates— firmly on the table. In this regard, NRAs (OPTA in the case concerned) are required to take “utmost account” of the Commission comments. Once again, *utmost account* comes into play in order to modulate the relationship among the different participating institutions, but this time in a different direction: NRAs are the bodies to take the utmost account of the Commission’s position. In reality, the CbB decided that its conclusions were *not* affected by the Commission’s Recommendation and the fact that NRAs have to take the utmost account does not imply that OPTA cannot deviate from the (non-binding) Recommendation, especially if this would require a breach of national law.⁴⁹⁰ According to the Court, “that Article 19(1) of the Framework Directive requires Member States to ensure that national regulatory authorities, when carrying out their duties, try their utmost to use the recommendations of the Commission, [...] does not affect the obligation of OPTA to deviate from the –non-binding– call termination recommendation because they would otherwise act in violation of provisions of national law”.⁴⁹¹ This is the only reference made to *utmost account* throughout the Judgment. Utmost account, then, would imply that “you do not have to follow it exactly, but you have to take account of it”.⁴⁹² Unfortunately, the Court did not go deeper into the nature of the Recommendation and did not clarify what *utmost account* actually involves either. In the case at issue, OPTA initially followed the Commission’s Recommendation because, above all, the new methodology (*pure* BULRIC) revealed itself after economic analyses to be the best solution economically; it was the national Court who overturned that decision.⁴⁹³

⁴⁸⁷ CbB Judgment of 31st August 2011, Section 5.

⁴⁸⁸ See S. Lavrijssen and M. De Visser (2006), “Independent Administrative Authorities and the Standard of Judicial Review”, *Utrecht Law Review*, no. 1.

⁴⁸⁹ Interview with an Economic Expert from OPTA, Florence 18.10.2012.

⁴⁹⁰ *Ibid.*: “And the Commission formally –and that’s also what the Court acknowledges– is that, formally, its Recommendation is not a binding measure, is not binding to OPTA, that measure. That’s also why the Court says: ‘ok, if it is not binding, it is just a Recommendation, is not binding’. So, OPTA is not bind to follow that Recommendation, but the law –in the way as the Court explains it- is binding. So...”.

⁴⁹¹ CbB’s Judgement 4.8.3.6.

⁴⁹² Interview with an Economic Expert from OPTA, Florence 18.10.2012.

⁴⁹³ Interview with an Economic Expert at OPTA, Florence 18.10.2012: “What we applied is the reasoning from the Court. OPTA does not necessarily agree with that, but we have to live with that”.

The role of soft-law

Essentially, what is at stake here is the influence of a Commission Recommendation. To this end, it is important to determine the nature of the Recommendation. The, let's say, "soft-law box" encompasses those instruments that we are reluctant to qualify as "hard law".⁴⁹⁴ Hence, Recommendations would fall within the category of "soft-law". To a lawyer's mind, that is directly translated into "non-binding". However, it is crucial to ascertain the legal effect of the measures contained in the Recommendation.

Article 60 TFEU enables the Commission to issue recommendations in the field of liberalization of SGEIs. Pursuant to Article 288 TFEU (former Article 249 in the EC Treaty), Recommendations do not have binding force.⁴⁹⁵ Instead, they are indicative guidelines to implement and to interpret legislation. Nonetheless, the Court of Justice of the European Union has recognized that they are not completely deprived of legal force, and that the national judges should take them into consideration.⁴⁹⁶ As a matter of fact, national courts shall take a Recommendation into account "where they are capable of casting light on the interpretation of other provisions of national or Community law".⁴⁹⁷ Against this background, Recommendations would serve the purpose of harmonization or, at least, the performance of the European Commission in this particular case study would shed some light on the reading that the Commission seems to make of the Recommendation by attributing *de facto* binding force.

The reasons that lead the Commission to issue a Recommendation on cost-accounting methodologies might well be its impact on private relations; a subject matter which falls outside EU competence. Actually, as recognized in *Grimaldi*, the European institutions generally adopt Recommendations "when they do not have the power under the Treaty to adopt binding measures".⁴⁹⁸ In the issue that has brought us here, the European Commission alleges lack of harmonization in the application of cost-accounting principles to termination markets, divergence between price control measures, and different practices in implementing costing tools.⁴⁹⁹ In addition, the Recommendation seeks a *consistent application* of the specific provisions concerning cost accounting and accounting separation.⁵⁰⁰

The confrontation of the case does not lie in the proportionality of the measure itself, but in the nature of the source where it stems from. Thus, the Court observes that the mandate of Article 19 of the Framework Directive for NRAs to try their utmost to follow Commission's Recommendations, when performing regulatory duties, does not preclude the possibility that they might deviate from them. Especially, the court acknowledges, it is particularly important that this compliance with EU rules entails a violation of national law. The regulatory decision on tariff-regulation setting cap prices using the *pure* BULRIC cost model is at odds with the former Article 6a.2(1), (a), and (3) of the Dutch Telecommunications Act.⁵⁰¹ Accordingly, the legal debate at stake is a supremacy concern: supremacy of EU *soft-law* vis-à-vis *hard* national law.

⁴⁹⁴Klabbers, J. (1998), "The Undesirability of Soft Law", *Nordic Journal of International Law*, 67, p. 381.

⁴⁹⁵ In the same vein the CJEU in the Case C-322/88, *Salvatore Grimaldi v. Fonds des Maladies Professionnelles*, [1989] ECR 4407; see, in particular, para. 13.

⁴⁹⁶*Ibid.* para. 18.

⁴⁹⁷*Ibid.* para. 19.

⁴⁹⁸ *Grimaldi* case supra n 91, at para. 13.

⁴⁹⁹ Recitals 2, 3 and 4 of the Recommendation on termination rates.

⁵⁰⁰ *Ibid.* Recital 6.

⁵⁰¹ CBB Judgment of 31st August 2011, Section 4.8.3.7. To date, in its previous version, as the *Telecommunicatiewet* (Telecommunications Act) was amended in 2012.

Determining the legal effect of the Recommendation might give a proper *locus standi* to other operators –those seeking access to the network– to appeal the regulatory decision⁵⁰² setting cap prices via the *plus BULRIC* methodology on the grounds that the national measure impairs the outcome achieved via the application of EU law (i.e. the Recommendation).⁵⁰³ Accordingly, the question to pose here would be whether the supremacy or precedence principle can be extended to a Recommendation that in practice –and as a result of the control mechanisms put in place such as the Article 7a procedure–might be considered *de facto* binding.

Independence and expertise

The issues at stake in this case also call for consideration of the roles of the actors involved and the governance structure. What is the difference between the Court and the regulatory authority? The court has taken over the role of the regulator thus undermining the remit of the regulator authority.

Independence could potentially be squeezed out of the picture with such a *complex* procedure. Furthermore, a veto power exercised by the Commission not only undermines national procedural autonomy, but also interferes with the independence of the national regulator, given that the Commission pursues policy goals.⁵⁰⁴ But to what extent does independence guarantee the effective application of the law? Regulators' independence, or independent regulatory decision-making, cannot be regarded either as a value or as an instrument. Rather, it would be more appropriate to contextualize independence as a (desirable) feature.

The role of the judiciary as a regulator calls for scrutiny given that telecommunications is a highly technical sector. In fact, expertise is one of the rationales for NRAs' continued existence.⁵⁰⁵ The independence requirement logically also applies to the judiciary. Thus, in order to ensure effective legal protection, the court (or the body in charge of deciding the appeal) should also ensure a proper level of expertise.⁵⁰⁶ This raises an institutional issue as to which body provides a better understanding, the national regulator or the judge? From a technical point of view, it is hardly impossible to translate into legal terms these costing methodology issues. Accordingly, the interpretation of the national market conditions requires a high level of specialization. In the case at stake, it turns out to be that the Dutch court is composed of a specialized team of economist. However, this might not be the case in every single Member State.

⁵⁰² See case C-426/05, *Tele 2* (See para. 33: are the operators entitled to derive those rights and are affected by the NRA decision?) Para: 36. *It follows that users or undertakings competing with an undertaking with significant power on the relevant market must be considered to be potential beneficiaries of the rights corresponding to the specific regulatory obligations imposed by a national regulatory authority on that undertaking with significant market power pursuant to Article 16 of the Framework Directive and the telecommunications directives cited therein. Consequently, those users and undertakings may be regarded as being 'affected', within the meaning of Article 4(1) of the Framework Directive, by decisions of that authority which amend or withdraw those obligations. Are these operators compliant with these requirements? Answer: Para 38. (...) a strict interpretation of Article 4(1) of the Framework Directive to the effect that that provision confers a right of appeal only on persons to whom the decisions of the national regulatory authorities are addressed would be difficult to reconcile with the general objectives and regulatory principles resulting, for those authorities, from Article 8 of that directive, particularly with the objective of promoting competition."*

⁵⁰³ See the case C-213/89 *Factortame* [1990] ECR I-2433, paras. 20 and 21. See also Case C- 106/77 *Simmenthal* [1978] ECR I-629, paras. 22 and 23.

⁵⁰⁴ Lavrijssen, S. and Ottow, A. (2012), "Independent Supervisory Authorities: A Fragile Concept", *Legal Issues of Economic Integration*, 39(4) 419–446.

⁵⁰⁵ Niskanen, W. A. (1975), "Bureaucrats and politicians", *Journal of law and economics*, 617–643

⁵⁰⁶ Article 4(1) Framework Directive.

Contextualization in further European experiences: termination of tariff regulation

As a matter of fact, the above case is neither the first nor the last where the Commission put into practice the mechanism of Article 7a. Despite its short life –Article 7a entered into force with the third package (May 2011)– to date there have already been 29 Opinions issued by BEREC in cases which have given rise to the Phase II investigation.⁵⁰⁷ As previously mentioned, in those cases BEREC largely shared the Commission’s doubts. In 18 of them BEREC supported the European Commission in having serious doubts. In another 5 cases, BEREC only partially agreed with the Commission, while in 5 cases BEREC considered that the Commission’s concerns were unjustified.

Particularly, in the field of termination rates, some NRAs in different Member States have followed the Commission’s Recommendation proposing *pure* BULRIC methodology in this context. In these countries, the application of this methodology has “succeeded so far”.⁵⁰⁸ On the contrary, there have been other cases where NRAs are also coming across similar issues in similar cases as the Netherlands when implementing the Commission’s Recommendation; this is the case for Germany⁵⁰⁹ and Italy⁵¹⁰ *inter alia*.

The role of the Court of Justice of the European Union

The Court of Justice of the European Union (CJEU) may become involved in this procedure as a consequence of the preliminary reference procedure.⁵¹¹ Already within the first appeal procedure culminating in the judgment that gave rise to the opening of Phase II of the Article 7a procedure, the national judge should have submitted the case for the European Court’s consideration. However, at that time, the CBB did not see the need to *consult* the European Court for clarification.⁵¹² This seems to be a general trend in the Dutch judiciary, at least in the highest administrative court.⁵¹³ In a case such as the one at stake, which concerns the validity of a European guidance embodied in the form of a Commission Recommendation, the national court is obliged to submit a request for a preliminary ruling to the CJEU.⁵¹⁴

Be that as it may, the new appeal on the new regulatory decision on termination rates seems now to be in the process of being referred by the CBB. The questions referred for preliminary ruling are as follows:⁵¹⁵

1. Must Article 4(1) of the Framework Directive, read in conjunction with Articles 8 and 13 of the Access Directive, be interpreted as meaning that, in principle, in a dispute concerning the lawfulness of a cost-oriented scale of charges imposed by the national regulatory authority

⁵⁰⁷ Data from March 2015 (Cullen International).

⁵⁰⁸ Interview with an Economic Expert at OPTA, Florence 18.10.2012.

⁵⁰⁹ Press Release at http://europa.eu/rapid/press-release_IP-13-180_en.htm.

⁵¹⁰ Press Release at http://europa.eu/rapid/press-release_IP-13-98_en.htm.

⁵¹¹ Article 267 TFEU.

⁵¹² According to one of the judges of the CBB involved in the case, the argumentation either from OPTA or the Commission was not enough to request a preliminary reference to the CJEU. He claims that if the regulator would have put the internal market argument over the table: “of course, it would have been different(!)”. The reasons why they did not refer the case, he says, is because they “knew that the answer (by the CJEU) to the question (legal effect of the Recommendation) is clearly *no*”. CBB’s judge, Brussels, 20.11.2014.

⁵¹³ On this account, see Lavrijssen, S., Eijkens, J., & Rijkers, M. (2014). The Role of the Highest Administrative Court and the Protection of the Interests of the Energy Consumers in the Netherlands. *TILEC Discussion Paper* No. 2014-032.

⁵¹⁴ Recommendations to national courts and tribunals in relation to the initiation of preliminary ruling proceedings (OJ C 338, 6.11.2012), para. 16. Although this recommendation was not in place at the time the appeal was pending.

⁵¹⁵ Case C-28/15, *Koninklijke KPN and Others v Autoriteit Consument en Markt (ACM)* [in progress].

(NRA) in the wholesale call termination market, a national court is permitted to make a ruling which does not accord with the European Commission Recommendation of 7 May 2009 on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU (2009/396/EC), 3 in which pure BULRIC is recommended as the appropriate price regulation measure for call termination markets, if, in that national court's view, this is required on the basis of the facts in the case brought before it and/or on the basis of considerations of national or supranational law?

2. If the answer to Question 1 is affirmative: to what extent is the national court permitted, in assessing a cost-oriented price regulation measure:
 - a. in the light of Article 8(3) of the Framework Directive, to evaluate the NRA's argument that the development of the internal market is promoted by reference to the degree to which the functioning of the internal market is in fact influenced?
 - b. to assess, in the light of the policy objectives and regulatory principles laid down in Article 8 of the Framework Directive and Article 13 of the Access Directive, whether the price regulation measure:
 - i. is proportionate;
 - ii. is appropriate;
 - iii. has been applied proportionately and is justified?
 - c. to require the NRA to demonstrate adequately that:
 - i. the policy objective, referred to in Article 8(2) of the Framework Directive, that the NRAs should promote competition in the provision of electronic communications networks and electronic communications services is genuinely being attained and that users are genuinely deriving maximum benefit in terms of choice, price and quality;
 - ii. the policy objective, referred to in Article 8(3) of the Framework Directive, that NRAs should contribute to the development of the internal market is genuinely being attained; and
 - iii. the policy objective, referred to in Article 8(4) of the Framework Directive, that the interests of the citizens should be promoted is genuinely being attained?
 - d. in the light of Article 16(3) of the Framework Directive, and of Article 8(2) and (4) of the Access Directive, when assessing whether the price regulation measure is appropriate, to take into account the fact that the measure has been imposed on the market on which the regulated undertakings possess significant market power but, in the form chosen (pure BULRIC), has the effect of promoting one of the objectives of the Framework Directive, namely the interests of end users, on another market which has not been earmarked for regulation?

The first question is expected to result in an important debate on the role of EU law. Furthermore, it addresses classic and timely questions about the role and legal effect of EU soft-law in the context of the new governance debate. The national judge asks the European court to clarify the discretion of the *national judge* to deviate from a European Recommendation when, at the national level, not only national legal but also factual circumstances require doing so. It refers here to the fact that the national conditions remain unchanged.

The second question would challenge the nature and rationale of the Article 7 procedure as a supervisory mechanism itself, provided that the effect on the Internal Market would be minimal to justify a mandatory compliance with a non-binding European instrument. For the telecommunications sector in particular, the court should also determine the suitability of the Internal Market argument to follow the Recommendation when it actually has little effect outside the national borders. To this end,

the European court will have to address the question of proportionality of the regulatory decision to modify a measure in the national market in accordance with the Recommendation, especially when national circumstances remain unchanged.

Interestingly, the national court poses the question(s) on the *legitimacy* of the court to deviate from the Recommendation, yet it does not refer to the NRAs, but only to the national court. This reflects a significant decoupling between the regulator and the judiciary, even though, in practice, they are performing the same task; tariff regulation. Thus, the role of the regulator might be *adulterated* by the Commission's view in its pursuit of the internal market-building project, or replaced by the judiciary when overturning regulatory decisions.

From legislative rule-making to *specialized* delegated powers in a networked decentralized structure that, in practice, works hierarchically under *sector-specific* supervisory mechanisms

The liberalization of the sector has entailed the shift from national regulation to supranational law-making of former public utilities. In the European Union, once liberalization was put in place, the regulation of Services of General Economic Interest (SGEIs) has been carried out mainly under the Treaty provisions on Internal Market competence (Article 114 TFEU, former Article 95 EC Treaty). Furthermore, this regulation has been accomplished under a sector-related approach, which has given rise to the emergence of different vertical sectors. Since the EU took the lead in the liberalization process, the harmonization of these services within the Internal Market has been the guiding light for legislative development.

The strategic importance of the regulated networked industries together with its complexity and technicality, explain the State-internal redistribution of power. Thus, the oversight functions lead to the delegation (outsourcing) of functions from the Congress to specialized agencies and to the private sector. A decentralized delegated implementation system is explained by the lack of information and expertise on the part of legislatures, which gives rise to a “perplexingly diffuse administrative state”.⁵¹⁶ In telecommunications –as in the energy sector– the Internal Market project and the level of technical complexity of the sector has led to the establishment of National Regulatory Authorities (NRAs) to oversee the regulatory process at national level. Accordingly, NRAs have been established as a way of securing liberalization via institutional design. A more elaborated expertise to monitor telecoms market seems to be the appropriate institutional choice in terms of regulatory efficiency and effectiveness. Against this background, “(...) [t]o survive the judicial review of such reforms, agencies must often justify the markets values and results of deregulation as simply another form of regulation”.⁵¹⁷ In this regard, empirical evidence verifies Niskanen's theory of regulation, by which even though regulatory institutions are supposed to be of an *ad interim* nature until the market has been rolled out, the sector-related structures find no incentive to abolish them or to eradicate sector-specific approaches to regulation once markets are fully competitive. Rather, sector-specific approaches tend to perpetuate “or at best [they are] modified”.⁵¹⁸ This is the trend actually followed in Europe with the emergence of different generations of sector-specific regulation once the liberalization of the market has been attained. As such, competition law is not only yet to take over entirely –as originally designed– but also (sector-specific) regulatory goals are shifting from liberalization to broader goals like the achievement of a Digital Single Market for Europe.

⁵¹⁶ As Somek has put it. Somek, A. (2014), *The Cosmopolitan Constitution*, Oxford University Press.

⁵¹⁷ Sassen supra n 21, at 176.

⁵¹⁸ Niskanen supra n 101. For an European account, see Möschel, W. (2009), “The Future Regulatory Framework for Telecommunications: General Competition Law instead of Sector-Specific Regulation – A German Perspective”, *European Business Organization Law Review*, 10(01), pp. 149-163.

Apart from National Regulatory Authorities in the national markets, additional supervisory mechanisms at EU level have been put in place, this time not with the aim of overseeing the liberalization process, but with the aim of achieving what turned out to be one of the overarching aims of the regulatory framework: development of the Internal Market.⁵¹⁹ To this end, the sector has developed towards the establishment of a network for cooperation (and supervision) in regulatory affairs. This network operates at both the national and the European level. The supranational dimension operates via networks of regulators. This network has reached its pinnacle with the establishment of the Body of European Regulators for Electronic Communications (BEREC) in 2009. The BEREC is the outcome of a path dependency of a set of practices that was followed in the previous years, which first emerged as an informal cooperation (the birth of the Independent Regulators Groups), and that later was institutionalized under a formal organization fostered by the European Commission (the European Regulators Group, ERG). While it is true that the BEREC was originally meant to be a European agency and that its current structure is the result of political fragmentation, the reality is that the BEREC, as a forum of regulators, together with other supervisory mechanisms (Article 7 and 7a procedures) represent a high level of regulatory convergence bypassing complex political commitments such as those associated with the establishment of a European Agency and the complex task of endowing it with competences.⁵²⁰ Furthermore, the empirical research conducted has demonstrated that even though the governance strategy followed in telecoms is rooted in the underlying idea of cooperation, in the interplay between the EU and its Member States via the national regulators, there is a kind of *fake interdependence* insofar as the EU is actually the leading voice in this cooperative relationship, mostly under internal market rationalities.

The Internal Market-building project has been reinforced by the establishment of procedures to ensure the proper and consistent application of the Regulatory Framework at the national level. The decision to establish a decentralized structure to monitor the proper implementation of the EU rules via NRAs responds to flexibility and efficiency motivations. In fact, national specialized agencies are potentially more efficient and flexible in comparison to the European Commission. In general, these authorities possess the necessary expertise and knowledge concerning local particularities. These distinctive features enable NRAs to better respond to intricate and incipient problems.⁵²¹ Under Article 7 and 7a procedures, NRAs are required to notify the Commission of the adoption of regulatory measures or the imposition of regulatory remedies when they concern the development of the Internal Market. The analysis of a real case on the effects of a conflict between the national regulatory decision and a Commission's Recommendation reveals the pervasive nature and the practical implications of the mandate contained in Article 7a of the Framework Directive. In addition to this governance conflict, this case also evidences a jurisdictional (and hierarchical) conflict between the regulator and the national judiciary. In particular, the main conflict is between the regulator applying EU (soft)law *vis-à-vis* the national judiciary applying national law, which will be ultimately decided by the Court of Justice of the European Union (CJEU). Should the CJEU rule in favor of the legal impossibility to deviate from the Commission's Recommendation, it would be a landmark in the role and effect of EU soft-law. However, such interpretation would also reinforce the assumptions exhibited above based on the grounds of empirical research.

⁵¹⁹ Article 8(3) of the Framework Directive.

⁵²⁰ By way of example, the conferring of powers to the European Securities and Markets Authority (ESMA), which gave rise to the Judgment of the Court (Grand Chamber) of 22 January 2014 (ESMA case), also C-217/04, ENISA. See also Ottow, A. (2012) 'Europeanization of the Supervision of Competitive Markets'. *European Public Law* 18(1), pp. 191–221.

⁵²¹ Interview with NRA expert. In the same vein, concerning competition law, see Svetiev, Y. (2010), 'Networked Competition Governance in the EU: Delegation, Decentralization or Experimentalist Architecture?' in Sabel, C. F., & Zeitlin, J. (Eds.), *Experimentalist governance in the European Union: towards a new architecture*. Oxford University Press; and Svetiev, Y. (2015), 'Scaling experimentalism: from convergence to informed divergence in transnational competition policy', in Zeitlin, J. (ed.), *Extending Experimentalist Governance?: The European Union and Transnational Regulation*, 169.

These transformations in the governance of telecommunications, largely resulting from the sector-related approach and linked to the technical complexity of the sector, have caused the emergence of new methods and actors in the regulatory process of private law. Thus, the research conducted here concludes that, from a private law perspective, this phenomenon has displaced the current law-making process for private law far away from the traditional approach in which the Nation State was the main –and only– actor in the legislative course. This displacement has not taken place via explicit legal delegation, but rather via (formal) *heterarchical* forms of accountability and legitimation as a result of the emergence of global administrative law as Ladeur has put it.⁵²² However, evidence suggests that the actual implications are comparable to those resulting from a genuine principal-actor delegation. As such, under the designed system of supervision, the EU Regulatory framework has put in place a hierarchical system based on a process of *legal self-review*. The case examined evidences how such a system might bypass the judicial limitations of the dynamics of sector-specific rationalities.⁵²³

To conclude, while the codification (of private law) era went hand in hand with the awakening of the Sovereign (Nation-)State, which was enshrined as the single source of lawmaking power, the regulatory framework for electronic communications involves a regulatory power transfer that represents a new source a law-making that virtually comes from polarized sources. Delegation has yielded a new approach in which there are many decision-making centres. Hierarchy is no longer paradigmatic and the “society of networks” is setting aside hierarchy, giving rise to an increasing set of relationships of heterarchical character (networks). In this new panorama, the legal structure of regulation has been heavily altered and the State is not its central actor anymore.⁵²⁴ This also has an impact in the way law is manifested. Whereas the civil codes symbolized the unity (and sovereignty) of the State,⁵²⁵ the new configuration eschews any codification or systematization attempt. Law sprouts from many sources and practices that do not follow a particular *pecking order*; instead, law derives from different norms and practices in which the domestic and the transnational domains intermingle.

⁵²² Ladeur (2011). The emergence of administrative law.

⁵²³ Teubner, G. (2004). ‘Societal Constitutionalism: Alternatives to State-Centered Constitutional Theory?’ *Storrs Lectures 2003/04 Yale Law School*.

⁵²⁴ Ladeur *supra* n 74. See also Ladeur, K. H. (2002), “The Changing Role of the Private in Public Governance-The Erosion of Hierarchy and the Rise of a New Administrative Law of Cooperation. A Comparative Approach”, *EUI Working Paper Series Law* 2002/09.

⁵²⁵ Zimmermann, R. (2012) “Codification. The Civilian Experience Reconsidered on the Eve of a Common European Sales Law”, *European Review of Contract Law*, 8, 367–399.

The transformation of the retail financial transactions in the EU and the role of contract law

Federico Della Negra

Introduction

After the global financial crisis EU law has undergone unprecedented changes. Since 2008 the European Commission has proposed more than 40 new legislative measures⁵²⁶ and the new European Supervisory Authorities (ESAs) have already adopted more than 190 draft technical standards.⁵²⁷ However, in the field of banking and finance the changes in the interpretation and application of the law do not always derive from “regulatory innovations”; they often reflect the economic,⁵²⁸ technological,⁵²⁹ societal⁵³⁰ changes that have not necessarily been translated into legal texts. In fact, the impact of economy, technology and society is stronger on the “law in action” than in the “law on books”: enforcers generally react much faster than legislators to the new economic, technological and societal developments because they are directly subject to the pressure generated by complaints and litigation.⁵³¹

The divergence between the “law on the books” and “law in action” is even more acute in the EU institutional context. Whilst the EU has gradually expanded its law-making competence in the banking and financial sector, its public and private enforcement’s competence is limited.⁵³² The new ESAs have only specific supervisory and enforcement powers and the new supervisory and enforcement powers of the European Central Bank (ECB), within the Single Supervisory Mechanism (SSM) are restricted to the prudential supervision of the significant credit institutions of the Euro area. Moreover, the private enforcement of EU banking and financial regulation remains exclusively based on national courts and alternative dispute resolution (ADRs) mechanisms.

⁵²⁶ See European Commission, *A new financial system for Europe. Financial reform at the service of growth*. 27 June 2014. Available at http://ec.europa.eu/internal_market/publications/docs/financial-reform-for-growth_en.pdf

⁵²⁷ Data available at www.eba.eu; www.esma.eu; www.eiopa.eu (23 January 2016)

⁵²⁸ Economisation refers to the process of the removal of the intra and inter-state barriers to the freedom of establishment, the free movement of services and capital. See H.-W. Micklitz, *The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation*. EUI Working Paper LAW 2008/14.

⁵²⁹ Technology refers to the innovations that allow financial markets participants to devise new products, services and processes. See J. Lerner-P. Tufano, *The Consequences of Financial Innovation: a counterfactual research agenda*, NBER Working Paper Series No 16780/2011, p. 6

⁵³⁰ Society refers to the societal factors that change and conform “established and embedded social rules and institutions that structure social interactions”. See G. M. Hodgson, *The Enforcement of Contracts and Property Rights: Constitutive versus Epiphenomenal Conceptions of Law*, *International Review of Sociology*, (2003) 13, 381.

⁵³¹ For the purpose of this study, “law in the books” indicates the EU legal acts adopted pursuant to Art. 288 (primary legislation) and Arts. 290, 291 (secondary legislation) as well as the national legal acts transposing EU legal acts. The “law in action” indicates the legal acts adopted by EU and national judicial and administrative authorities which do not fall within the EU legal acts mentioned above.

⁵³² Public enforcement includes the public mechanisms which enforce the law on the initiative of public authorities; private enforcement includes the legal mechanisms, private or public, which enforce the law on the initiative of private parties.

In addition to this, as the EU has not yet harmonized the contractual duties and remedies of financial transactions, their legal governance remains subject to a dual regulatory regime: national law governs the contract⁵³³ and EU law governs the duties of conduct of investment firms vis-à-vis clients.

Despite the existence of this dual regulatory regime, I argue that the EU post-crisis regulatory and institutional changes will affect national contract law and the private enforcement of financial regulation. This argument builds on two main findings. First, in the wake of the global financial crisis many national courts and ADRs interpreted the national law of contract in light of the purpose of EU financial regulation by using important “regulatory inputs” contained in the Directive 2004/39/EC (MiFID I)⁵³⁴ in order to increase the effective legal protection of retail investors vis-à-vis investment firms. This study shows that the Directive 2014/65/EU (MiFID II)⁵³⁵, the Regulation (EU) No 600/2014 (MiFIR)⁵³⁶ and the ESAs Regulations could further strengthen this process of “Europeanization” of contract law governing retail financial transactions.

Second, more strikingly, although the EU legislation seems rather reluctant to harmonize the national laws of contract related to retail financial transactions, it has recently introduced new contractual tools to support the banking resolution procedures which could give rise to a process of “contractualisation of EU law”. Both of these processes originate in EU law and materialize through national law. But whereas the trend towards the “Europeanization of contract law” responds to the need of strengthening the private law rights and remedies of retail investors vis-à-vis financial firms, the “contractualisation of EU law” is driven by the need of minimizing the impact of the banks’ crisis and failures on sovereigns. It is submitted that this objective, which underpins the Directive 2014/59/EU (BRRD)⁵³⁷, Regulation (EU) No 1024/2013 (SSM Regulation)⁵³⁸ and the Regulation (EU) No 806/2014 (SRM Regulation)⁵³⁹, will inevitably have an impact on the firm-client relationships as well as on the supervision of financial market participants.

The evolution of EU financial regulation

From the 1966 Segré Report to the FSAP legislation

The evolution of EU financial regulation is marked by four turning-points: the 1966 Segré Report, the 1985 White Paper on the completion of the internal market, the 1999 Financial Services Action Plan (FSAP) and the 2008 Lehman Brothers collapse which marked the beginning of the global financial crisis.⁵⁴⁰ In 1966 the Segré report advocated for the first time the creation of a European capital market

⁵³³ In national law, investment contracts will normally qualify as contracts of mandate or sui generis contracts based on the contract of mandate and other contractual schemes (deposit).

⁵³⁴ Directive 2004/39/EC on markets in financial instruments (MiFID I) O.J. L 145/1 (2004).

⁵³⁵ Directive 2014/65/EU on markets in financial instruments (MiFID II) O.J. L 173/349 (2014). Art. 94 of MiFID II repealed the MiFID I with effect from 3 January 2017.

⁵³⁶ Regulation (EU) No 600/2014 on markets in financial instruments O.J. L 173/84 (2014).

⁵³⁷ Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD) O.J. L 173/90 (2014).

⁵³⁸ Council Regulation (EU) No 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation) O.J. L 287/63 (2013).

⁵³⁹ Regulation (EU) No 806/2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (SRM Regulation) O.J. L 225/1 (2014).

⁵⁴⁰ For a more detailed analysis of the evolution of EU financial regulation see T. Tridimas, *EU Financial Regulation: Federalization, Crisis Management and Law Reform*, in P. Craig-G. de Búrca (eds.), *The Evolution of EU Law*, OUP, 2011, 786.

in order to achieve the monetary and economic union.⁵⁴¹ This idea underpinned the First⁵⁴² and Second⁵⁴³ Directives for the implementation of Art. 67 of the European Economic Community Treaty. But the process towards the liberalisation of financial markets slowed down over the 1970s and 1980s: the directives on financial institutions,⁵⁴⁴ admission listing⁵⁴⁵ and listing particulars,⁵⁴⁶ have been adopted after a lag in the decision-making process caused by national protectionist resistances.

In the 1983 Communication on Financial integration, the Commission affirmed the need to “re-launch efforts towards financial integration” after the stagnation of the 1970s.⁵⁴⁷ This Communication anticipated the 1985 White paper on the completion of the internal market which advocated the creation of a “minimal coordination of rules” for authorization and supervision in order to foster competition between firms. Regulatory competition was intended to be the tool to achieve more competition between financial services providers in the EU.⁵⁴⁸ In fact, the most important directives adopted during the “minimum standards period” (UCITS I,⁵⁴⁹ Second Banking Directive,⁵⁵⁰ and Investment Service Directive⁵⁵¹) have been based on the principle of home country control and aimed an EU passport for financial and banking activities.

Starting from the premise that financial services are a crucial sector to foster economic growth and employment expansion,⁵⁵² in 1999 the Commission put forward the Financial Services Action Plan (FSAP). The FSAP laid down a timetable for the adoption of a series of 42 ambitious measures aimed at establishing wholesale market for financial services, strengthening investor protection, harmonising prudential regulation and financial supervision.⁵⁵³ The FSAP was accompanied by the Lamfalussy Report which introduced a new policy-making framework aimed at combining harmonisation with a sufficient degree of regulatory flexibility in order to rapidly adjust the system to the developments of finance.⁵⁵⁴

⁵⁴¹ C. Segré, *The development of a European capital market. Report of a Group of Experts appointed by the EEC Commission*. November 1966.

⁵⁴² First Directive of 11 May 1960 for the implementation of Article 67 of the Treaty.

⁵⁴³ Second Directive of 18 December 1962 adding to and amending the First Directive for the implementation of Article 67 of the Treaty.

⁵⁴⁴ Directive 73/183/EEC on the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions O.J. L 194/16 (1973).

⁵⁴⁵ Directive 79/279/EEC coordinating the conditions for the admission of securities to official stock exchange listing O.J. L 66/21 (1979).

⁵⁴⁶ Directive 80/390/EEC coordinating the Requirements for the Drawing Up, Scrutiny and Distribution of the Listing Particulars O.J. L 100/1 (1980).

⁵⁴⁷ Financial integration. Communication from the Commission to the Council. COM (83) 207 final, 20 April 1983.

⁵⁴⁸ Commission, *Completing the Internal Market*. White Paper from the Commission to the European Council (Milan, 28-29 June 1985). COM (85) 310 final, 28.

⁵⁴⁹ Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities O.J. L 375/3 (1985).

⁵⁵⁰ Directive 89/646/EEC on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of credit institutions O.J. L 386/1 (1989). See also Directive 77/780/EEC on the Coordination of Laws, Regulations and Administrative Provisions Relating to the Taking up and Pursuit of the Business of Credit Institutions O. J. L 322/30 (1977).

⁵⁵¹ Directive 93/22/EEC on investment services in the securities field (ISD) O.J. L 141/27 (1993).

⁵⁵² Commission, *Communication on Financial Services: Building a framework for action*, 28 October 1998.

⁵⁵³ Commission, *Communication on Implementing the framework for financial markets: action plan*. Brussels, 11 May 1999 COM(1999) 232 final.

⁵⁵⁴ Report of the Committee of Wise Men on the Regulation of European Securities Markets, (Lamfalussy report), November 2000. In the Nineteens important financial innovations have been introduced. For example, in 1987 the bankers of the Drexel Burnham Lambert Inc. invented the first CDO model. In 1993 the Boston asset manager State Street Global

With the FSAP Directives, the EU started to develop its own financial regulatory capacity, as distinct from the US and UK regulatory models which had been “passively cross-loaded” in the EU until the 2000s.⁵⁵⁵ The FSAP directives⁵⁵⁶ have been based on Art. 95 TEC (now Art. 114 TFEU) on the assumption that the higher the harmonisation of national laws, the higher the level of market integration.⁵⁵⁷ The MiFID I is an emblematic example of the paradigm shift from competition through differentiation (regulatory competition) to competition through (minimum) harmonisation. In other words, the shift from competition through differentiation to competition through harmonisation. In order to foster competition between trading venues the MiFID I removed the “concentration rule”, by which Member States required investment firms to route orders to regulated markets only, and introduced new (harmonised) trading venues.⁵⁵⁸ This regulatory change followed the first “technological revolution” in finance, namely the substitution of the manual transmission order mechanisms with the automatic trading or mechanical trading systems.⁵⁵⁹

The other important MiFID I change concerned intensification of the conduct of business rules. Whereas the Investment Service Directive laid down seven general principles that Member States were supposed to implement into national law, the MiFID I and the MiFID implementing directive⁵⁶⁰ designed a new system of conduct of business rules (conflict of interest, appropriateness, suitability, best execution, disclosure, conflict of interest client order handling rules) calibrated on the nature of client (retail, professional, eligible counterparty), service (advised, non-advised) and product (complex, non-complex).⁵⁶¹

A distinct feature of the FSAP harmonisation programme was its emphasis on a public enforcement rather than private enforcement of financial regulation. The Prospectus Directive⁵⁶², Transparency Directive⁵⁶³ and MiFID I⁵⁶⁴ harmonised the administrative sanctions but they did not harmonise civil law remedies in favour of investors. This regulatory choice has been motivated both by reasons of

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Advisors launched the Standard & Poor's Depository Receipts, known as “spider”, as the first Exchange Trade Fund (ETF). In 1994 a group of bankers of JP Morgan designed the first model of credit default swap (CDS).

⁵⁵⁵ See L. Quaglia, *Europe and the Governance of Global Finance*, Oxford, 2014, 63. But see E. Posner, N. Veron, *The EU and financial regulation: power without purpose?*, JEPP (2010) 3, p. 400 ss. who argue that the post FSAP regulation has been still based on the agenda elaborated in international fora.

⁵⁵⁶ See, in particular, MiFID I, Directive 2002/65/EC concerning the distance marketing of consumer financial services O.J. L 271/16 (2002); Directive 2003/6/EC on insider dealing and market manipulation O.J. L 96/16 (2003); Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading O.J. L 345/64 (2003).

⁵⁵⁷ See N. Moloney, *EU Securities and Financial Markets Regulation*, 3 ed., OUP, 2014, p. 27.

⁵⁵⁸ See G. Petrella, *MiFID, Reg NMS and Competition Across Trading Venues in Europe and United States*, Journal of Financial Regulation and Compliance (2010), 3, 257-271.

⁵⁵⁹ The automatic trading system was introduced in 1976 in the New York Stock Exchange (NYSE) (see http://www1.nyse.com/about/history/timeline_technology.html) and in 1986 in the London Stock Exchange (LSE) (see <http://www.londonstockexchange.com/about-the-exchange/company-overview/our-history/our-history.htm>).

⁵⁶⁰ Commission Directive 2006/73/EC implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive O.J. L 241/26 (2006).

⁵⁶¹ See M. Kruihof, W. van Gerven, *A Differentiated Approach to Client Protection: The Example of MiFID*, Financial Law Institute WP 2010/07.

⁵⁶² Art. 25 of Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading O.J. L 345/64 (2003). Art. 6 requires Member States to ensure that their laws, regulation and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus.

⁵⁶³ Art. 24 of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC O.J. L 390/38. Art. 7 for a general reference Article 7 requires Member States to ensure that their laws, regulations and administrative provisions on liability apply to the issuers.

⁵⁶⁴ Art. 51 of MiFID I.

necessity (it is easier to harmonise administrative sanctions than civil law remedies)⁵⁶⁵ and conviction (harmonised civil law remedies could give rise to opportunistic litigation by professional clients and endanger the efficiency of financial markets).⁵⁶⁶

The EU post-crisis legislation

Between 2009 to 2015 the EU legislator has proposed more than 40 legislative measures to tackle the various “crisis” triggered by the Lehman Brothers collapse: the subprime crisis phase (mid-2007 to September 2008), the systemic crisis phase (as of September 2008), the economic crisis phase” (as of 2009), the sovereign crisis phase (as of 2010) and the crisis of confidence in Europe phase (as from 2012).⁵⁶⁷ The EU post-crisis legislation could be analysed from the perspective of its harmonisation technique and its regulatory objectives.

Likewise the FSAP legislation, the post-crisis legislation, including the measures setting up the ESAs and, more critically, the Single Resolution Board (SRB)⁵⁶⁸, has been based on Art. 114 TFEU, the classical legal basis for the measures aimed at strengthening the functioning of the internal market.⁵⁶⁹ The other shared feature between the pre and post-crisis legislation is the public enforcement based approach to financial regulation. Whilst the ESFS, the SSM and SRM have located some supervisory and enforcement powers at the EU level, the private enforcement of financial regulation remains firmly based on national law and national enforcement mechanisms.⁵⁷⁰

However, unlike the FSAP legislation,⁵⁷¹ numerous post-crisis measures have been adopted by means of regulations. Directly applicable legal acts are intended to increase the functioning of the internal market,⁵⁷² reduce regulatory complexity and investment firms’ compliance costs,⁵⁷³ eliminate competitive distortions,⁵⁷⁴ ensure a level playing field between market participants with regard to specific obligations imposed on private parties (notification, disclosure, clearing).⁵⁷⁵ Undoubtedly, the maximum harmonisation of national laws, combined with the broadening of the scope of

⁵⁶⁵ See T. Tridimas, *EU Financial Regulation: Federalization, Crisis Management and Law Reform*, cit., p. 794.

⁵⁶⁶ See I. MacNeil, *Enforcement and Sanctioning*, in E. Ferran, N. Moloney, N. Payne (eds.), *Oxford Handbook on Financial Regulation*, cit., p. 293.

⁵⁶⁷ See E. Liikanen, High-level Expert Group on reforming the structure of the EU banking sector. Final report. October, 2012. For a complete overview of the EU post-crisis reforms, see House of Lords, *The post-crisis EU financial regulatory framework: do the pieces fit?*, European Union Committee, 5th Report of Session 2014–15, February 2015.

⁵⁶⁸ The SRM covers the credit institutions that fall in the remit of the SSM (Art. 2(1)).

⁵⁶⁹ The CJEU in the case C-270/12, *UK v. Parliament and Council*, EU:C:2014:18 (Short-Selling case) held that Art. 28 of Regulation No 236/2012 improves the conditions for the establishment and functioning of the internal market in the financial field and therefore Art. 114 TFEU is an appropriate legal basis for the adoption of Article 28 of Regulation No 236/2012.

⁵⁷⁰ New tortious liability regimes have been introduced by Art. 21 of Directive 2011/61/EU on Alternative Investment Fund Managers (AIFMD) O.J. L 174/1 (2011) and Art. 35 of Regulation (EU) No 462/2013 on Credit Rating Agencies O.J. L 146/1 (2013). The Commission’s proposals to introduce a civil liability regime in the MiFID II and in the PRIIPs Regulation have been dropped during the legislative process.

⁵⁷¹ For an exception, see Council Regulation (EC) No 2157/2001 on the Statute for a European company (SE) O.J. L 294/1 (2001).

⁵⁷² See recital No 3 of MiFIR.

⁵⁷³ See recital No 12 of Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (CRR) O.J. L 176/1 (2013); recital No 5 of Regulation (EU) No 596/2014 on market abuse (MAR) O.J. L 173/1 (2014); recital No 5 of MiFIR.

⁵⁷⁴ See recital No 12 of CRR; Recital No 5 of MiFIR.

⁵⁷⁵ See recital No 3 of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) O.J. L 201/1 (2012); recital No 5 of MAR.

regulatory intervention especially in the wholesale segment of the markets,⁵⁷⁶ will substantially reduce the margin of manoeuvre for Member States and financial market participants.

On the basis of its regulatory objectives, the post-crisis legislation can be divided into four groups. The first group of reforms reacted to “emergency” situations, such as the speculation on the default of sovereign borrowers,⁵⁷⁷ the infamous scandals (Madoff fraud)⁵⁷⁸ and the manipulation of the LIBOR index.⁵⁷⁹

The second group of EU reforms⁵⁸⁰ and particularly the CRR⁵⁸¹ and the CRD IV,⁵⁸² has reflected the objective, laid down by the international agenda (G20, the Financial Stability Board and Basel Committee on Banking Supervision), to ensuring financial stability namely by addressing the moral hazard problems posed by systemically important financial institutions (SIFIs)⁵⁸³ and other sources of systemic risk (e.g. shadow banking, market infrastructures, financial instruments, credit crunch, market illiquidity, leverage cycle).⁵⁸⁴

The third group of reforms, in line with the FSAP legislation, aimed at strengthening legal and market integration in the EU through substantive law-related and institutional innovations. On the substantive law level, the internal market building legislation has placed much emphasis on the protection of retail clients. The EU introduced new product distribution rules,⁵⁸⁵ disclosure rules for investment products⁵⁸⁶, product governance rules⁵⁸⁷ and product intervention rules.⁵⁸⁸

This set of measures has reacted to various factors: the widespread detriment caused to retail clients by mis-selling practices, the potential risks associated to structured financial products, the shortcomings of the traditional disclosure-based paradigm of retail market regulation and the increasing importance of financial services in the everyday life of EU citizens. Whereas the FSAP legislation aimed at “empowering” investors, through disclosure and financial literacy, this post-crisis measures aim at “protecting” investors, through new product governance and product intervention rules. The shift from

⁵⁷⁶ See the short-selling regulation, the AIFMD, the EMIR.

⁵⁷⁷ Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps O.J. L 86/1 (2012).

⁵⁷⁸ Directive 2014/91/EU on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS V) O.J. L 257/1 (2014) and AIFMD.

⁵⁷⁹ See MAR; Directive 2014/57/EU on criminal sanctions for market abuse O.J. L 173/1 (2014); proposal for a Regulation of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts, COM/2013/0641 final.

⁵⁸⁰ See recital No 1 of MiFIR (referring to G20); recital No 89 of AIFMD (referring to G20); recital No 5 of EMIR (referring to G20); recital No 7 of Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (ESRB Regulation) O.J. L 331/1 (2010).

⁵⁸¹ See recital No 1 of CRR (referring to BCBS and G-20)

⁵⁸² See recital No 79 of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD IV) O.J. L 176 (2013) (referring to FSB, BCBS, G-20).

⁵⁸³ FSB, *Reducing the moral hazard posed by systemically important financial institutions*, FSB Recommendations and Time Lines, 20 October 2010.

⁵⁸⁴ See L. Quaglia, *Europe and the Governance of Global Finance*, 50 who argued that the recommendations of the international fora have not been automatically transposed on the EU level. For a different view see D. Mügge, *Europe’s regulatory role in post-crisis global finance*, JEPP (2014) 3, p. 316 ss.

⁵⁸⁵ See Art. 25 seq. of MiFID II.

⁵⁸⁶ See Art. 5 seq. of PRIIPs Regulation.

⁵⁸⁷ See Art. 16 of MiFID II.

⁵⁸⁸ See Art. 40 seq. of MiFIR and Art. 15 seq. of PRIIPs Regulation.

the “reasonable investor” to “vulnerable consumer”⁵⁸⁹ has become apparent also in the institutional reforms. In the new European System of Financial Supervision (ESFS) the protection of investors take up a crucial role.⁵⁹⁰ The three ESAs⁵⁹¹ – the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) – have a “consumer protection” task and have specific powers in order to promote transparency, simplicity and fairness in the market for consumer financial products or services across the internal market.⁵⁹²

The four group of reforms has given rise to the European Banking Union (EBU) which is composed of the SSM, the SRM and the “single rule book”⁵⁹³. Whereas the internal market driven legislation has been driven by market integration and competition, the EBU is mainly driven by the need of severing the vicious banks-sovereign circle and ensure financial stability in the Euro zone.⁵⁹⁴ As it is well known, the SSM and SRM do not cover the entire internal market but only the Euro area.⁵⁹⁵ Moreover, unlike the ESFS, the SSM and SRM have not been tasked with the protection of consumers/investors.⁵⁹⁶ The EBU may well have an indirect impact on the firm-client relationship⁵⁹⁷ but investor protection considerations will rank after the micro and macro prudential concerns.

Another important difference between the internal market and EBU concerns the idea of investor behind this legislation. Unlike the MiFID II, MiFIR, PRIIPs and ESAs Regulation which endorse the model of a “consumer-investor”, the BRRD implicitly backs the model of the informed, reasonable and self-responsible investor. The removal of states’ support to failing banks and the emphasis on bail-in will require investors (especially shareholders or bondholders) to assess the creditworthiness of the bank (debtor). This is particularly dangerous for retail unsophisticated clients because in the current period of low interest rates they could be attracted by the financial instruments issued by credit institutions to meet the minimum requirements for bailinable own funds and eligible liabilities.⁵⁹⁸

⁵⁸⁹ See in particular N. Moloney, *The Investor Model Underlying the EU’s Investor Protection Regime: Consumers or Investors?*, EBOR (2012) 13, p. 169 ss.

⁵⁹⁰ See, in particular, B. Haar, *Organizing Regional System. The EU example*, in E. Ferran, N. Moloney, N. Payne (eds.), *Oxford Handbook on Financial Regulation*, cit., p. 158 ss.

⁵⁹¹ Regulation (EU) No 1093/2010 of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) Decision 2009/78/EC (EBA Regulation) O.J. L 331/12 (2010); Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority) O.J. L 331/48 (2010); Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority) (ESMA Regulation) O.J. L 331/84 (2010). In the hereinafter “ESAs Regulations”.

⁵⁹² See Art. 9 of ESAs Regulations.

⁵⁹³ The single rule book is composed of the CRR, CRD IV, the BRRD and the Directive 2014/49/EU on deposit guarantee schemes O.J. L 173 (2014). See also European Commission, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 806/2014 in order to establish a European Deposit Insurance Scheme, Strasbourg, 24 November 2015 COM(2015) 586 final.

⁵⁹⁴ See H.-W. Micklitz, *The Transformation of Private Law through Competition*, in this Working Paper, p. 56; T. Beck, *Does Europe Need a Capital Market Union? And How Would We Get There?*, in F. Allen, E. Carletti, J. Gray (eds.), *The New Financial Architecture in the Eurozone*, 2015, Fiesole, p. 120.

⁵⁹⁵ Notably, the SSM has been based on Art. 127 (6) TFEU, the SRM has been based on Art. 114 TFEU.

⁵⁹⁶ See recital No 28 of SSM Regulation.

⁵⁹⁷ See S. Grundmann, *The Banking Union Translated into (Private Law) Duties: Infrastructure and Rulebook*, EBOLR (2015), p. 1 ss.; C. Hadjiemmanuil, *The Banking Union and Its Implications for Private Law: A Comment*, EUI Working Paper RSCAS 2015/74, p. 7

⁵⁹⁸ Article 45 of BRRD and Article 12 of SRM Regulation. In addition to this, the Single Resolution Fund may make a contribution to the institution under resolution subject to a number of strict conditions including the requirement that losses totalling not less than 8 % of total liabilities including own funds have already been absorbed, and the funding provided by the Fund is limited to the lower of 5 % of total liabilities including own funds or the means available to the Fund and the amount that can be raised through ex-post contributions within three years

Second, banks and investments firms, under the pressure to issue a minimum level of bailinable debt may be incentivized to undertake more aggressive distribution practices with the risk of increasing mis-selling.

After the crisis-driven legislation, in 2015 the Capital Market Union project has brought back the model of the “responsible investor” in the EU retail market regulation agenda. Disclosure, transparency and financial literacy become again a fundamental tool to allow investors, in the present context of declining deposit rates, to shift their financial wealth from banks into market securities.⁵⁹⁹ The “empowering investor” strategy underpins also the Green Paper on retail financial services which complements the other EU initiatives (CMU, the Digital Single Market⁶⁰⁰ and the Single Market Strategy⁶⁰¹) aimed at rebuilding the consumers’ confidence in the internal market and boosting growth. In fact the Green Paper views new technological developments and financial innovations as opportunities to increase consumers’ choice rather than a challenge for their effective protection⁶⁰² and reconsiders the importance of disclosure in helping investors accessing the internal market, choosing better products and switching from one product to a cheaper one.⁶⁰³

The rationales and objectives of contract law in the EU financial markets

Retail market regulation is at the forefront of economic, technological and societal changes. Before the global financial crisis, EU regulators have supported technological developments, financialization of economy⁶⁰⁴ and society⁶⁰⁵ in order to increase financial integration in the EU. Between 2009 and 2015 EU regulators have principally pointed out, through a set of “consumer protective” measures, the potential dangers created by these drivers. After 2015 they have strengthened (again) the link between technological developments, financialisation of economy and society and market integration. So far this new move towards market-finance and competition has remained at the level of policy stances and it has not yet been translated into legislative texts.

Yet, the question arises what role contract law play in EU financial regulation and whether the evolution of EU retail regulation will have any impact on national contract law.

⁵⁹⁹ Commission, Building a Capital Markets Union. Green paper, COM/2015/063 final, p. 20. See T. Beck, *Does Europe Need a Capital Market Union? And How Would We Get There?*, in F. Allen, E. Carletti, J. Gray (eds.), *The New Financial Architecture in the Eurozone*, Florence, p. 120.

⁶⁰⁰ Commission Communication: A Digital Single Market Strategy for Europe (http://ec.europa.eu/priorities/digital-single-market/docs/dsm-communication_en.pdf).

⁶⁰¹ Communication from the Commission to the European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions – Upgrading the Single Market: more opportunities for people and business, COM (2015) 550 Final.

⁶⁰² Commission, *Green Paper on retail financial services. Better products, more choice, and greater opportunities for consumers and businesses* COM(2015) 630 final. See also *See OECD, G20 High-Level Principles on Financial Consumer Protection*. October, 2011. On the risks of “financial-inclusion” driven policies see, in particular, G. Comparato, *The rationales of financial inclusion in the changing European private law*, cit., p. 22 ss.

⁶⁰³ Commission, *Green Paper on retail financial services*, p. 14.

⁶⁰⁴ Financialisation of economy indicates the increasing importance of financial markets, financial motives, financial institutions, and financial elites in the operation of the economy and its governing institutions See T. I. Palley, *Financialization: What It Is and Why It Matters*, *The Levy Economics Institute and Economics for Democratic Economics for Democratic and Open Societies Washington D.C.* Working paper 525/2007.

⁶⁰⁵ Financialisation of society indicates the increasing importance of financial instruments in everyday life and in the supply of welfare-related services (e.g. pensions). See N. Moloney, *Regulating the Retail Markets*, in N. Moloney, E. Ferran, J. Payne (eds.), *The Oxford Handbook of Financial Regulation*, Oxford, 2015, p. 764.

Traditionally, contract law has been regarded as one of the externally-imposed regimes which limits the private autonomy of financial market participants.⁶⁰⁶ Unlike in other regulated sectors, in the field of financial services the EU has not yet harmonised the rules governing the formation, performance, interpretation of contracts and contractual remedies. EU law governs the firms' conduct and financial products but does not govern the contract. This is the minimum common denominator across the various phases of EU retail market regulation. The harmonisation of financial regulation has been achieved through legislative measures of non-contractual nature addressed to Member States and NCAs as regulators rather than private parties.⁶⁰⁷ This regulatory choice was intended to set up a self-sufficient architecture of duties, standards, principles and sanctions in order to achieve its regulatory objectives without need to rely on national contract law.⁶⁰⁸

That means that EU financial regulation is insensitive to national contract law but it does not clearly mean that national contract law is insensitive to EU financial regulation. Before analysing the impact of EU financial regulation on national contract law, it is important to identify the rationales and objectives contract law in financial markets.⁶⁰⁹ What contract law could add to the legal framework of retail financial transactions and what could be its functions?

In financial markets the law of contract can be based on the following rationales: autonomy, efficiency or functionalism. The autonomy-based theories consider the law of contract as a tool to protect and facilitate the individual autonomy.⁶¹⁰ The efficiency-based theories argue that contract law should maximize the joint gains (the "contractual surplus") of the parties from the transaction.⁶¹¹ The functionalistic-based theories argue that the law of contract should be driven by an heteronomous driver which nevertheless does not correspond to efficiency to others regulatory goals, such as the protection of weaker parties and the competition between services' providers.⁶¹² Whilst the autonomy and efficiency-based theories agree on the fact that the enforcement of contractual obligations is the main objective of the law of contract, the functionalistic-based theories claim that the law of contract can serve different objectives, including the protection of investors, the stability of individual banks and the financial system.⁶¹³

To increase the protection of the retail unsophisticated client vis-à-vis the information and bargaining power of credit and investment firms, some national legislations establish that the contract clauses setting lower standards than that laid down by national law transposing EU financial regulation are

⁶⁰⁶ See C. Goodhart, P. Hartmann, D. Llewellyn, L. Rojas-Suarez, S. Weisbrod, *Financial Regulation - Why, How And Where Now?*, 1998, p. 3.

⁶⁰⁷ L. Azoulai, *The Complex Weave of Harmonization*, in D. Chalmers, A. Arnulf (eds.), *The Oxford Handbook of European Union Law*, Oxford, 2015, p. 610.

⁶⁰⁸ On the concept of self-sufficiency see H.-W. Micklitz, Y. Svetiev, *A Self-Sufficient European Private Law – A Viable Concept?*, EUI Working Papers Law No. 2012/31.

⁶⁰⁹ For the purpose of this study, the rationale means the reason why contract law exists; the objective means the final outcome that the law of contract wants to achieve. See for a similar perspective C. Hadjiemmanuil, *The Banking Union and Its Implications for Private Law: A Comment*, EUI Working Paper RSCAS 2015/74, p. 7.

⁶¹⁰ See A. Hudson, *Law of Finance*, London, 2013, p. 13; M. Bridge, J. Braithwaite, *Private Law and Financial Crises*, JCLS (2013) 2, p. 1.

⁶¹¹ See A. Schwartz, R. E. Scott, *Contract Theory and the Limits of Contract Law*, YLJ (2003) 113, p. 1 ss.

⁶¹² See H.-W. Micklitz, *The Visible Hand of European Regulatory Private Law—The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation*, cit., p. 1 Undoubtedly, efficiency-driven theories have integrated the European functionalism because the limitations of private autonomy, imposed through mandatory rules, have been often justified by the need of preventing market-failures (e.g. information asymmetry, market power and agency costs). See S. Grundmann, W. Kerber, S. Weatherill (eds.), *Party Autonomy and the Role of Information in the Internal Market*, De Gruyter, 2001.

⁶¹³ See H.-W. Micklitz, *The Transformation of Private Law through Competition*, in this Working Paper, p. 58.

ineffective⁶¹⁴ or confer on retail investors the power to claim compensation for the losses suffered as a result of the firms' breach of their conduct of business rules.⁶¹⁵

To enhance the effectiveness of banking resolution tools, Art. 55 of BRRD requires institutions and entities to include a contractual term by which the creditor or party to the agreement creating the liability recognises that liability may be subject to the write-down and conversion powers. This contractual recognition of bail-in principally aims at preventing the contractual circumvention of bail-in through contracts governed by a non-EU law and contributes to strengthening the legal and commercial certainty.⁶¹⁶

To protect sovereigns in times of market turmoils, Art. 12 (3) of the Treaty establishing the European Stability Mechanism provided, amongst other things, for the mandatory inclusion of standardised and identical Collective Action Clauses (CACs) in all new Euro area sovereign bonds from 1 January 2013. The CACs aim to ease the process of sovereign debt restructuring and to discourage holdout behaviors but they can also signal an end to bailouts and reassert national autonomy over government debt contracts.⁶¹⁷

The role of the national courts

These three examples are illustrative of the multiple objectives that contract law can achieve. However, it is interesting to note that whereas the EU has started to use contract law mechanisms to ensure the full achievement of the objectives of the resolution procedure and protect sovereigns, it still refrains from introducing harmonised contract law rules for the firm-client relationship.⁶¹⁸ Similarly, the national legislators have generally refrained from introducing express civil law or contract law remedies in favour of retail clients when the firm contravenes EU financial regulation (as transposed by national law). Both the EU and (the majority of) national legislators have kept separated national contract law duties-remedies and financial regulatory duties-sanctions. Therefore, the question arises whether the breach of a regulatory duty gives rise to a contract law remedy or, to put it otherwise, whether financial regulatory duties can be enforced by means of contract law remedies. To this crucial question, national courts have given different answers.

In many civil law countries, national courts have established that the firm's breach of its MiFID I conduct of business rules gives rise to a contract law remedy, such as the termination of the contract, pre-contractual damages or avoidance for mistake.⁶¹⁹ At the basis of this judicial translation of regulatory duties into private law duties lies the functionalistic or purposive-oriented interpretation of national contract law, i.e. courts interpret contract law remedies in light of the purpose of conduct regulation.⁶²⁰ Such judicial reasoning determines the "Europeanisation" of national contract law: contract law remedies become a tool to strengthen the retail client regulation.

⁶¹⁴ See C. Hadjiemmanuil, *The Banking Union and Its Implications for Private Law: A Comment*, cit., p. 5; D. Busch, *Why MiFID matters to private law—the example of MiFID's impact on an asset manager's civil liability*, CMLJ (2012) 4, p. 400.

⁶¹⁵ See Section 138D of Financial Services and Markets Act 2000 (FSMA).

⁶¹⁶ A. Gardella, *Bail-in and the Financing of Resolution within the SRM Framework*, in D. Busch, G. Ferrarini (eds.), *European Banking Union*, Oxford, 2015, p. 373 ss.

⁶¹⁷ See M. Gulati, A. Gelper, *The wonder-clause*, *Journal of Comparative Economics* 41 (2013) p. 367 ss.

⁶¹⁸ See Art. 31 (2) of BRRD.

⁶¹⁹ F. Della Negra, *The private enforcement of the MiFID conduct of business rules. An overview of the Italian and Spanish experiences*, ERCL (2014) 4, p. 590

⁶²⁰ See Tribunal Supremo, 13 October 2015, n. 550; 26 February 2015, n. 115; 7 July 2014, n. 384; 20 January 2014, n. 840/2013.

By contrast, in the UK the regulatory duties have been translated into private law duties only by the legislator which empowered private persons to claim damages for the firm's failure to comply with certain conduct of business rules.⁶²¹ The courts instead refuse to enforce regulatory standards through private law remedies and to interpret the common law in light of the purpose of these regulatory standards. Therefore, a contract clause disclaiming the firm's liability for negligent advice cannot be attacked on the basis of the fact that, by doing so, the firm breached its conduct obligations.⁶²² In fact, as a Judge recently pointed out in a case where the bank negligently advised its client but successfully disclaimed its liability, "while the result may seem harsh to some, it is not the role of the common law and this court to act as a regulator".⁶²³ For this reason, apart from very few cases,⁶²⁴ English courts have constantly affirmed that the breach of financial regulation cannot give rise to any remedy based on common law.⁶²⁵

The separation between contractual and regulatory standards is based on the idea that contract law should facilitate private autonomy and do nothing else. The facilitative role of contract law creates the environment for financial innovation,⁶²⁶ ensures commercial and legal certainty⁶²⁷ and strengthens the regulatory power of English courts. The reason why they have become "global regulators"⁶²⁸ of financial derivatives contracts is their capacity to give full effect to the self-regulation established by standardized terms namely by referring to the historical meaning and the intent of the original drafters, rather than to the intentions of the specific parties.⁶²⁹

Yet, there is an important difference between the financial litigation in the UK and in continental Europe. Whereas in continental Europe financial litigation mainly concerns retail clients disputes, where the value at stake is relatively low and the information/bargaining power asymmetry between the parties very high, in the UK financial litigation concerns high value claims between professional clients who are supposed to have similar informative/bargaining power.

The role of the EU courts

Whilst before the crisis the CJEU had not played a major role in the development of EU financial regulation,⁶³⁰ after the crisis it has dealt with three important cases concerning the validity of the EU post-crisis measures⁶³¹ and, for the first time, with one case regarding the interpretation of the MiFID I

⁶²¹ Section 138D of FSMA. On the interpretation of this provision see, in particular, *Titan Steel Wheels Ltd v The Royal Bank of Scotland Plc* [2010] EWHC 211 (Comm).

⁶²² See, in particular, *Peekay Intermark Limited, Harish Pawani v Australia and New Zealand Banking Group Limited* [2006] EWCA Civ 386 and *JP Morgan Chase Bank v Springwell Navigation Corporation* [2008] EWHC 1186 (Comm) 2008 WL 2148250.

⁶²³ See *Crestsign Ltd v NatWest and RBS* [2014] EWHC 3043 (Ch).

⁶²⁴ See *Loosemore v Financial Concepts* [2001] Lloyd's Rep. P.N. 235; *Seymour v Caroline Ockwell & Co.* [2005] EWHC 1137 (QB); *Shore v Sedgwick Financial Services Ltd* [2007] EWHC 2509 (QB).

⁶²⁵ See *Green v Royal Bank of Scotland Plc* [2012] EWHC 3661 (QB).

⁶²⁶ At the same time the decisions and ratio decidendi of these complex cases strengthen the transparency of these markets. See J. P. Braithwaite, *OTC derivatives, the courts and regulatory reform*, CMLJ (2012) 4, p. 364 ss.

⁶²⁷ See M. Bridge, J. Braithwaite, *Private Law and Financial Crises*, JCLS (2013) 2, p. 1.

⁶²⁸ C. A. Whytock, *Domestic Courts and Global Governance*, TLRev (2009) 68 ss.; J. Braithwaite, *The impact of crises by way of the courts*, JIBFL (2014) 3, 147.

⁶²⁹ See S. J. Choi, G. M. Gulati, *Contract as Statute*, MLRev. (2006) 104, p. 1129 ss.; R. J. Gilson, C. F. Sabel, R. E. Scott, *Contract and innovation: the limited role of generalist courts in the evolution of novel contractual forms*, NYULRev. (2013) 88, p. 172.

⁶³⁰ See N. Moloney, *Financial Market Regulation*, Oxford, 2015, p. 772.

⁶³¹ Case C-270/12, *United Kingdom of Great Britain and Northern Ireland v European Parliament, Council*, ECLI:EU:C:2014:18 (unsuccessful); Case C- 507/13, *United Kingdom of Great Britain and Northern Ireland v European*

conduct of business rules (*Genil v. Bankinter*).⁶³² Moreover, some depositors/shareholders have brought two actions for damages to the General Court, alleging non-contractual liability of the European Union for the damages caused to the applicants by the bail-in measures imposed by the EU on the Republic of Cyprus.⁶³³

For our purposes, the most relevant case, is *Genil v. Bankinter*. This case was referred by a Spanish court to the CJEU at the peak of the wave of financial litigation on complex financial products which has inundated Spain and the other EU countries since 2008. The referring court asked the CJEU, among other things, whether the omission of the appropriateness and suitability test provided for by Art. 19 (4) and (5) of MiFID I in relation to the distribution of an interest rate swap to a retail investor, determines the absolute nullity of the contract entered into between the investor and the investment institution. The CJEU held that, since the MiFID I lays down administrative sanctions for the firm's breach of national provisions transposing the directive but it does not require the Member States to provide for contractual consequences, it is for the internal legal order of each Member State to determine the contractual consequences of non-compliance with those obligations, subject to observance of the principles of equivalence and effectiveness.⁶³⁴

By referring to the *Genil v. Bankinter* case the Spanish Supreme Court has recently declared the nullity of an interest rate swap distributed to a retail client because the bank did not carry out the suitability test under Art. 19 (5) of MiFID I.⁶³⁵ However, in other jurisdictions (Italy, France, Netherlands) the breach of this rule cannot determine the avoidance of the contract but only the liability of the investment firm⁶³⁶ and in the UK investment firms can be held liable only on the basis of the statutory cause of action of Section 138D of FSMA 2000.⁶³⁷ Whether these different judicial approaches are in line with the principle of effectiveness of EU law can be doubted.

The problem is that the CJEU did not clarify whether Member States have the obligation to establish a contractual remedy if the firm fails to comply with its conduct of business rules and how the effectiveness of that remedy should be assessed. It could be argued that Member States, in light of the principle of procedural autonomy, are free to decide not to introduce any contractual remedy for the investors. However, this line of reasoning would give rise to the paradoxical consequence that only those Member States that establish contractual remedies could be subject to the requirement of effectiveness and equivalence.⁶³⁸ Moreover, the case law of the CJEU has shown, in many different areas, that the principle of the procedural autonomy does not mean that Member States are free to regulate or not to regulate a specific matter but it rather establishes their competence to regulate the matters that have not been covered yet by EU law.⁶³⁹

(Contd.) _____

Parliament and Council, ECLI:EU:C:2014:2394 (The Advocate General JÄÄSKINEN concluded for the dismissal of the action and the UK withdrew the action); Case C-209/13, *United Kingdom of Great Britain and Northern Ireland v Council*, ECLI:EU:C:2014:283 (unsuccessful).

⁶³² CJEU, case C-604/11, *Genil v. Bankinter*, ECLI:EU:C:2013:344.

⁶³³ Case T-405/14, *Yavorskaya v Council and Others v. Council e. a.*; case T-680/13, *K. Chrysostomides & Co. e.a. v Council e.a.*

⁶³⁴ CJEU, case C-604/11, *Genil v. Bankinter*, para 56.

⁶³⁵ Tribunal Supremo, 26 February 2015, n. 115.

⁶³⁶ See O.O. Cherednychenko, *Contract Governance in the EU: Conceptualising the Relationship between Investor Protection Regulation and Private Law*, ELJ (2015) 21, p. 500 ss.

⁶³⁷ See P. Reynolds, *Selling financial products: the interface between regulatory and common law standards*, JIBLR (2014) 5, p. 269 ss.

⁶³⁸ See also S. Grundmann, *The Bankinter Case on MIFID Regulation and Contract Law*, ERCL (2013) 3, p. 267 ss.

⁶³⁹ See, for this opinion, W. Van Gerven, *Of Rights, Remedies and Procedures*, CMLRev (2000) 3, p. 501 ss.; C.M. Kakouris, *Do the Member States Possess Judicial Procedural "autonomy"*, CMLRev (1997) 6, p. 1389; S. Prechal, *Community Law in National Courts: the Lessons from Van Schijndel*, CMLRev (1998) 2, p. 681 ss.

The role of extra-judicial enforcement mechanisms

It is not possible to understand the institutional role played after the global financial crisis by national courts without taking into account the increasing relevance of the ADR mechanisms. At the EU level, the harmonization of ADRs has become an essential element of the retail financial market regulation and it reflects the societal trend of the transformation of the citizen into a “financial citizen”. As financial services have become essential for the everyday life, the settlement of disputes between services’ providers and clients should be designed in order to ensure an effective, cheap and informal access to justice for retail clients. This rationale accounts for the trend from a convergence towards the harmonization of ADR schemes in the EU. In 2001 the European Commission launched an out-of-court complaints network called “FIN-NET” in order to facilitate cross-border retail client dispute resolution,⁶⁴⁰ in 2004 the MiFID I required Member States to establish “efficient and effective complaints and redress procedures for the out-of-court settlement of consumer disputes” (Art. 53) and in 2014 the MiFID II reiterated the same principle and further imposed to the national authorities the obligation to notify ESMA of the complaint and redress procedures (Art. 75). Moreover, under the MiFID II, Member States shall set up mechanisms “to ensure that compensation may be paid or other remedial action be taken in accordance with national law for any financial loss or damage suffered as a result of an infringement of this Directive or of Regulation (EU) No 600/2014” (Art. 69). Although this innovative provision, which was added by the Parliament to the MiFID II Commission’s proposal,⁶⁴¹ does not introduce an express remedial action for the firm’s breach of MiFID II and MiFIR, it seem to transpose to the EU level the model of the consumer redress scheme operated by the FCA in the UK on the basis of Section 404 of FSMA 2000.⁶⁴²

The most important question is whether these extra-judicial mechanisms represent only a means to resolve a dispute or whether they can also perform an EU law-enforcement function. This question is relevant in order to assess whether the EU is considering the private enforcement via ADRs as a part of its regulatory strategy to improve the functioning of the internal market. In some Member States (Italy and Spain) ADRs have been originally designed as an “emergency measure” to compensate the losses suffered by investors due to widespread mis-selling scandals and lighten the work load of national courts. The research has shown that, although the procedural schemes remain very diverse even in the same jurisdiction, national ADRs (e.g. *Arbitro Bancario Finanziario* in Italy and the *Comisionado para la Defensa del Cliente* in Spain) increasingly take into account statutory law, the case law of the Supreme Courts and the principles of financial regulation to motivate their decisions.⁶⁴³

In the UK the Financial Ombudsman Service (FOS) determines the complaint by reference to what is “fair and reasonable in all the circumstances of the case”.⁶⁴⁴ English courts have emphasized the special nature of this adjudicating body by holding that the FOS is not bound by common law⁶⁴⁵ and that its determinations can be set aside by means of judicial review only if “his opinion as to what is

⁶⁴⁰ See also Commission, Communication on alternative dispute resolution in the area of financial services. Brussels, 11.12.2008 MARKT/H3/JS D(2008).

⁶⁴¹ Art. 72 of MiFID II (version adopted by the European Parliament on 26 October 2012 (COM(2011)0656 – C7-0382/2011 – 2011/0298(COD))).

⁶⁴² The FCA can require financial firms to establish and operate a consumer redress scheme when there may have been a widespread or regular failure by relevant firms to comply with its conduct of business rules, consumers have suffered (or may suffer) loss or damage and it considers that it is desirable to make rules for the purpose of securing that redress is made to the consumers. It is for the firm to investigate whether it has failed to comply with the conduct of business rules, to determine whether the failure has caused any loss or damage to consumers and to award compensation.

⁶⁴³ See F. Della Negra, *The private enforcement of the MiFID conduct of business rules. An overview of the Italian and Spanish experiences*, ERCL (2014) 4, p. 590

⁶⁴⁴ See Section 228 FSMA 2000. The FOS shall take into account, among other things, the relevant law and regulations (DISP 3.6.4 of FCA Handbook Dispute Resolution Complaints).

⁶⁴⁵ See *R. (on the application of London Capital Group) v Financial Ombudsman Service Ltd* [2013] EWHC 2425 (Admin).

fair and reasonable in all the circumstances of the case is perverse or irrational”.⁶⁴⁶ The nature of the FOS’ adjudication, together with its broad competence (up to 150,000£), gives to retail unsophisticated investors, who could not afford access to courts, an effective way to protect their rights vis-à-vis financial firms.

The role of EU supervision and public enforcement

The establishment of ESAs and conferral of micro-prudential supervisory powers to the ECB confirm the public enforcement-oriented approach of the EU. However, the new tasks and powers conferred on these EU authorities and, in particular the consumer protection task of the ESAs, increase the interactions between financial regulation and national contract law. The ESMA has been entrusted with the objective of protecting customers (Art. 1 (5) (f)) and with the task of protecting investors (Art. 8 (1) (h)) and consumers (Art. 9). Strangely whereas the legislator refers to the different notions of consumer, investor, customer, it has not mentioned that of client which is expressly defined by the MiFID I/II and other relevant financial directives.

Despite this terminological confusion, both consumers and retail clients fall into the ESMA’s remit.

Firstly, ESMA can take action not only when the service involved a retail client, as defined by the MiFID II, but also when it involves a consumer if its action is necessary to ensure the effective and consistent application of EU law (Art. 1 (3)). This interpretation also reflects the composition of its Stakeholder Group which shall include, among others, representatives of “consumers and users of financial services” (Art. 37 (2)). Moreover, ESMA can take action to protect both retail and professional clients. Had the ESMA’s mandate been restricted only to the protection of consumers, ESMA could protect only the retail clients who are natural persons.

The ESAs do not have direct competence with regard to complaints against a credit or financial institution. However, under Art. 17 of ESAs Regulations they can open investigations and take further actions concerning the failure of national competent authorities to comply with their obligations. Moreover, in the framework of their consumer protection’s task, the ESAs can adopt a wide range of measures (draft technical standards, guidelines and recommendations, warnings and product intervention) which can have an impact on both the contract-making and enforcement. First, both (quasi) regulatory and supervisory acts may perform a contract-shaping function namely they can be used to (or they may have the effect to) limit the parties’s autonomy to enter into transactions or to decide the content of the transaction.⁶⁴⁷ In particular, guidelines/recommendations can set higher standards of client protection than those established by EU law.⁶⁴⁸ Although guidelines are not binding, the NCAs and market participants shall make every effort to comply with them and the reiterated firm’s non-compliance with a guideline, in so far as determines a breach of the relevant EU

⁶⁴⁶ See *R. (on the application of IFG Financial Services Ltd v Financial Ombudsman Services Ltd v Mr and Mrs Jenkins* [2005] EWHC 1153 (Admin).

⁶⁴⁷ By referring to the content of the transaction, rather than the contract, I consider both the rules which impose certain duties to conduct to the parties (e.g. pre-contractual information duties) and those that specify the content of the contract (e.g. the price of goods and services).

⁶⁴⁸ See *Y. Svetiev-A. Ottow*, *Financial Supervision in the Interstices Between Private and Public Law*, *ERCL* (2014) 4, p. 496 ss.

See ESMA, *Guidelines on certain aspects of the MiFID suitability requirements*, 6 July 2012, ESMA/2012/387. ESMA states that the age, family situation or educational level of the client should be included into the “necessary information” the firm must collect when assessing client’s suitability under Art. 25 (2) MiFID II (para 34). See also ESMA, *Guidelines on ETFs and other UCITS issues*, 18 December 2012, ESMA/2012/832 where ESMA imposes to the UCITS’ managers duties to conduct that have not been laid down in the relevant UCITS legislation (para 22, 37, 43).

law, may activate enforcement proceedings under Art. 17 of ESAs Regulations.⁶⁴⁹ Similarly, practical convergence tools intended to build consistent supervisory practices pursuant to Art. 29 (2) of ESAs Regulations,⁶⁵⁰ may have the effect of driving the parties' conduct and to affect the content of their contracts.

Against the contract-shaping function of ESAs acts it could be argued that ESAs, unlike some NCAs, do not have the power to terminating, suspending, modifying obligations arising from contracts and therefore cannot take measures which interfere with the parties' contractual obligations. However, the fact that ESAs have not been entrusted with express "contract-intervention" powers is the logical corollary of the EU choice of regulating financial contracts as products; this choice serves, among other things, the purpose of increasing the effectiveness of the EU regulatory intervention by preventing Member States to circumvent EU regulation through their national contract laws. This consideration does not indicate, however, that the concrete exercise of ESAs powers do not affect national contract law. If market participants could challenge an ESAs act addressed to them because it interferes with their contractual obligations, the ESAs consumer protection mandate would lose its effectiveness and credibility. Financial transactions are based on contracts and any intervention affecting the transaction may produce spill-over effects on the contract.

With regard to private enforcement, the main issue arises whether the decisions of the ESAs (and the ECB) can be binding on national courts. For example, in the event that the investors claims damages against the bank for the alleged mis-selling of a complex product that has been subsequently banned by ESMA, is the national court bound by the ESMA's decision or can the court decide that the product was suitable for this investor? In the field of competition law, EU law requires national courts to take decisions that do not run counter the decisions of the European Commission and the NCAs but in the field of banking and finance there is a lack of coordination between public and private enforcement.⁶⁵¹

It is doubtful whether national courts can deviate from a decision of the ESAs or the ECB.⁶⁵² In conformity with the principles of the separation of powers and rule of law, which are common to the constitutional traditions of Member States, the national courts should not be bound by the decisions of the ESAs and NCAs. But it could also be argued that to the extent that ESMA and NCAs ensure the consistent application and interpretation of the EU legislation (Art. 8 (1) (b) ESAs Regulations), national courts, which have the obligation to interpret national law in light of the objective of EU law, should follow the EU law interpretation given by ESMA. If the court's judgments run counter the ESAs' decisions, the ESAs mandate of ensuring the effectiveness and convergence of EU regulatory standards would be utterly frustrated.

The impact of the SSM on national contract law is less evident because the ECB does not have any investor/consumer protection mandate.⁶⁵³ For this reason, the ECB may not take action or base its instructions to NCAs exclusively or even mainly on concerns of consumer protection. But when a detrimental business conduct is systemic and it is capable of undermining the stability of the financial markets the ECB should coordinate with NCAs and take adequate action.⁶⁵⁴ A concrete scenario in

⁶⁴⁹ See European Commission, *Report to the European Parliament and the Council on the evaluation of the Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps*, COM(2013) 885 final.

⁶⁵⁰ See, for example, ESMA, *Questions and Answers. Application of the AIFMD*, 21 July 2014, ESMA/2014/868.

⁶⁵¹ Art. 9 of Directive 2014/104/EU of 26 November 2014 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 O.J. L 349/1 (2014) and art. 16 of 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 O.J. L 1/1 (2003).

⁶⁵² See S. Grundmann, *The Banking Union Translated into (Private Law) Duties: Infrastructure and Rulebook*, EBOR (2015), p. 19.

⁶⁵³ Recital No 28 of SSM Regulation.

⁶⁵⁴ See S. Grundmann, *The Banking Union Translated into (Private Law) Duties: Infrastructure and Rulebook*, cit., p. 18.

which the SSM's division between prudential and conduct supervision could be challenged is the mis-selling of hybrid capital instruments and subordinated debt instruments.⁶⁵⁵ These financial instruments provide additional external capital to banks in times of financial distress but they can pose particular risk to retail clients due to their complex loss absorption mechanisms⁶⁵⁶ or because they are issued to offset limited equity and insured deposits⁶⁵⁷.

To avoid the risk of consumer detriment, the UK FCA has permanently restricted the distribution of COCOs to ordinary retail clients.⁶⁵⁸ By contrast, in Spain the national competent authorities did not take any preventive measure to restrict the distribution of hybrid instruments (*participaciones preferentes*) to retail clients by banks subject to the resolution procedures of the Fund for Orderly Bank Restructuring (FOBR).⁶⁵⁹ Rather, given the large scale of detriment caused by such products to investors, these banks (Bankia, Catalunya Caixa, NCG Banco) set up a special-purpose arbitration, under the supervision of a commission of inquiry (*Comisión de seguimiento de instrumentos híbridos de capital y deuda subordinada*) the main purpose of compensating the investors taking into account the need not to aggravate taxpayers. Similarly, in Italy the Government has recently proposed to up a special arbitration procedure in order to compensate investors who suffered a loss as a result of the distribution of subordinated debt instruments by banks that have been subject to resolution procedures.⁶⁶⁰ The Spanish and Italian cases show that the banks' crisis and large scale distribution of hybrid capital instruments are strictly correlated and that widespread mis-selling practices can indicate a deterioration of the prudential situation of banks.

Concluding remarks

The unprecedented changes undergone by the EU after the global financial crisis have not directly transformed the contract governance of retail financial transactions. The key retail market legislation (MiFID I, MiFID II, PRIIPs Regulation) does not harmonise national contract laws and remedies. Therefore, whereas regulatory duties and sanctions have been increasingly harmonised, contractual duties and remedies remain based on national law. In spite of that, the EU plays an increasingly important influence on contract law in the "law in action" because both many national courts and ADRs take into account the EU regulatory standards when interpreting national contract law. However, this claim cannot be generalised.

The English courts interpret financial contracts in order to protect the private autonomy of the parties and reject any purposive-oriented interpretation of national common law in light of EU financial regulation. Contract law serves to facilitate financial innovation and judicial interpretation aims at

⁶⁵⁵ See also E. Ferran, *European Banking Union: Imperfect, But It Can Work*, cit., p. 14. Under the CRR, hybrid capital instruments qualify as additional tier 1 items (Art. 489) while subordinated debt instruments qualify as tier 2 items (Art. 62).

⁶⁵⁶ See ESMA, *Potential Risks Associated with Investing in Contingent Convertible Instruments*, 31 July 2014 ESMA/2014/944

⁶⁵⁷ See ESMA, *Warning on risks of investing in complex products*, 7 February 2014.

⁶⁵⁸ FCA, *Restrictions on the retail distribution of regulatory capital instruments* Feedback to CP14/23 and final rules. June 2015. The new rules entered into force on 1 October 2015 for CoCos. The 1 October 2014 the FCA issued a temporary ban for the distribution of COCOs.

⁶⁵⁹ The FROB is a banking bailout and reconstruction program initiated by the Spanish government in June 2009 under the Real Decreto Ley 24/2012. See in more detail F. Zunzunegui, *Mis-selling of preferred shares to Spanish retail clients*, in JIBLR (2014) 3, p. 174 ss.

⁶⁶⁰ See Banca d'Italia, *Informazioni sulla soluzione delle crisi di Banca Marche, Banca Popolare dell'Etruria e del Lazio, Cari Chieti e Cassa di Risparmio di Ferrara*, 22 November 2015. Available at <https://www.bancaditalia.it/media/notizia/informazioni-sulla-soluzione-delle-crisi-di-quattro-banche-in-amministrazione-straordinaria>

ensuring the certainty of legal transactions. By contrast, in many continental jurisdictions, national courts interpret contractual duties and remedies in light of EU financial regulation in order to protect retail investors against the information and economic power of the financial firm. The emphasis is placed on the effective protection of the retail investor rather than on the private autonomy of the financial firm or the certainty of legal transactions.

This purposive-oriented interpretation of national contract law triggers a process of “Europeanization” of national contract law governing retail financial transactions which is also reinforced by the role of national ADRs and EU supervisory authorities. National ADR mechanisms do not only provide for a cheaper and faster retail disputes resolution but they can also contribute to the enforcement of EU retail financial regulation because their decisions are significantly influenced by the regulatory principles laid down by EU law. The (quasi)-regulatory and supervisory powers of the ESAs have the potential for shaping not only the conduct but also the contractual practices and documentation of financial market participants. In the framework of the SSM, even if the ECB does not have the task and power to protect consumers, prudential and conduct supervision should be coordinated because detrimental distribution practices may indicate the deterioration of the solidity of credit institutions.

Besides the ongoing process of “Europeanisation” of national contract law, this study has shown the emergence of what I named the “contractualisation of EU law” in the governance of banks and sovereign crisis. Whereas the law of contract plays a little role in the MiFID I and MiFID II – the most important EU conduct-shaping regulatory instruments – it has recently been used as a device to support the resolution tools introduced by the BRRD. In this context, contract law does not serve to protect investors vis-à-vis credit and investment firms but it aims at ensuring the full achievements of the resolution’s objectives.

Contorting the law of torts

Ronan R. Condon*

Introduction

Tort law has been traditionally concerned with attributing to actors rights and duties. These rights and duties are justified on the basis of isolating from individual harmful conduct that is legal relevant. In the common law, the conceptual tools used by tort law are wrongful conduct, duty, reasonable care, causation and harm.⁶⁶¹ These conceptual tools place the individual, her rights and duties, at the centre of tort law. In general, the law is more willing to protect negative liberties, harmful interferences with another's person or property, than to make parties conform to good ends.⁶⁶²

EU law, on the other hand, is a functional legal order. It uses the individual as a tool to construct the internal market.⁶⁶³ Therefore, while judged in terms of legal outcomes the individual's rights may be enhanced by EU law, especially *vis-à-vis* the state, the individual, her legal rights and duties, is not at the core of EU law.⁶⁶⁴ The enlargement of the scope of individual legal rights are, more properly, considered secondary or incidental to the market-building objectives of the EU.⁶⁶⁵ The objectives of EU law are regulatory.⁶⁶⁶ In this context, the regulatory tasks undertaken by the EU have grown considerably in the past thirty years with the EU involving itself, more and more, in what is usually referred to a programme of positive integration. While tort law is mostly touched somewhat indirectly

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⁶⁶¹ The conceptual tools used in leading civil law jurisdictions such as France or Germany are quite similar. The main difference vis-a-vis France relates to duty. Whereas, duty is an important control mechanism in English common law, in France causation used for similar 'control' purposes. French law also is more willing to allow recovery for 'affirmative duties', which is well-known. Although French and German law are more willing, also, to allow recovery for economic loss than the common law, German law with its concept of 'protective scope' has a similar control mechanism to English law. This is a rough sketch; analogies are not precise.

⁶⁶² Affirmative duties have always been somewhat problematic in English law. This is quite obviously the case with regard to state liability but is also evident from negligence law more generally.

⁶⁶³ M Ruffert, 'Rights and Remedies in European Community Law: a Comparative View' (1997) 34 *CML Rev* 307; T Eilsmanberger, 'The Relationship between Rights and Remedies in EC Law: In Search of the Missing Link' (2004) 41 *CML Rev* 1199 both speak of the 'functional subjectification' of the individual in EU law.

⁶⁶⁴ One might argue that while the individual's rights or obligations are not the 'core' objective of EU law, the EU has done a sufficiently good job at protecting individual interests traditionally protected by national law. Focusing too closely on 'subjective right' is misleading. Indeed, although there is no concept of subjective right in English law, the negative liberties of the individual have been, traditionally, well protected. G Samuel 'Le droit Subjectif and English Law' (1987) 46(2) *CLJ* 264. This is an argument for another day.

⁶⁶⁵ A lot has already been written on this subject, and its connection to the rule of law more generally see S Prechal.

⁶⁶⁶ This is not to discount, of course, the possibility that EU law gives rise to its own patterns of justice. Nevertheless, it is of a different type of legal order than the traditional nineteenth century legal orders. G Comparato & HW Micklitz 'Regulated Autonomy between Market Freedoms and Fundamental Rights in the Case-Law of the CJEU' in U Bernitz, X Groussot & F Schulyok (eds) *General Principles of EU Law and European Private Law* (Ashgate, 2013) 121. In this perspective, it is a form of 'regulated' autonomy. For an incisive critique see H Dagan 'Between Regulated and Autonomy Based Private Law' (ssrn, 14 November 2015).

by this process⁶⁶⁷, in product liability law EU law is directly relevant. In this respect, the regime of product liability at the EU level was slow to develop. Initially, it was considered a regime of minimum harmonisation meaning that national law was free to impose a higher standard of care on producers. Second, the presence of a developmental risk defence led some commentators to wonder whether it was, in fact, a toothless regime. However, with a number of judgments flowing from France's late implementation of the Directive and, then, the *Gonsalez Sanchez* judgment, it became clear, somewhat dramatically, that it was rather a regime of full harmonisation.⁶⁶⁸

While product liability law has long been an outlier in terms of the underlying (individualistic) philosophy of tort law, concerned more with enterprise liability than fashioning rules of individual responsibility, such strict enterprise liability can be fitted into the conceptual tools of tort liability stated above. The main difference between enterprise liability and more traditional tort liability is at the standard of care stage: causation alone is sufficient to give rise to liability without a requirement of fault being made out. Before the *Boston Scientific* judgment, a main concern of the ECJ was to police national courts such that they might not surreptitiously bring fault back in via their interpretation of the requirements of product liability.⁶⁶⁹ However, it is submitted that *Boston Scientific* is of a different order: it is a far more, shall we say, ambitious judgment that throws the conceptual tools of tort law into disarray. It is an attempt to pursue full-fledged risk management via tort law, a functional subjectification of the 'individual', to be sure, but also a functionalization of tort law to this end. A minimum basic corrective justice is replaced by the concept of private enforcement leading to a transformation of liability, developed in the USA, but particularly new in the European context. While this might be criticised from a traditional tort law perspective as a poorly reasoned judgment, we argue that it should be analysed rather to understand its underlying normative commitments to bring to the surface, as it were, the Court's basic commitments.

This short paper, thus, proceeds in three steps. First, by briefly analysing the twentieth-century reshaping of tort law. Second, by briefly sketching the New Approaches' relevance to tort law. Third, by examining the recent *Boston Scientific* judgment with a view to how liability is transforming under the influence of EU law. The claim of this paper is that these developments impact on the internal rationale of tort law and, consequently, more generally on the division of labour in 'private' obligations between contract and tort law.

National regulatory tort law

The idea that private law, and tort law in particular, is transforming is not a new one. It is claimed that tort law has always served both an internal and external function.⁶⁷⁰ Traditionally, internally tort law is linked to corrective justice while externally serves a market function: market building (nineteenth-

⁶⁶⁷ One might read *Francovich* in this manner. While it challenges state liability law, it leaves largely untouched the core tort doctrine of negligence. ECHR law is more relevant in this domain especially with regard to state liability e.g. *Osman* and post-*Osman* case-law.

⁶⁶⁸ This development was much bemoaned in France see G Viney L'INTERPRÉTATION PAR LA CJCE DE LA DIRECTIVE DU 25 JUILLET 1985 SUR LA RESPONSABILITÉ DU FAIT DES PRODUITS DÉFECTUEUX. 44 La Semaine Juridique 177.

⁶⁶⁹ We might recall, famously, C-300/95 *Commission v UK* [1997] ECR I-2649.

⁶⁷⁰ More generally regarding private law see C Schmid 'The Thesis of the Instrumentalisation of Private Law by the EU in a Nutshell' in C Joerges & T Ralli (eds.) *European Constitutionalism without Private Law: Private Law without Democracy* (Arena Report 3/11); and those scholars applying and influenced by a systems' theory analysis e.g. K-H Ladeur 'The Evolution of General Administrative Law and the Emergence of Postmodern Administrative Law' Osgoode CLPE Research Paper No. 16/2011; M Renner 'Death by Complexity – the Financial Crisis and the Crisis of Law in World Society' in P Kjaer et al *The Financial Crisis in Constitutional Perspective: The Dark Side of Functional Differentiation* (Hart Publishing, 2011).

century), mediating social interdependence (twentieth-century), and now perhaps market regulation (EU – a possible role for tort law as *ex post* regulation).⁶⁷¹

Ever since the industrialization of Western society at the end of the nineteenth-century, courts and scholarly treatment of tort law has outpaced legislatures in finding novel solutions to problems of mass production and the injuries such activities engender.⁶⁷² The story of enterprise liability is a well-told one, especially in the United States.⁶⁷³ Outside of the United States the regulatory mix is different but nonetheless a broadly similar pattern is evident whereby tort law is expanded and utilised for regulatory purposes. We might call what developed during the welfare state as national regulatory private (tort) law.⁶⁷⁴

While the instrumentalization of tort law towards substantive ends, e.g. consumer protection or economic efficiency, has developed at the national level, this competition of ideas, has not been resolved at the European level.⁶⁷⁵ We propose to examine *Boston Scientific* (manufacturer liability) in this short note to examine the relationship between regulation and liability, and how the former might be shaping the latter its aims and doctrines. This concerns what is called above the internal aspect of tort law, which might be thought to be disintegrating under the functionalist approach in EU law i.e. functional subjectivisation, no *droit subjectif*.⁶⁷⁶ In other words, a fundamental question is whether this new transnational regulatory private law can be undergirded by a conception of relational justice, whether a weak conception or whether it is entirely functionalist? In terms of the external dimension of tort law, the question is whether a model of ‘institutional complementarity’ is developing.⁶⁷⁷ Before fixing on the *Boston Scientific* judgment, however, it is necessary to reconstruct the development of national regulatory private law to delineate the differences between this form of ‘instrumentalization’, and the approach the CJEU appears to be pursuing.

⁶⁷¹ This is an extrapolation of KH Ladeur’s argument (previous citation) about the role of administrative law in the post-French Revolutionary state. In addition, market building was linked to nation-building in the nineteenth-century. See also, M Jansen & R Michaels ‘Private Law and the State: Comparative Perceptions and Historical Observations’ (ssrn, accessed 10 June 2015).

⁶⁷² Legislatures began by introduction acts such as Workers’ Compensation Acts, and social insurance but tort law soon developed to reflect similar purposes. For example, the rise of strict liability can be read in this light especially if one considers the American gloss placed on *Rylands v Fletcher* allowing strict recovery for ultra-hazardous activities. For a more detailed analysis, see G Brüggemeier ‘Risk and Strict Liability: The Distinct Examples of the Germany, the US and Russia’ EUI Working Paper Series LAW 2012/29.

⁶⁷³ G Priest ‘The Modern Expansion of Tort Liability: Its Sources, Its Effects, and Its Reform’ (1991) 5(3) *The Journal of Economic Perspectives* 31.

⁶⁷⁴ O Kahn-Freund ‘On Uses and Misuses of Comparative Law’ (1974) 37 MLR 1. His thesis on ‘transplants’; and T Wilhelmsson ‘Varieties of Welfarism in European Contract Law’ (2004) 10(6) ELJ 712: on the relationship between private (contract) law and the welfare state; on the relationship between tort law and the welfare state see D Howarth ‘Three Forms of Responsibility: On the Relationship between Tort Law and the Welfare State’ (2001) 60(3) CLJ 553. Also, D Priel ‘British Politics, the Welfare State and Tort Law’ (ssrn, accessed on 10 June 2015).

⁶⁷⁵ See BS Markenisis & S Deakin ‘The Random Element of their Lordships’ Infallible Judgment: An Economic and Comparative Analysis of the Tort of Negligence from *Anns* to *Murphy*’ (1992) 55(5) MLR 619 reconstruction of the policy questions at issue in the English case-law from an economic perspective. This analysis remains valid, although has become more complex in light of the impact of human rights on tort law.

⁶⁷⁶ M Ruffert ‘Rights and Remedies in European Community Law: A Comparative View’ (1997) 34 C.M.L.R 307.

N Reich ‘Rights without Duties? Reflections on the State of Liability Law in the Multilevel Governance System of the Community. Is there a Need for a More Coherent Approach in European Private Law?’ EUI Working Paper Series LAW 2009/10. Although obviously one can have an objective law that protects individual liberties, which might be as extensive as the protection of individual rights. Nevertheless, the latter model i.e. traditionally associated with the common law, is more open to a utility calculation. G Samuel “‘Le Droit Subjectif’ and English Law’ (1987) 46(2) CLJ 264.

⁶⁷⁷ Cafaggi. ‘A Coordinated Approach to Regulation and Civil Liability in European Law: Rethinking Institutional Complementarities’ in *The Institutional Framework of European Private Law* (OUP, 2006) 191.

The emergence of national regulatory tort law

The first transformation of liability law can be traced to the nineteenth-century.⁶⁷⁸ In Brüggemeier's terms, nineteenth-century tort law derives its structure from the natural law premised on individual responsibility and fault-based liability.⁶⁷⁹ This law aimed at market-building by providing procedural ground rules of interaction via contract law, and fostered growth by ensuring that not all externalities were internalized.⁶⁸⁰ These rules were developed in a world of small entrepreneurial activity in which the large vertically integrated firm had not yet emerged; nevertheless, this structure of liability persisted for quite a while thereafter.⁶⁸¹ Indeed, despite the rise of industry in the latter-half of the nineteenth-century, which included the rise of firms, technical risks and insurance, by the end of the century this individualistic model remained largely intact:

Notwithstanding these social upheavals civil law in general and law of delict in particular of the continental European codifications adhere to their pre-industrial moral heritage: namely, Roman law (*iniuria/culpa*) and natural law. In a similar way the law of torts of the Anglo-American Common Law remained pre-industrial until the 20th Century.⁶⁸²

In the common law, this involved the crystallization of the will theory in contract and the definition of tort law as being an excess of will. Tort law's province was parasitic on that of contract law and contractual ways of thinking, as it were, influenced the shaping of tortious recovery.⁶⁸³ The most famous example of this, in practice, is the well-known *Wright v Winterbottom* decision.⁶⁸⁴ Atiyah refers to the concatenation of values in English contract law as those of '...classical economics, of Benthamite radicalism, of liberal political ideals, and of the law itself, created and moulded in the shadow of these movements.'⁶⁸⁵ Where contract led, tort law followed. It would appear, therefore, that the line between tort law and regulation is blurred because from the very beginning a notion of the public-private divide is inherent by giving priority to contract as a means of private ordering.⁶⁸⁶

⁶⁷⁸ The reorganization of private law in the nineteenth-century, in both common law and civil law jurisdictions, is well-documented. D Ibbetson *A Historical Introduction to the Law of Obligations* (OUP, 2001) (contract and tort), GE White *Tort Law in America: An Intellectual History* (OUP, 1980) (tort) PS Atiyah *The Rise and Fall of Freedom of Contract* (OUP, 1979) (contract). Most apparent is the link to the state in France, only later in Germany.

⁶⁷⁹ For a general overview see F Ewald *L'Etat Provenence* (Grasset, 1986); for a more doctrinal analysis of English common law D Ibbetson *ibid*; for the 'Langwellian revolution' and its impact on tort law, which led to the creation of the fault paradigm see GE White *ibid* esp. ch.2.

⁶⁸⁰ This is the controversial 'Horwitz thesis' see M Horwitz *The Great Transformation of American Law, 1780-1860* (Harvard, 1979); See also Howarth (n 14); On the difference between proceduralist private law and substantive private law see R Brownsword 'A Time to Stand and Stare' in R Brownsword et al *The Foundations of European Private Law* 159.

⁶⁸¹ In Germany, the classical contract-tort model was adopted in the BGB without what was perceived at the time as the necessary 'social oil' (Von Gierke quoted in HW Micklitz 'Do Consumers and Businesses Need a New Architecture of Consumer Law? A Thought Provoking Impulse' (2013) 32(1) Yearbook of European Law 266. This model continues to pose problems for the development of 'public' tort law.

⁶⁸² G Brüggemeier (n 12) 1.

⁶⁸³ Famously, the 'Holy Trinity' of the doctrines of assumption of risk, common employment and contributory negligence which, in effect, denied employees recovery against their employers for workplace accidents in both the US and the UK.

⁶⁸⁴ (1842) 10 M&W 109.

⁶⁸⁵ PS Atiyah 'Contracts, Promises and the Law of Obligations' in *Essays on Contracts* (Clarendon, 1986) 10. This formed the paradigm of modern contract law, and continues to cause controversy, in terms of its underlying values and secondly, in its practical ability to serve commercial expectation. For the former see the legal realists, most prominently, MR Cohen 'The Basis of Contract' (1933) 46(4) Harvard Law Review 553. In the latter vein, see C Mitchell *Contract Law and Contract Practice: Bridging the Gap Between Legal Reasoning and Commercial Expectations* (Hart Publishing, 2013). This is not the entire picture, however, because natural law also influence these developments see J Gordley 'The Common Law in the Twentieth Century: Some Unfinished Business' (2000) 88(6) *California Law Review* 1815.

⁶⁸⁶ In other words, against the use of what the French refer to as 'objective law' to intervene to reallocate contractual risks.

This state of affairs led to legislative enactment to circumvent the strictures of the private law of contract and tort, providing for recovery based on the ideas of risk spreading, internalization and insurance. In the common law, Workers Compensation Acts are the paradigmatic example of this move to legislative enactment to circumvent the structural limits of private law. Caffagi remarks:

In the last part of the nineteenth century and the first part of the twentieth, the emergence of regulation, and in particular that of welfare regulation, was primarily due to significant limits of compensation. These shortcomings were associated with the internal structure of civil liability and the weaknesses of other branches of private law, especially contract and labour law. Worker compensation regimes for industrial accidents are only one example of an emerging body of legislation stimulated by the combined weaknesses of civil liability and labour law.⁶⁸⁷

The expansion of regulation was, of course, a fundamental change in the role and function of the state and required an expansion of executive power to achieve its ends.⁶⁸⁸ The concept of security replaced individual responsibility and self-help, and necessitated an expansion of the domain of state activity.⁶⁸⁹ The ‘machine age’ required coordinated, social responses.⁶⁹⁰

Where regulation led, tort law followed.⁶⁹¹ Grafting on to its existing conceptual structure, placing greater emphasis on arguments based on policy, tort law entered the twentieth-century. In product liability, this change is most evidenced through making the firm liable for typical business risks.⁶⁹² In the common law, at least, the leading judgments were those of Cardozo J. in *McPherson v Buick*, and in *Palsgraf v Long Island Railroad Co.* These established that the general duty of care could outflank contract law, and apply to indirect property and physical injuries.⁶⁹³ The first decision, established a general duty of care, the second clarified that it applies the emerging policy goals of compensation and prevention in tort law to specific relations.⁶⁹⁴ Not all injuries result in liability, only those in which a proximate relationship can be established.⁶⁹⁵ This is what Schmid means, it would appear, by the ‘weak corrective justice’ in twentieth-century private law.⁶⁹⁶ By this notion, Schmid highlights a very interesting dimension to liability law and its relationship to broader conception of the regulatory role of the state. On the one hand, one might discern the normative relationship between A and B that

⁶⁸⁷ Caffagi (n 17) 192-93. For similar movements in German, American and Russian law see G Brüggemeier (n 12).

⁶⁸⁸ M Taggart (ed) *The Province of Administrative Law* (Hart Publishing, 1997).

⁶⁸⁹ Ewald (n 19). C Harlow *State Liability: Tort Law and Beyond* (Clarendon, 2002) is disquieted by the influence of the welfare state on tort law, which she refers to as a ‘distortion’ of the corrective justice basis of tort law. She traces this supposedly malign influence to *Dorset*.

⁶⁹⁰ L Josseland *L'évolution de la responsabilité (conférence donnée aux Facultés de Droit de Lisbonne, de Coimbre, de Belgrade, de Bucarest, d'Orades, de Bruxells, à l'institut français de Madrid, aux centres juridiques de L'Institut des Hautes Études marocaines à Rabat et à Casablanca) Évolutions et Actualités Conférences de Droit Civil*, (Receuil Sirey, 1936).

⁶⁹¹ The pressure exerted on tort law was, it is true, less in Europe than in the United States due to the more developed functional equivalents to tort law available.

⁶⁹² G Brüggemeier *Common Principles of Tort Law: A Pre-Statement of Law* (BICILL 2004),

⁶⁹³ *Palsgraf* was somewhat of a retreat from *MacPherson*. For analysis see GE White (n 18).

⁶⁹⁴ Although if one examines the early scholarship, the emphasis is more on compensation (and risk spreading) than deterrence e.g. H Laski ‘The Basis of Vicarious Liability’ (1916-1917) 26 *Yale LJ* 105.

⁶⁹⁵ *ibid*, 67: ‘Courts are not regulatory agencies that set general standards. They decide concrete cases. In such situations, they determine ‘correct’ behaviour, appropriate to the situation and the defendant.’

⁶⁹⁶ C Schmid ‘The Thesis of the Instrumentalisation of Private Law by the EU in a Nutshell’ in C Joerges & C Railli (eds.) *European Constitutionalism without Private Law, Private Law without Democracy* Arena Report 3/11, no. 14, 17-37, 21-22 esp. In other words, despite the fact that the law might serve ‘external’ objectives, here compensation and prevention, it can be justified in terms of justice between the parties. Herein, proximity is a way to tie the parties together in terms of justice. For a sophisticated inquiry into the duty of care test in English law, its interpersonal justice and policy dimensions see A Robertson ‘Constraints on Policy-Based Reasoning in Private Law’ in A Roberston & T Hang Wu (eds.) *The Goals of Private Law* (Hart Publishing, 2009) 261.

affixes responsibility, on the other, the role of tort law to intermediate group relations in an interdependent world e.g. consumer-manufacturers. Cane refers to this as the distributive justice dimension to tort law that uses the duty of care to reallocate benefits and burdens by adjusting rights and duties.⁶⁹⁷ However, the paradigmatic tort action – that of motor accidents – resulted in little trouble with regard to the ordinary operation of rules of causation, proximity and requirement of harm meaning that the normative core of tort law remained unperturbed. The duty of care approach, its effluxion, expanded grounds and bounds of tort law without upsetting too much its underlying relational structure.⁶⁹⁸

These internal and external faces of liability relate to the role of liability in creating a normative framework and in responding to the state’s regulatory framework. In the latter case, the ‘secularization’ of the standard of care goes a long way to give to tort law a regulatory function.⁶⁹⁹ Renner, in particular, stresses this dimension in relation to strict (enterprise) liability. For Renner, the law enhanced its internal complexity to deal with corporate activity:

The establishment of the legal concept of strict liability was based upon the consideration that liability for the causation of damages should, in an age of automated production, not be made contingent upon (human) failure. But, in order to impose strict liability for certain types of activities, the courts necessarily had, more or less scientifically, to evaluate social risks rather than indulge in the normative questions of intent and negligence. In doing so, they specifically had to pay due regard to the technical falsibility and to the costs of preventive measures. Thus, cognitive expectations with regard to the technological-scientific state of the art, industry-specific standards and economic calculus soon found their way into legal reasoning.⁷⁰⁰

Strict liability did not, of course, mean absolute liability. Causation and individual agency remained important. It was strict liability largely for high risk activities. In addition, negligence was transformed into negligence enterprise liability.⁷⁰¹ This organizational model of liability existed side-by-side with ex ante regulation and complemented it.⁷⁰² The trend was towards the development of an organizational-type liability, which by the use of negligence and strict liability law makes enterprises internalize their externalities. By the development of separate legal personality for firms at the end of the nineteenth-century, the corporation as distinct from the individual entered the law. It entered a law that relied on the language of individuals, to be sure, but nevertheless reshaped liability towards an internalizing model. A good example of this transformation is given by Brüggemeier when he contrasts *Thomas v Winchester* and *MacPherson v Buick*.⁷⁰³ In the earlier judgment, an assistant of a pharmacist sold drugs to an individual, who gave it to the end-consumer, the plaintiff. The plaintiff

⁶⁹⁷ P Cane ‘Distributive Justice and Tort Law’ (2001) *NZ L Rev.* 401: ‘...my suggestion is that making rules that define the grounds and bounds of tort liability is a distributive task, while applying such rules in individual cases is a corrective task.’ (412).

⁶⁹⁸ For a clear, recent treatment rationalizing the interaction between relational or ‘interpersonal’ aspects of the duty of care and ‘community welfare’ see A Robertson ‘Justice, Community Welfare and the Duty of Care’ (2011) 127 *LQR* 370. Interestingly, Robertson places the relevance of the ‘contractual context’ to tort remedies, a question relevant to *Boston Scientific*, as a question of interpersonal justice, whereas it is submitted that this consideration re-surfaces perhaps more strongly at the community welfare stage also i.e. law and economic arguments concerning efficiency.

⁶⁹⁹ Some argue that the objective standard of care goes back to the early nineteenth-century, at least in the common law. However, we find Ibbetson’s reconstruction more plausible noting that admonitory aspect of the standard of care in the nineteenth-century. Ibbetson (n 18).

⁷⁰⁰ M Renner (n 10) 103.

⁷⁰¹ Brüggemeier (n 32); A Ehrenzweig ‘Negligence without Fault’ 54(4) *Californian Law Review* 1422.

⁷⁰² A tension existed between providing a tortious remedy and a regulatory one. According to Calabresi, this tension belongs to pragmatic bric-a-brac approach of the mixed society. See G Calabresi ‘Torts – the Law of the Mixed Society’ (1977-1978) 56 *Tex. L. Rev.* 519.

⁷⁰³ Brüggemeier (n 32), 133-134. The analogy with *Donoghue* should, it is submitted, be patent.

sued the assistant and the pharmacist for personal injury. The employee was held liable in tort, on the old ‘natural or necessary consequences’ rule, while the pharmacist was held liable on the basis of vicarious liability. By the time *MacPherson* was decided, the requirement of showing vicarious liability had disappeared. Again, *MacPherson* concerned a situation that traditionally would have failed due to an absence of privity of contract. Instead of examining the primary liability of the seller and the secondary liability of the manufacturer, a direct duty of care was imposed on the manufacturer to take reasonable care in manufacture. Brüggemeier states that this represents a profound shift: ‘The goal of legal policy was to channel liability to the ‘correct’ address, the enterprise owner, and at the same time to reach the “deep pocket”’.⁷⁰⁴ Outside product liability, vicarious liability remained but was increasingly and expediently re-shaped to follow the same policy goals that influenced the development of product liability.⁷⁰⁵ Organizations or firms, replaced individuals as the driving force of legal analysis; *enterprise negligence liability* had emerged.

The law, of course, was not a *tabula rasa* and the development of legal doctrine was incremental with the scope of liability gradually enlarging by means of casuistic reworking of existing principles.⁷⁰⁶ Nevertheless, these developments all favoured making enterprises pay their way. The extent to which the introduction of liability insurance influenced these developments is debated, but is largely thought to have been influential.⁷⁰⁷

The third transformation

The emergence of regulatory frameworks that are no longer rooted in the state lead, presumptively, to a need for an institutional complement to *ex ante* regulation at the transnational level. The move from command-and-control regulation to self-regulation and co-regulation means that, *prima facie*, a greater share of responsibility should be assumed by private actors, including those who fulfil formerly public functions.⁷⁰⁸ It is not simply that private firms are held liable for their failures to reach a standard of care towards individuals (the horizontal concept of liability) but that a degree of (self-)regulatory responsibility is ‘delegated’ to them. This has occurred because of the difficulty of establishing hard and fast rules to ensure safety in an era of high technology. The ‘New Approach’ exemplifies a general transformation of regulation towards ‘essential requirements’ and self- or co-regulation.⁷⁰⁹ In circumstances in which *ex ante* controls are less encompassing, liability law takes on a new importance from a regulatory perspective.⁷¹⁰

The move from government to governance in the new approach

The move from government to governance is considerably discussed. In terms of its scope, Chalmers notes that the incorporation of self-regulatory regimes into ‘policy design and government’ occurs in

⁷⁰⁴ *ibid*, 135.

⁷⁰⁵ PS Atiyah *Vicarious Liability in the Law of Torts* (Butterworths, 1967) remains the most canonical treatment in English law. Howarth (n 14) is critical of Atiyah’s treatment.

⁷⁰⁶ Illustrative: Cardozo J. in *McPherson*: ‘Precedents drawn from the days of travel by stage coach do not fit the conditions of travel to-day. The principle that the danger must be imminent does not change, but the things subject to the principle do change. They are whatever the needs of life in a developing civilization require them to be.’ (392)

⁷⁰⁷ A proper understanding of its role is not assisted by the courts unwillingness to discuss it openly until quite recently. A classic example of formulistic reasoning here is Williams. More recently, the courts have dealt with this issue more openly see *Stovin v Wise* [1996] AC 923.

⁷⁰⁸ Cafaggi (n 17) goes far in analysing this new departure from a liability perspective, drawing largely on Shavell’s assumptions in this area.

⁷⁰⁹ *Ibid*.

⁷¹⁰ S Shavell ‘Strict Liability versus Negligence’ 9(1) *The Journal of Legal Studies* 1.

areas as diverse as ‘financial markets, insurance, environmental protection, broadcasting, advertising, product standards, and crime prevention.’⁷¹¹ It is not simply regimes, *per se*, that fulfil a regulatory role but under the New Approach considerable liberty is extended to private actors to fulfil the essential requirements with limited post-market surveillance afforded to the state.⁷¹²

Because product liability is an important area of tort law, we will examine the possible response of tort law through that lens. From a regulatory perspective, tort law becomes a form of ‘private enforcement’.⁷¹³ The deterrent function of tort law is elevated and the compensatory dimension of tort law becomes a ‘function’ of the law of torts rather than a consequence of a corrective normative framework.⁷¹⁴ Thus, the link between the law of torts and the idea of an excess of the subjective right is weakened. As we argued above, this was already occurring in the welfare state; however, the *sui generis* nature of European law radicalizes this process.⁷¹⁵ In European law, it appears non-existent unless re-framed in citizens’ rights terms – but this is distributive rather than corrective in focus.⁷¹⁶ In light of this, it leads to a logic of balancing rights rather than a framework of private sovereignties.⁷¹⁷

In the New Approach, thus, private actors are given a greater responsibility to achieve compliance with product standards, when they do not one might expect a higher degree of responsibility. The governance of society, as distinct from the government-bureaucratic model of the welfare state, means that post-1980s the state makes attempts at ‘...steering a self-governing society.’⁷¹⁸ This is quite separate from the question of state responsibility. It is primary responsibility for failure to reach an exacting standard of care. Nevertheless, this forms part of an overall regulatory strategy; it is not simply civil liability for private harm but civil liability in the context of a new mix of public-private governance because of the ‘delegated’ self-regulatory possibility devolved to private actors via the ‘essential requirements’ approach.⁷¹⁹

The question for private law, and in this contribution for the law of torts, is what demands does this place on European tort law, and whether it leads to a transformation towards a European, as distinct from a national, regulatory tort law. The claim, in short, is that this transformation from government to

⁷¹¹ D Chalmers ‘The Government and Citizenship of Self-Regulation’ in F Cafaggi (ed.) *Reframing Self-Regulation in European Private Law* (Kluwer, 2006) 163, 164.

⁷¹² The main directives in this area all follow the logic of limited *ex ante* controls, and a narrow post-market surveillance role for the state. Hodges perceives this as a weakness of the New Approach. Of course, ‘essential requirements’ are simply a ‘passport’ to access the market and do not constitute an assurance of safety.

⁷¹³ P Cane ‘Tort Law as Regulation’ (2002) 31 *Comm. L. World Rev.* 305 ‘From a regulatory perspective, tort actions are often set in this conceptual framework as a form of non-statutory private enforcement of regulatory standards.’ (312)

⁷¹⁴ *Ibid* ‘Understood in terms of interpersonal responsibility, tort remedies ‘correct’ the harm done by the tortious conduct; but understood in regulatory terms they provide an incentive and a reward for the reporting of breaches of regulatory standards to the standard setter (i.e. the court).’ (316) Interestingly, Cane is more pessimistic than Schepel regarding tort law’s capacity to evaluate complex and contested empirical and scientific data. H Schepel *The Constitution of Private Governance* (Hart Publishing, 2005) who argues that tort law, with regard to the standard of care, should develop a more exacting review of standards, in particular focusing on deliberative processes see p. 400.

⁷¹⁵ P Pescatore *The Law of Integration* (Sijthoff, 1974). Arguments regarding no subjective right e.g. Ruffert (n 3). C Schmid ‘Governance and Judicial’ noting how the frame of reference of EU law is apt to distort national law.

⁷¹⁶ F du Bois ‘Private Law in an Age of Rights’ University of Leicester School of Law Research Paper No. 13-03.

⁷¹⁷ The latter is a typical way to conceptualize private law according to the notion of the *droit subjectif*.

⁷¹⁸ Chalmers (n 51), 166. It could be argued that the extent to which the the idea that the state was the ‘direct government’ of society is a gross-overstatement. See KH Ladeur (n 2).

⁷¹⁹ F Cafaggi ‘LE RÔLE DES ACTEURS PRIVÉS DANS LES PROCESSUS DE RÉGULATION : PARTICIPATION, AUTORÉGULATION ET RÉGULATION PRIVÉE’ (2004) 119 *Revue française d’administration publique* 23: notes that it is a mistake to view this as purely a question of delegation: ‘Le développement de nouveaux modèles de régulation privée a été interprété comme un transfert du pouvoir de réglementation du public vers le privé, dans le cadre des phénomènes de privatisation réalisés aux plans législatif et juridictionnel. C’est là une lecture partielle et imprécise car plutôt qu’un simple transfert de pouvoir l’on a affaire à de nouveaux modèles de coopération réglementaire.’ (23)

governance places strain on *traditional* tort law to become ever more regulatory in its ‘aims’.⁷²⁰ In this perspective, tort law is reconceived on the model of *ex post* regulation derived mostly from law and economics.⁷²¹ In Europe, this ‘economization’ is filtered through the lens of the effectiveness of the Internal Market. This impacts on the exact form it takes, nevertheless it is deeply connected with a concept of tort law that departs from the bilateral frame of reference, relational justice, and focuses instead on the idea of efficient levels of regulation. This profound shift in how we consider tort law gradually emerged in the pre-WWII ‘regulatory’ and then welfare state, but has accelerated under conditions of globalization, and Europeanization.⁷²² The disaggregation of the state and the move to self-regulation impacts tort law. Tort law, in particular, its traditional focus on harm and causation does not fit well with a the model of regulation established under the New Approach that drastically reduces the importance of *ex ante* controls in favour of minimum standards and post-market surveillance.⁷²³ By way of contrast, Shavell explains the traditional paradigm: ‘Tort law is private in nature and works not by social command but rather indirectly, through the deterrent effect of damage actions that may be brought once harm occurs. Standards, prohibitions and other forms of safety regulation, in contrast, are public in character and modify behavior in an immediate way through requirements that are imposed before, or at least independent of, the actual occurrence of harm.’⁷²⁴ To the extent that the New Approach results in a regulatory framework with fewer *ex ante* public controls, this may be considered to place additional pressures on tort law to fulfil a deterrence and compensatory function. Now, the claim would be that the ‘ethos’ of regulation is permeating tort law.⁷²⁵ It is at this juncture and from this perspective that *Boston Scientific* enters our discussion.

Boston Scientific: Contorting tort law by balancing rights and duties in an overall framework

The CJEU’s judgment in *Boston Scientific* is indicative of the interplay between consumer protection and market access insofar as the judgment involved the interplay between the dual-aims of the Directive.⁷²⁶ These broad aims are the motors of the legal analysis, as distinct from the interpersonal relationship between the manufacturer and the consumer.

After its judgment in *Gonzalez Sanchez*, the court has reinterpreted product liability law in light of the aim of maximum harmonization in what appears to be a *contra legem* manner. This has arrogated a large area of policy-making to the court such that it alters the balance between the requirements of national consumer protection law and CJEU law-making. In *Boston Scientific*, the first respondent imported and sold pacemakers and defibrillators. It transpired that these products were defective. In the case of the pacemakers, a leak in the sealant utilised meant that this over time could lead to the depletion of battery rendering the device inoperative. The relevant manufacturer, Boston Scientific, following the obligatory procedures under the Safety Directive recalled the product and reimbursed

⁷²⁰ Already in the 1950s, English scholars were discussing the ‘aims’ of tort law i.e. G Williams ‘The Aims of Tort Law’ (1951) 4(1) Current Legal Problems 137. This discussion began earlier in the USA with the legal realists e.g. Kessler, Llewellyn, and in Germany Bruggemeier avers to Mataja’s claim that the aims of tort law are deterrence and compensation already showing a regulatory approach to tort law which goes beyond the natural law inspired scholarship of the nineteenth-century. For a summary see J Gordley (n 20).

⁷²¹ Cafaggi (n 17).

⁷²² C Schmid (n 10) 17-37.

⁷²³ Explained by C Hodges *European Regulation of Consumer Product Safety* (OUP, 2005).

⁷²⁴ This is, of course, already a ‘functionalist’ account of tort law emphasising its ‘deterrence’ function, which Shavell openly avers to by describing his account as ‘instrumentalist’. Shavell (n 50).

⁷²⁵ An illuminating analysis of the shifting sands of tort law and its relationship to the particular model of the state preferred is found in G Calabresi (n 42).

⁷²⁶ *Boston Scientific* (unreported, 5 March 2015). The Directive could have been read in a less expansive manner i.e. in a way that did not emphasise the difference of these aims but their identity or at least complementarity. Instead, the Court favoured ‘splitting’ the aims.

the claimant the cost of a new pacemaker.⁷²⁷ The claimant, then, sued for the cost of the medical procedure to fit a new pacemaker under the Product Liability Directive.⁷²⁸ The defibrillators were similarly defective, and the claim was largely consistent with the pacemaker claim, namely, the claimants sought relief contra the respondent for the costs of the replacement medical procedure. The reference was pursuant to a number of questions by the German Federal court, the most pertinent of which involved the interpretation of articles 6(1) and 9(1) of the Product Liability Directive, 85/374. According to that directive a producer is liable for a defect product, if and only if, the claimant can prove the damage, the defect, and causal link between damage and the defect. This is, of course, transposed into German law. The problem for the claimants was that although the product was patently defective, the claimants were wont to show that this occasioned specific harm to them, as distinct from increasing the harm to individuals more generally, as a group. Hence, the case bears considerable similarity to what are known in English law as the ‘asbestos case-law’ which treated, not without ambivalence, the relationship between an increase of risk of harm versus the requirement of demonstrating a causal link.⁷²⁹ In any event, the key questions the CJEU was asked can be summarised in the following manner:

1. Is article 6(1) to be interpreted to mean that an increased risk of failure in the same product group means that it also covers situations where no such defect has been discovered in the device which has been implanted in the specific case-in-point, i.e. the claimants
2. If it is to so-interpreted, does article 9(1) encompass the costs of the operation to remove the pacemakers/defibrillators

In his opinion, Advocate-General Bot stated that the defective pacemakers were 17-20 times more likely to fail than non-defective pacemakers. The risk that defibrillators might fail represented a lower probability but, nevertheless, their defectiveness increased the risk of failure. While the German Federal Court accepted that the products in question were defective, on an ordinary causal test this was insufficient to demonstrate that the causal link between the increased risk of failure and the specific injury to the claimants. A-G Bot drawing on the French version of the Directive at paragraph 29 noted that the use of the terms ‘*on*’ and ‘*légitime*’ were sufficient broad to warrant the conclusion that ‘...the concept of a defect is to be assessed in the abstract with reference not to a specific user, but to the public at large, having regard to the standard of safety which the consumer may reasonably expect.’ This, for the first time, clarified that the notion of defect is to be interpreted objectively and is, perhaps, a rejoinder to certain Member States which tended to diminish the test from strict liability to a standard more akin to fault. Hence, the concept of safety is relatively imprecise and calls for an interpretation in light of the objectives of the Directive. The A-G, then, turned to the recitals. Recital 2 mentions that the aim of the Directive is to obtain a fair apportionment of risks regarding modern technological development, which is understood as varying depending on the nature of the risk. In the circumstances, the risk of failure is particularly grave because were these products to fail they could lead to the injury or death of the patient. Hence, once more this type of reasoning echoes national law in the idea that for ultra-hazardous products a higher standard of care is required than for less risky products.⁷³⁰ Hence, it is risk (or safety) and not danger that is relevant for the Directive. As A-G Bot states: ‘In other words, the defect for the purposes of article 6(1) of the Directive is a risk of damage of such a degree of seriousness that it affects the public’s legitimate expectations in so far as concerns

⁷²⁷ The so-called ‘Safety Directive’.

⁷²⁸ To be more accurate, the insurance company sued by subrogation.

⁷²⁹ This area of law has long vexed English courts. To refer to but a few troublesome but critical judgments: *McGhee*, *Fairchild*, *Barker*, *Sienkiewicz*, *Trigger*. Discussed critically in B Markesisis, S Deakin & A Johnston *Tort Law* 7th edn (OUP, 2013).

⁷³⁰ This echoes American product liability law, at least in its interpretation of *Rylands v Fletcher*. As most tort lawyers are aware, a similar test appeared ‘in the offing’ in English law but foundered in *Reid v Lyons* (1943), but the English courts subsequently back-tracked.

safety.⁷³¹ In the circumstances, the mere possibility of failure was considered enough to constitute a defect, the claimants were not required to show that a particular pacemaker or defibrillator was faulty. A very revealing passage, indeed, is paragraph 35. A-G Bot stated that although an objective of the Directive is undistorted competition, another main objective of the Directive is consumer protection. Although this paragraph might be considered merely a supporting argument, it reveals the deeper balancing at issue.⁷³² It is not simply a question of balancing costs and benefits, rather the deeper commitment is to balance the underlying values or principles that undergird the EU legal order.⁷³³

Notwithstanding A-G Bot's invocation of the aim of 'welfare state tort law', namely compensation and deterrence, the analysis suggests a deeper constitutional as well as regulatory dimension.⁷³⁴ This rationale impacts, then, on the interpretation of the relevant Directive. At paragraph 38, A-G Bot states that to make safety subject to the occurrence of specific damage undermines the consumer protection regime because it saps the preventative function of the Directive and the risk creation-injury cost bearing rationale of the Directive.⁷³⁵ Furthermore, A-G Bot links his reasoning to article 35 of the Charter and article 168(1) TFEU which aims to guarantee a high level of human health protection in the definition and implementation of all Union activities and policies, and states that this should be a guide to interpretation regarding the Directive, especially with regard to the concept of defect. This argument was not repeated at court; yet, although it was not repeated, the judgment as we will see tracks in any event his argument at paragraph 35. The A-G goes on to note the special position of medical devices in European law, particularly the higher level of protection legitimately expected by consumers with regard to devices implanted in individuals by contrast to, for example, bottled water.⁷³⁶ At paragraph 55, the A-G summarises his position on the first question. It is sufficient to belong to a group alone. There is no need to show that the actual pacemaker is deficient, such that were we to follow the manner in which it is treated in English law the 'gist' of the action is the increased risk of harm rather than damage *per se*.⁷³⁷

The second question, namely, whether the claimants can recover for the medical expenses of replacement receives a differentiated treatment. This is, in effect, a question of pure economic loss. In the case of pacemakers, A-G Bot posed a *reductio ad absurdum*.⁷³⁸ The aim of the Directive would be frustrated were it to apply to personal injury only. This would require that the injury or death materialize. In our terms, for one's rights to be vindicated one would have to be extinguished entirely, and in those circumstances it cannot be said that one has legal rights at all. In consequence, the aim of achieving consumer safety that the Directive pursues would be discounted were the Directive to be interpreted restrictively such that the cost of removal and replacement were not covered.

The CJEU's judgment, by contrast, was not as emphatically pro-consumer. Nevertheless, a number of common strands between the A-G's opinion and the Court, which can be described as pro-consumer,

⁷³¹ para. 30.

⁷³² This might be an attempt at providing a 'corrective' to the perceived pro-market bias in previous product liability judgments. In Reich's analysis, however, one should be careful to note that *AGM-COS.MET* was a case of state liability. N Reich, 'AGM-COS.MET or: Who is Protected by Safety Regulation?', (2008) 33 European Law Review 85.

⁷³³ This relates to D Kennedy's analysis of 'neoformalism' and EU law.

⁷³⁴ Gerstenberg (n 85) has recently identified that both dimensions are important to an understanding of CJEU reasoning. This might be important since it is arguable that such a high standard of care is not justifiable from an economic perspective alone. In A-G Bot's Opinion, explicit reference is made to the constitutional rights dimension; although this is not followed in the judgment of the Court, it would appear to be an important 'hidden' dimension. For an extensive analysis in this direction see Comandè 'The Fifth Freedom'.

⁷³⁵ At this point, A-G Bot rehearses the social's reason for enterprise liability, namely, where X creates a risk she is in a better position to minimize the risk and prevent damage at the lowest cost.

⁷³⁶ It would be remiss not to remind the reader here that her example is close to *Donoghue v Stevenson* [1932] AC 465.

⁷³⁷ The infamous *Barker* decision, heavily criticised by Deakin (n 69).

⁷³⁸ para. 68.

emerge. The method of interpretation is largely purposive, examining the articles of the Directive in light of its recitals.⁷³⁹ Unlike the A-G's opinion, the vulnerability of the parties is stressed more overtly.⁷⁴⁰ Given their vulnerability, '...the safety requirements for those devices which such patients are entitled to expect are particularly high.'⁷⁴¹ At paragraph 40, the Court more clearly follows A-G Bot by stressing the abnormal nature of the risk as pertinacious to the definition of what safety requires on the facts before the Court. In other words, the greater the vulnerability of the claimants, the higher and more abnormal (serious) the risk, the more exacting the standard of care, or to put it otherwise, the more broadly the provisions of the Directive will be interpreted. This abnormal potential for damage justified the relaxation of the causal requirement. In circumstances where products of the same group/series are defective '...it is possible to classify as defective all the products in that group or series, without there being any need to show that the product in question is defective.'⁷⁴² The Court, then, at paragraph 42 invoked squarely the balancing this required. Thus, by examining the second and seventh recitals of the Directive the Court stated that the objective pursued was '...a fair apportionment of the risks inherent in modern technological production between the injured person and the producer.' Given this objective, there was no requirement to show that a particular pacemaker was defective for the purposes of article 6(1) of the Directive. On the second question, the Court followed A-G Bot's reasoning such that this broad interpretation of the Directive required the cost of surgical operation to be recompensed, certainly in the case of pacemakers, and perhaps in the case of defibrillators the latter was left open to the German Federal Court to decide.

Analysis

What Coleman referred to as judgments that cannot be fitted into the traditional notions of tort law, such as *Sindell*, are multiplying in the EU legal order.⁷⁴³ The underlying rationale of the *Boston Scientific* judgment is, in a sense, the mirror-image of the *AGM.COS.MET* decision. The arguments in *Boston Scientific* that provoked the radical interpretation of the court, concern the classic social arguments about loss spreading, and deterrence. Although it appears a triumph of the social, we are more cautious, and consider it a balancing exercise in which the particular facts of the case provoked the court to re-assess its balance between market access and consumer protection, each as distinct rationale leading to different allocations of rights and duties. The deeper question would appear to be the overall regulatory framework and the extent to which this requires to be modified *ex post* to give a higher standard of protection than required on the face of the Directive. This abstracts from the dispute before the Court and focuses instead on the overall architecture of the Internal Market.

The Court, having assumed the authority to decide such cases by its maximum harmonization approach, now is required to resolve social conflicts but on a distinctly case-by-case responsive or experimental basis.⁷⁴⁴ The language of colliding rights is not yet overt, but is 'hidden' lurking below the surface. For example, the whole rhetoric of what level of safety consumers are entitled to expect, and the distinction between vulnerable and non-vulnerable consumers assumes a citizen dimension. This is not simply arid technical detail, but the shaping of an independent European concept of the requirements of consumer protection. Nevertheless, by interpreting the Directive *contra legem*, or at least broadly in *Boston Scientific*, the rights of consumers are elevated at the expense of those of producers leading to at least implicit constitutional balancing. This is troubling for traditional tort

⁷³⁹ The first, second, sixth and ninth recitals to the preamble were considered relevant.

⁷⁴⁰ Vulnerability is another word for the scope of personal responsibility, and in this sense at least, we can detect an type of interpersonal reasoning. On the connection between vulnerability and personal responsibility see Robertson (n 38).

⁷⁴¹ Para. 39.

⁷⁴² Para. 41.

⁷⁴³ C-65/09 *Weber v Wittmer* and C-87/09 *Putz v Medianess*, ECLI:EU:C:2011:396

⁷⁴⁴ Gerstenberg (2015) ELJ (forthcoming).

scholars. As stated, there is a certain inevitable logic to such an approach once one assumes maximum harmonization.

However, as well as importing a constitutional dimension the judgment more immediately aligns *ex ante* safety regulation and *ex post* tortious liability by contorting the structure of a tort action to abandon the requirement of proving human agency (causation), in effect, and dispensing with the specific harm requirement. It might well be that the product in question is not, in fact, defective. Although it is certainly true that one should be cautious not to read the judgment in a too-expansive manner, it certainly goes some way to redress the perceived inadequacy of the product liability-safety approach. This inadequacy was highlighted by Cafaggi a few years ago:

In the area of product safety, coordination between the two strategies is absent or, at best, implicit. No explicit signs of complementarity can be seen in the Directives. The only stated clear principle of coordination in the field of product safety is that the regulatory Directives (in particular EC Directive 01/95) cannot be interpreted as decreasing the level of consumer protection ensured by the PL Directive.⁷⁴⁵

The Court substantially increased the scope of the Product Liability Directive by interpreting the scope of the Directive as including product recall and the attendant (medical) costs this might impose on consumers. To be sure, the Court went on to limit the application of this principle beyond the instant case, but nevertheless appears to link regulatory and civil liability strategies such that the latter buttresses the former. However, given the contortion of the 'structure' of tort law it might go beyond simply a question of complementarity and represent, it is submitted, its functionalization.⁷⁴⁶

Cafaggi has previously stressed, in particular, the role causation plays in civil liability in which the concept of human agency is important.⁷⁴⁷ Absent human agency, it is difficult to attribute cause to a natural or legal person supporting his thesis that the better framework for understanding the relationship between regulation and civil liability is institutional complementarity as distinct from functional equivalence. There is no such difficulty regarding cause in regulatory strategy.⁷⁴⁸ Be that as it may, the gradually decreasing accent placed on causation at both a national and European level in exceptional cases suggests that the divergence between regulatory strategy and tort law as compensation or deterrence is less pronounced than previously considered. In *Boston Scientific*, the obvious objection that the risk in question was a general one was dismissed by reference to the overall regulatory purpose of the safety and product liability regime, which coloured the A-G's and the Court's interpretation of the balancing of interests required. This holistic approach reminiscent of Traynor J. in *Escola* fifty years prior calls into question whether tort law is 'public law in disguise.'⁷⁴⁹ However, if it were simply a question of reallocating benefits and burdens in a uni-directional manner in all cases, this would understate the constitutional dimension of the judgment. In other words, there is an implicit constitutional dimension that elevates citizens' rights and it is not simply a question of internalization of risks for economic or social justice purposes.

Nevertheless, the strong regulatory dimension, providing a deterrence approach, is more patent when one considers that the Court's reasoning bypasses the relational aspect, that is the relation between A and B, in its endorsement of general causation as a sufficient basis for recovery. *Boston Scientific* concerns, mostly, the overall adjustment of benefits and burdens in the Internal market rather than the

⁷⁴⁵ F Cafaggi (n 17) (citations omitted) 201.

⁷⁴⁶ Shavell (n 50) noted the limitations on tort law in terms of its regulatory use in 1984. The *Boston Scientific* judgment appears to be meliorating, from a certain perspective, these limitations.

⁷⁴⁷ The most comprehensive, recent examination of causation is probably T Honore *Responsibility and Fault* (Hart Publishing, 1999).

⁷⁴⁸ F Cafaggi (n 17) 'Causation does not play such a significant role in economic regulation, while in welfare it may play any role at all.' (202) (citations omitted)

⁷⁴⁹ L Greene 'Tort Law as Public Law in Disguise' (1959-1960) 58 *Tex. L. Rev.* 257.

particularities of the relationship between A and B. The global question, as it were, is who should bear the costs when a risk materializes and the argument is premised on the constitutional balance between consumer protection and producer economic rights. These aims of European law are filtered through the rights rhetoric of the Court with the balance falling on the side of ‘vulnerable’ consumers. This is a victim-centred tort law.⁷⁵⁰ This is not an all-or-nothing principle because the vulnerability of the consumers in question and the seriousness of the risk involved tip the balance. In other words, a preference for consumer protection does not mean in all cases that the burden should fall to the manufacturer and the provisions of the Directive should be interpreted in light of these aims. It does suggest, however, that the Court is performing a constitutional function by balancing rights, and appears consistent with other liability case-law. To be sure, it appears less proceduralist than judgments such as *Aziz*. Nevertheless, it is argued that *Boston Scientific* is a very particular application of social thinking within a proceduralist paradigm.⁷⁵¹

In addition, it blurs the line between contract and tort by, in effect, implying a warranty extending to the cost of medical procedures. It allows recovery for pure economic loss because no physical injury is proved. In this respect, it is consistent with the *Putz/Weber* decision. The doctrinal divisions in national law are set aside in the face of overall regulatory imperatives. The notion of legitimate consumer expectations facilitates the dismantling of the contract/tort divide or, perhaps, its overlooking. This poses problems for national law, particularly in those jurisdictions in which a strong division exists between contract and tort premised on the idea that the parties to a contract are best placed to decide the allocation of risk or, in the case of pure economic loss occasioned by manufacturing defects to third parties, that the spectre indeterminate liability justifies policy-backed restraints on recovery.

This is not without significance, because by stripping the law of the subjective right as traditionally understood, it is questionable whether private law’s normativity is not by analogy devalued.⁷⁵² By devaluing or instrumentalising the law in this manner makes it subservient to some other logic, and while the ‘weak corrective justice’ of the twentieth century went some way in this direction; EU law appears to take the next step into the unknown.

⁷⁵⁰ But not without its problems. It has been highlighted that it may prejudice poorer consumers in the future as the additional liability costs are passed on to them.

⁷⁵¹ The proceduralist, experimental orientation of the Court is hypothesized by O Gerstenberg (n 85).

⁷⁵² In a very direct way see Renner (n 10).

The EU's new approach to goods and private law claims in the aftermath of the PIP breast implant scandal

Barend van Leeuwen

Introduction

The PIP breast implant story is well-known. It is a scandal of enormous proportions. Hundreds of thousands of women across the EU and beyond received (potentially) defective breast implants produced by a fraudulent French manufacturer. The manufacturer randomly used cheaper industrial silicone gel to fill breast implants instead of the required medical silicone gel. There is still a significant degree of scientific uncertainty about the precise medical effects of the use of industrial silicone gel.⁷⁵³ Moreover, many women do not even know whether they received breast implants which were manufactured by PIP. And even if they know that they received PIP breast implants, as a result of the random nature of PIP's fraud, they still cannot be certain whether their breast implants contained medical or industrial silicone gel. As a result, many victims have decided to have their breast implants removed or replaced. They are now trying to obtain compensation for the physical and psychological damage which they suffered as a result of the PIP scandal. However, the PIP factory has gone bankrupt and the management of the factory is serving long sentences of imprisonment. They offer no realistic prospect of compensation. Therefore, victims in several Member States are using different litigation strategies to try and obtain compensation. They have often organised themselves through group litigation orders or with the support of consumer protection organisations. One of the main parties against which actions have been brought is TÜV Rheinland, the German certification body which was responsible for the certification of PIP's quality management system. While there is an obvious European dimension to the various claims, the extent to which victims have coordinated their strategies at the European level remains limited. This lack of coordination also resonates in the judgments of national courts.

This paper will argue that the PIP scandal ultimately shows that, in the aftermath of the PIP scandal, private law is being forced to perform a regulatory function which it is not (yet) able to perform. With the New Approach to goods, the EU has placed private certification bodies in the position of gatekeepers of the internal market. These certification bodies use private law tools in their regulatory activities. They are now also held to account by victims through the application of private law – whether on the basis of contract law or tort law. However, “traditional” or national private law does not possess the tools to assess the responsibility and potential liability of private certification bodies in the New Approach. Essentially, this is because the role of private certification bodies in the New Approach is much more like that of public bodies. The public duties or obligations of private certification bodies cannot at the moment be adequately translated to private law. There is a gap in the construction of the New Approach, in that it does not provide sufficient clarity about how the obligations imposed on private certification bodies should be translated to obligations in private law.⁷⁵⁴ In construing the regulatory framework for the New Approach, the EU has not sufficiently thought

⁷⁵³ European Commission, Scientific Committee on Emerging and Newly Identified Health Risks, ‘Preliminary Opinion on the safety of Poly Implant Prothèse (PIP) Silicone Breast Implants (2013 update)’, September 2013, http://ec.europa.eu/health/scientific_committees/emerging/docs/scenih_r_o_038.pdf, last accessed on 16 November 2015.

⁷⁵⁴ B. van Leeuwen, ‘PIP Breast Implants, the EU's New Approach for Goods and Market Surveillance by Notified Bodies’, (2014) 3 *European Journal of Risk Regulation* 338.

about its private law consequences beyond product liability. However, with a bankrupt manufacturer, product liability alone does not provide sufficient protection to recipients of goods in the EU's internal market. The various cases after the PIP scandal show that national private law is not able to assess the conduct of private certification bodies in the light of the role that these bodies play in the EU's regulatory framework for goods. Clearer guidance at the European level – either through legislation or through litigation – is necessary to provide which private law consequences are required to guarantee the effective and safe application of the New Approach to goods.

Overall, the various cases after the PIP scandal show that national private law is not able to provide an adequate *ex post* regulatory framework for victims of defective breast implants. It has to be fused with more *ex ante* European regulation to adapt private law to the role it has to play in the EU's regulatory framework for goods.⁷⁵⁵ At the same time, one has to question to what extent the result of this fusion between private law and EU law aims could still properly be described as private law. After all, if private law has to be adapted – or even transformed – to hold private parties to account for quasi-public conduct in the EU's regulatory framework for goods, the result is that private law becomes less private and more public. Such a transformation of private law would be the direct consequence of the creation of the New Approach and the role which private parties have to play in that regulatory framework.

Three transformations of private law

To illustrate how private law came to have to play this role three transformations of private law and the drivers of these transformations will be analysed. They coincide with the chronology of the PIP scandal. First of all, developments in technology led to the creation of the New Approach to goods. The internal market for goods could only realistically and effectively be completed if national product standards were replaced by European product standards. Because of the technological and scientific difficulties with making these standards, the standard-making process was outsourced to private standardisation organisations, while the enforcement of the standards was outsourced to private certification bodies. Breast implants are regarded as medical devices and, as such, they are covered by the New Approach to goods.⁷⁵⁶ This means that the European standardisation organisation CEN is responsible for making European standards for breast implants and that private certification bodies – so-called “notified bodies” – have to verify that the production process for breast implants complies with the relevant European standards. As such, they have effectively obtained the position of gatekeepers of the internal market for goods. Their stamp of approval is necessary before breast implants can be placed on the European market.

Secondly, the globalisation of the market for cosmetic surgery services has resulted in much more free movement of both service recipients and service providers. The cosmetic surgery sector is a genuinely transnational sector in which there is a lot of competition on price.⁷⁵⁷ Patients are often willing to travel to other Member States if they can obtain cheaper treatment there.⁷⁵⁸ In parallel, the New Approach has significantly increased the free movement of goods in the EU. As a consequence, cosmetic surgery services to receive breast implants might have a number of transnational dimensions: the provider might be in one Member State, the recipient might be from another Member State and the breast implants might have been manufactured in another Member State. These transnational dimensions of both the service and the product have serious implications for the potential of victims to

⁷⁵⁵ Ibid.

⁷⁵⁶ Commission Directive 2003/12/EC on the reclassification of breast implants in the framework of Directive 93/42/EEC on medical devices.

⁷⁵⁷ Interview with Chairman of Dutch Mirror Committee for Aesthetic Surgery Services (Goes) on 29 December 2012 and Interview with ASI (Vienna) on 12 November 2012.

⁷⁵⁸ Interview with VKI (Vienna) on 5 November 2013.

obtain compensation for defective breast implants. They pose a challenge to traditional private law claims for compensation, while at the same time they make private law the more likely forum to deal with failures in the regulatory framework.

Thirdly, and finally, in the aftermath of the PIP scandal, it is clear that there have been a number of developments in society to deal with the consequences of the scandal. In particular, consumer organisations are taking up a more prominent role in helping victims to organise themselves and to try and obtain legal redress.⁷⁵⁹ Furthermore, in some Member States group litigation orders are providing a tool to victims to join forces and to share expertise.⁷⁶⁰ Similarly, many victims use the Internet to exchange views and to inform each other about developments. However, the extent to which their attempts to obtain compensation are successful is limited. Lawyers across the EU are struggling to find the tools to obtain compensation for victims. The three transformations will now be discussed in detail.

Technology, the EU's internal market for goods and the New Approach

In the last decades, the technology for the production of goods has developed enormously. This has resulted in the possibility of much more mass production and standardisation of goods. The production of such product standards created difficulties for the EU. After all, if all Member States adopt different product standards with which products have to comply before they can be placed on the market, such national standards would create obstacles to free movement of goods within the EU.⁷⁶¹ Manufacturers would constantly have to adapt their product standards to the specific requirements of the Member State in which they wanted to place their products on the market. Therefore, it became clear that if the EU wanted to realise a functioning internal market for goods it would have to harmonise national product standards. The CJEU's judgment in *Cassis de Dijon* provided a clear incentive for the EU to make a move from negative integration through the removal of obstacles to free movement to positive integration through the adoption of European product standards.⁷⁶² However, it was difficult for the EU to decide on the precise tools to achieve harmonisation of product standards. The legislative route was extremely slow. Moreover, it proved difficult to agree on technical standards through the legislative process. Finally, there were constant technological innovations, which meant that the legislative process was not really able to keep up to speed with developments in technology. As a result, it became clear that it was not effective to rely exclusively on European harmonisation of legislation to improve the internal market for goods.⁷⁶³

The EU then developed an innovative regulatory framework to improve free movement of goods. This regulatory approach was given the appropriate name of the New Approach. The set-up of the New Approach is relatively simple.⁷⁶⁴ The EU adopts product safety directives which lay down the "essential requirements" with which products have to comply before they can be placed on the market. The technical specifications are then laid down in European standards developed through the European standardisation organisation CEN. If the Commission plans to adopt a directive under the New Approach, it will issue a mandate to CEN to ask it to develop a standard in the field of the planned directive. It will also provide the funding for the making of this standard. After the European

⁷⁵⁹ Ibid.

⁷⁶⁰ Interview with UK barrister (London) on 28 January 2014.

⁷⁶¹ For more background, see M. Egan, *Constructing a European Market: Standards, Regulation and Governance*, (Oxford, OUP, 2003).

⁷⁶² Case 120/78, *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein*, [1979] ECR 649.

⁷⁶³ M. Egan, 'Regulatory strategies, delegation and European market integration', (1998) 5 *Journal of European Public Policy* 485.

⁷⁶⁴ For a detailed analysis of the New Approach, see H. Schepel, *The Constitution of Private Governance* (Oxford, Hart Publishing, 2005), 63-67.

standard has been adopted through CEN, the Commission will publish the reference of the standard in the OJEU. Upon publication of the reference, it is automatically presumed that manufacturers who comply with the provisions of the European standard also comply with the essential requirements of the relevant directive. As such, compliance with the European standard becomes one way for manufacturers to show that they comply with the European product safety legislation. For many products they can show that they comply with the European legislation by placing the CE mark on their products. This is effectively a form of self-certification. For certain more dangerous products the CE mark can only be placed on products after the involvement of a private certification body. This certification body has to be notified to the Commission by the Member State in which it is based as accredited for carrying out certain procedures under the Directive – hence the term “notified body”. For most products the certification body will carry out a conformity assessment procedure, which means that it will whether the manufacturer’s quality management system and product dossier show that they comply with the requirements of the directive. There is no actual inspection of the products – this is only necessary for the most dangerous type of products.

The idea behind the New Approach is that the European legislature remains responsible for the broad framework in which the standardisation organisations and certification bodies operate and that all political choices are made in the legislative process. As a result, the mandate of the private parties is restricted to narrow issues of technology, which can be separated from the more political issues. With the New Approach, the EU has effectively outsourced two aspects of the governance of the internal market for goods to private parties. For both aspects it is believed that private parties have more technological expertise than the State or the EU, which means that it is more efficient to delegate certain tasks – traditionally carried out by public bodies – to them. First of all, private standardisation organisations become responsible for the standard-setting process. While the European Commission will always take the initiative for a European standard under the New Approach, it is unlikely that it actually participates in the standard-setting process.⁷⁶⁵ The Standardisation Regulation 2012 is supposed to provide a number of procedural safeguards to ensure that European standardisation includes the views of a broad and representative group of stakeholders.⁷⁶⁶ However, in reality it is difficult for the EU to really exercise direct influence on parties who are involved in the making of European standards.⁷⁶⁷ One of the fundamental questions about the New Approach is to what extent the outsourcing of standard-setting to private parties was necessary because of a lack of experience of the EU institutions or public supervisory agencies. It could be the case that the outsourcing or delegation of responsibility to private parties was just a matter of convenience to the EU. To address this question in detail is beyond the scope of this paper. In any event, it is clear that the fact that the EU has delegated certain tasks to private parties does not mean that it is no longer responsible for failures in the regulatory framework in which these private parties act.

Once a European standard has been adopted, the next question is how this standard is enforced. The fundamental basis of the New Approach is that manufacturers are individually responsible for ensuring that their products comply with the requirements of a European standard. This is combined with the Product Liability Directive, which provides for liability of the manufacturer if defective products are placed on the market.⁷⁶⁸ The Directive does not oblige manufacturers to exercise monitoring of their products – they are only liable for damage caused by defective products. Monitoring obligations are not included in the scope of the Directive. As such, the construction of the New Approach places significant reliance on the declaration of manufacturers that their goods comply with the relevant European standard. For certain types of products, manufacturers first have to go to a

⁷⁶⁵ Interview with DG Enterprise of the European Commission (Brussels) on 29 November 2012.

⁷⁶⁶ Regulation 1025/2012 of the European Parliament and of the Council on European standardisation.

⁷⁶⁷ Interview with DG Enterprise of the European Commission (Brussels) on 29 November 2012.

⁷⁶⁸ Council Directive 85/374/EEC on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products.

notified body for a conformity assessment procedure. For breast implants, the precise requirements of the conformity assessment procedure have been laid down in the Annexes of the Medical Devices Directive.⁷⁶⁹ It is important to note that notified bodies are not required to inspect breast implants to verify if they comply with the European standards. Their role remains limited to inspecting the paperwork of manufacturers – the product design dossier and the quality management system have to show that the manufacturer is complying with the European standards.⁷⁷⁰ In most Member States there are only a limited number of notified bodies. They do not possess a general competence under the New Approach – they must always be notified for a specific directive. Most of the notified bodies are private certification organisations, but some of them are in fact public bodies.⁷⁷¹ The role of notified bodies focusses on *ex ante* regulation. Manufacturers have to obtain the approval of notified bodies *before* they can place their products on the European market. Therefore, notified bodies have obtained a key position in the EU's internal market for goods – they control access to the market for goods. However, the principle remains that notified bodies only help manufacturers to make the required declaration of compliance. They do not themselves guarantee that the products which have been approved by them actually comply with the European standards. Although the focus of notified bodies is on *ex ante* regulation, they also have a role to play after the products have been placed on the market. The Annexes of the Medical Devices Directive provide that notified bodies have to carry out inspections after the product has been placed on the market.⁷⁷² However, it would appear that these inspections do not have to be unannounced. Public supervisory agencies also have an important role to play in the supervision of the market. However, their role is limited to the moment *after* products have been placed on the market. As such, they do not exercise the same degree of control over the access to the market as notified bodies. Nevertheless, they have the power to remove products from the market if it has become clear that they do not comply with the European standards.⁷⁷³ This once again emphasises the gatekeeper function of notified bodies. They are the only party that really controls the access to the market. The control exercised by public supervisory bodies is significantly less strict, because they are always one step behind and have no power to avoid the initial step of products being placed on the market.

In the PIP case, the notified body responsible for the conformity assessment procedure was TÜV Rheinland (“TÜV”). TÜV is a large German private certification body which is active all over the world. The conformity assessment procedure for PIP was undertaken by a French subsidiary. From 1997 to 2004 TÜV issued a number of certificates to PIP at a time when PIP's fraudulent conduct had already started. As a result, PIP was able to continue to place its products on the European market. Furthermore, TÜV carried out a number of announced inspections. After the PIP scandal was finally discovered in 2010, a number of victims in Germany and France decided to bring claims for compensation against TÜV. In particular, they argued that TÜV had not complied with their obligations set out in the Medical Devices Directive. They claimed that TÜV should have inspected actual products and should have carried out unannounced inspections. If TÜV had done this, they would have discovered the fraud and the damage to victims would have been much more limited. As will be discussed below, the German and French courts reached different conclusions about the liability of TÜV in the New Approach. These cases will be further analysed below.

Before we move on to the second process of transformation through economisation and globalisation, it is important to emphasise the impact of the creation of the New Approach – driven by technological developments – on private law. The New Approach does not only represent a shift from public

⁷⁶⁹ Annex II of Council Directive 93/42/EEC concerning medical devices.

⁷⁷⁰ Articles 3 and 4 of Annex II.

⁷⁷¹ J.-P. Galland, ‘The Difficulties of Regulating Markets and Risks in Europe through Notified Bodies’, (2013) 3 *European Journal of Risk Regulation* 365-373.

⁷⁷² Article 5 of Annex II.

⁷⁷³ Articles 10 and 19 of the Medical Devices Directive.

regulation to private regulation – whether through European standardisation or through the activities of notified bodies –, it also has a direct impact on the function of private law in the internal market. The relationship between manufacturers and notified bodies is contractual – the conformity assessment procedure is a contract for services concluded between the manufacturer and a notified body. It is this contract which is necessary for manufacturers to obtain access to the internal market. Certification is a common regulatory tool in the services and goods sectors, but normally it remains without direct consequences in private law.⁷⁷⁴ Consumers cannot claim that because a product or service is certified they are entitled to absolute compliance with the standards on the basis of which certification has taken place. In the New Approach, certification has a much more direct legal impact. Certification has been upgraded to a precondition for access to the internal market. As a consequence, the New Approach has not only had an impact on the question of *who* provides access to the internal market, but also on *how* access to the market is provided. The contract between manufacturer and notified body constitutes a crucial step towards access to the market. Private law has been given a central regulatory function in the New Approach. The question which will be discussed later is to what extent the private law relationship between manufacturer and notified body has broader legal implications beyond the relationship between these two parties.

Economisation and globalisation of cosmetic surgery services

The New Approach provided a real boost to free movement of goods in the EU. As a result, PIP was able to place thousands of breast implants on the European market. It is estimated that a total of 300,000 women received PIP breast implants in around 65 countries.⁷⁷⁵ It is clear that the impact of the scandal reaches far beyond the borders of the EU. The breast implants would usually be supplied by suppliers to service providers in the Member States. Doctors or private clinics would normally not obtain the breast implants directly from the PIP factory. The result is a complicated supply chain with a number of different actors in different Member States. However, the transnational dimension of the PIP scandal is not just restricted to the free movement of goods. Similarly, both cosmetic surgery providers and patients frequently move from one Member State to another.

The success of the New Approach also contributed to a process of economisation and globalisation of the provision of cosmetic surgery services in the EU. Cosmetic surgery has become a very profitable market. Statistics in the UK show that in 2014 there were 45,406 aesthetic surgical procedures.⁷⁷⁶ This was a slight decrease in comparison with 2013. One of the explanations for the decrease could be the PIP scandal. Another explanation could be the financial crisis.⁷⁷⁷ Cosmetic surgery is normally offered by private healthcare providers outside the public healthcare system. There is a significant amount of advertisement, treatments are voluntary and easy to obtain. This means that the patient is not really a patient but more of a consumer. This consumer is even prepared to travel across borders for treatment. As a result, it is possible to say that cosmetic surgery is offered on a market which is removed from the traditional public healthcare systems. Furthermore, the market is truly European, or even international. Secondly, the medical professionals who operate on this market have very different qualifications.⁷⁷⁸ Various medical specialties perform treatments which could be described as falling within the scope of cosmetic surgery. Plastic surgeons are the main specialty which has entered the cosmetic surgery market, but dermatologists, ENT-surgeons and even general practitioners also operate on the market. Moreover, it is possible for doctors with basic training to be involved in

⁷⁷⁴ H. Schepel and J. Falke, *Legal Aspects of Standardisation of the EC and EFTA, Volume 1: Comparative Report*, (Luxembourg, Office for Official Publications of the European Communities, 2000), 237-238.

⁷⁷⁵ See <http://www.bbc.com/news/health-16391522>, last accessed on 16 November 2015.

⁷⁷⁶ See <http://www.bbc.com/news/health-30883387>, last accessed on 16 November 2015.

⁷⁷⁷ *Ibid.*

⁷⁷⁸ Interview with Chairman of Dutch Mirror Committee for Aesthetic Surgery Services (Goes) on 29 December 2012.

cosmetic surgery. In some Member States it is even possible for nurses to perform cosmetic surgery treatments.⁷⁷⁹ This means that the market is full with different service providers. Some do not have a fixed location and travel from one Member State to another with their products and materials. Some of them have decided to call themselves cosmetic surgeons, which in many Member States is not a protected title.⁷⁸⁰ This could create confusion for patients, as the use of the term surgeon would imply specialist training as a surgeon. This is just one example of a lack of regulation of cosmetic surgery services at the national level. The only Member State which has a very clear regulatory framework is France, in which it is provided by law that all aesthetic surgery treatments have to be performed under the supervision of a plastic surgeon.⁷⁸¹ Following the PIP breast implant scandal, the cosmetic surgery sector has come under the attention of national regulatory agencies that, in cooperation with the EU, are working to fill regulatory gaps and to tighten the regulation of the cosmetic surgery sector.⁷⁸²

The PIP scandal provides a perfect illustration of the economisation and globalisation of the cosmetic surgery sector. Many of the Austrian victims who are currently represented by the Austrian consumer organisation VKI travelled to the Czech Republic, Slovenia or Hungary for treatment. They often did not speak the language, which meant that it was difficult for them to communicate with the doctor who treated them.⁷⁸³ Moreover, they returned to Austria almost immediately after the treatment. The process of after-care was not supervised by the doctor who performed the original treatment. It is clear that the price of the treatment – which was significantly lower than in Austria – was the main factor in deciding to travel to Central Europe for cosmetic treatment.⁷⁸⁴ The Austrian women regarded cosmetic surgery services as a product – they did not think about the qualifications of the provider and the potential complications after the operation. They now pay the price for this in the aftermath of the PIP scandal. It is often difficult for them to identify the clinic where they were treated and it is even more difficult to identify the doctor who treated them. They have limited information about the contract which they concluded with the clinic or doctor. Therefore, it is difficult to identify its contractual terms. Furthermore, they sometimes cannot even be sure about the type of breast implants they received, because they have been given limited documentation. The result of the cross-border dimension of the provision of cosmetic surgery is that it is not a realistic option for Austrian victims to start legal proceedings in the Member State in which treatment took place. As a consequence, they have united themselves through a consumer organisation and have brought their claim for compensation against PIP's insurer, the French subsidiary of the German insurer Allianz.⁷⁸⁵ This adds a number of complications, because Allianz had been obliged to insure PIP by French legislation, which provided that they only had to cover damage that occurred in France. On that basis, Allianz is now arguing that it is not liable to compensate Austrian victims for whom the damage occurred outside France.

This story has a number of implications for private law. First of all, it is clear that the globalisation of the market has reduced the ability of the State to exercise control over the cosmetic surgery sector. National legislation has difficulties to regulate the transnational dimensions of cosmetic surgery. Consequently, private regulation could potentially obtain a more dominant regulatory function. However, the main point is that public law supervision has failed to cope with the PIP scandal. It has failed *ex ante* and its *ex post* role is also limited. Very few of the victims of the PIP scandal are trying

⁷⁷⁹ Ibid.

⁷⁸⁰ Ibid.

⁷⁸¹ Interview with ASI (Vienna) on 12 November 2012.

⁷⁸² By way of example, in the UK, a report was published by a Commission chaired by Sir Bruce Keogh: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/192028/Review_of_the_Regulation_of_Cosmetic_Interventions.pdf, last accessed on 16 November 2015.

⁷⁸³ Interview with VKI (Vienna) on 5 November 2013.

⁷⁸⁴ Ibid.

⁷⁸⁵ Ibid.

to obtain compensation from the State. This could be for pragmatic reasons, for example because the public supervisory agency they would have to bring a claim against is based in another Member State. However, a more fundamental issue is that the role of the State in regulating the market for breast implants is limited and that the State is not really able to effectively supervise the cosmetic surgery sector. The outsourcing of the gatekeeper function to notified bodies has more general implications for public supervision of the market. In the New Approach, private regulation is much more prominent and dominant. Therefore, the focus of the victims has shifted to private law to obtain compensation. Private law has obtained a more dominant regulatory function as a result of the economisation and globalisation of the cosmetic surgery sector.

Within private law, globalisation has also had an impact on the parties against whom victims are now bringing their actions. For the reasons set out above, it is only a small group of victims who are now bringing traditional private law claims against their doctors. Similarly, victims are unable to start a traditional European private law claim under the Product Liability Directive against the manufacturer because PIP has gone bankrupt. The result is that they are looking for other options for compensation. Inevitably, this process is somewhat opportunistic. It also means that the struggle for compensation has become fragmented. In Germany and France actions have been brought against TÜV, while in France different actions have been brought against Allianz. In the UK and the Netherlands claims are brought against the private clinics where victims received their breast implants. All of this shows the *fragmentation* of the regulatory function of private law. The fragmentation is visible in the different fora in which claims are brought, but also in the different parties against which actions for compensation brought. While a more fragmented approach to compensation is not necessarily problematic, it is complicated because it means that different legal standards are applicable to the actions of different actors in the PIP scandal.⁷⁸⁶ For example, the actions of TÜV will primarily be assessed under the Medical Devices Directive, while the actions of Allianz will be assessed under the relevant French legislation. The question is to what extent this fragmentation makes it more difficult for private law to integrate the EU law dimension in the claims for compensation brought by the victims. This EU law dimension is necessary, because EU law – in this case, the New Approach to goods – is at the very root of the problem.

New forms of private organisation and transnational private law claims

As has already been introduced above, after the PIP scandal victims have organised themselves in different ways to try and obtain compensation. In many cases they have brought collective claims to share the burden of bringing legal proceedings and to be able to share expertise. The transnational dimension of their claims makes it even more important for victims to unite. Consumer organisations are playing an important role in channelling and coordinating the efforts of victims to obtain redress.⁷⁸⁷ At the same time, victims have made different choices as to whom to bring an action against. This has resulted in several different actions in different Member States.

The Austrian consumer organisation VKI has brought a claim against the insurer Allianz in Paris on behalf of about 70 victims. All victims are Austrian and the case management is coordinated in Vienna. However, the lawyers of VKI are cooperating intensively with a French lawyer in Paris, who is bilingual in German and French.⁷⁸⁸ She is responsible for conducting the proceedings in Paris. The main basis of their claim is that Allianz is responsible and liable to compensate victims for the damage which has been caused by the fraudulent conduct of PIP. However, there are two main obstacles to this claim. The first is that Allianz is claiming that the insurance contract was invalidated as a result of the fraud committed by PIP. Secondly, Allianz had been obliged to provide insurance to PIP under French

⁷⁸⁶ See B. van Leeuwen, above n 2.

⁷⁸⁷ Interview with VKI (Vienna) on 5 November 2013.

⁷⁸⁸ *Ibid.*

legislation. The requirement of insurance was imposed by national law and only covered damage that occurred in France.⁷⁸⁹ There was no requirement under EU law or under the Product Liability Directive for manufacturers to obtain insurance. The French legislation limited insurance to damage that occurred in France. In other proceedings against Allianz in France, the validity of the French legislation has been upheld and Allianz has only been held liable to compensate victims for damage that occurred in France.⁷⁹⁰ However, the French courts have rejected Allianz' defence that the PIP's fraud meant that the insurance contract was no longer valid. The proceedings in Paris are ongoing.

In the United Kingdom, victims have brought a group action against a number of private clinics in which patients received PIP breast implants. This group action is less transnational, since both the service recipients – the patients – and the service providers – the clinics or doctors – are based in the UK. The claims are brought in contract law and the victims claim that the PIP breast implants which they received did not comply with the implied term that they would be of satisfactory quality. The first substantive hearing was supposed to take place in October 2014. The intention of the parties was that the judge would deal with two preliminary issues before deciding how the case should proceed.⁷⁹¹ First, the issue of satisfactory quality: were the PIP breast implants of satisfactory quality? Secondly, the issue of remedies: would victims be entitled to replacement of the breast implants or would they only be entitled to damages? These two issues would be decided in four sample cases, which were considered to be representative of most of the cases. For all these cases the victims had received the breast implants in the same private clinic. However, just before the hearing it became clear that there was an ongoing legal dispute between this private clinic and its insurer about the validity of the insurance contract.⁷⁹² As such, it appeared that the case might have been brought against a clinic with no insurance and, as a result, very limited resources to pay compensation. It has now been agreed between all parties that the hearing should be postponed until the insurance dispute has been resolved.⁷⁹³ The group litigation in the UK shows how difficult it is for claimants to identify potential defendants who would actually have the financial means to pay compensation. In the Netherlands, an individual victim has also brought an action against the clinic in which she received breast implants. The Court of Appeal of 's-Hertogenbosch has held that the clinic would in principle be liable to the victim if the victim could show that her breast implants contained industrial silicone gel.⁷⁹⁴ Therefore, it would not be necessary for her to prove that the industrial silicone gel caused medical harm. However, she would still have to prove that her breast implants did in fact contain industrial silicone gel. The case has now been adjourned for the claimant to provide evidence that her breast implants contained industrial silicone gel. This is still quite a challenge for victims, since their original breast implants have often been destroyed and it cannot be ascertained with sufficient certainty when they were made and whether the series that they were part of were filled with industrial silicone gel.

The cases in France, the UK and the Netherlands provide a good illustration of the difficulties that victims of the PIP scandal face in trying to obtain compensation. First, they have to identify defendants who have the financial means to pay compensation. Second, they have to overcome several evidential – were the breast implants in fact defective? – and legal obstacles – is there an obligation to compensate for damage that occurred outside France? – before their claims can be successful. From that perspective, it is not surprising that victims have also tried to identify another potential defendant with a significant amount of financial resources. This is why they have also focussed on the role of TÜV in the PIP scandal. Both in France and Germany claims have been brought against TÜV. The

⁷⁸⁹ Ibid.

⁷⁹⁰ See <http://www.lefigaro.fr/actualite-france/2012/06/14/01016-20120614ARTFIG00706-pip-allianz-devra-indemniser-les-victimes.php>, last accessed on 16 November 2015.

⁷⁹¹ Interview with UK barrister (London) on 28 January 2014.

⁷⁹² E-mail with UK barrister (London) on 5 October 2014.

⁷⁹³ Ibid.

⁷⁹⁴ Judgment of Court of Appeal 's-Hertogenbosch, 25 november 2014, ECLI:NL:GHSHE:2014:4936.

claims focus on the way in which TÜV conducted the conformity assessment procedure of the PIP factory and the way in which they conducted the periodic inspections after the products had been brought on the market. In France, the case was brought before the Tribunal de Commerce de Toulon on behalf of a large group of victims and suppliers based in several countries (not only EU Member States). In Germany, most cases were brought by individual victims. Because the French case was successful at first instance many victims from other Member States joined the proceedings against TÜV in France. In Germany, so far all claims have been dismissed. However, the Bundesgerichtshof has now made a preliminary reference to the CJEU with a number of questions about the scope of the obligations of notified bodies under the Medical Devices Directive and about whether the aims and purpose of the Medical Devices Directive require that notified bodies can be held liable to provide compensation to victims of defective goods if they have breached their obligations under the Directive.⁷⁹⁵

Both in France and in Germany the claims against TÜV were based on two foundations. First of all, TÜV should have done more *during* the conformity assessment procedure – in particular, they should have inspected actual products. Secondly, TÜV should have done more *after* the conformity assessment procedure – in particular, they should have carried out unannounced inspections of the PIP factory. If they had done this, TÜV would have discovered the fraud earlier and the damage caused by PIP's fraud would have been much more limited. In France, the Tribunal de Commerce de Toulon delivered its judgment in November 2013.⁷⁹⁶ First of all, it criticised TÜV for conducting the conformity assessment procedure through its subsidiary in France. This subsidiary had not been notified under the Medical Devices Directive and, therefore, was not formally allowed to conduct conformity assessment procedures.⁷⁹⁷ The Tribunal held that the functions performed by TÜV constituted a real delegation of public services.⁷⁹⁸ Moreover, it found that if TÜV had carried out unannounced inspections it would have discovered the fraud committed by PIP. Previous problems with the PIP factory in the early 2000s should have alerted TÜV and should have resulted in more stringent control of PIP by TÜV.⁷⁹⁹ The Tribunal concluded that TÜV had kept to an absolute minimum of its obligations under the Medical Devices Directive. It concluded that TÜV had breached its duties of vigilance and surveillance. On that basis, it held TÜV liable to compensate the victims. It awarded interim damages of €3000 per claimant. However, in July 2015, the Court of Appeal of Aix-en-Provence allowed the appeal and found in favour of TÜV. The Court held that TÜV had fulfilled its obligations under the Medical Devices Directive. TÜV was not obliged to carry out unannounced inspections and it was not required either to inspect products to test if they contained the required medical silicone gel.⁸⁰⁰

The German courts had taken this approach from the start. In March 2013, the Landgericht ("LG") Frankenthal dismissed a claim brought by a German victim against TÜV.⁸⁰¹ The claim was dismissed on three main grounds. First of all, the claimant could not show that she had suffered medical harm as a result of receiving PIP breast implants. The implants had been removed pre-emptively.⁸⁰² Secondly, she could not prove that she had received implants which contained industrial silicone gel. The

⁷⁹⁵ See http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=pm&pm_nummer=0052/15, last accessed on 16 November 2015.

⁷⁹⁶ Judgment of Tribunal de Commerce in Toulon of 14 November 2013 (N° de rôle: 2011F00517).

⁷⁹⁷ *Ibid.*, 141.

⁷⁹⁸ *Ibid.*, 141.

⁷⁹⁹ *Ibid.*, 141-142.

⁸⁰⁰ See http://www.lemonde.fr/societe/article/2015/07/02/protheses-pip-le-certificateur-n-a-pas-commis-de-faute-selon-la-justice_4667137_3224.html, last accessed 16 November 2015.

⁸⁰¹ Judgment of Landgericht Frankenthal (Pfalz) of 14 March 2013 – 6 O 304/12.

⁸⁰² M. Oeben, LG Frankenthal: Industriesilikon in Brustimplantaten – Kontrollpflichtverletzung durch die benannte Stelle', *MPR* 2013, 134-140, 135.

approach of the LG Frankenthal was similar to that later taken by the Dutch court – it was necessary for the claimant to prove that her specific breast implants contained industrial silicone gel.⁸⁰³ Thirdly, the LG Frankenthal held that TÜV had not breached any of its obligations under the Medical Devices Directive.⁸⁰⁴ The obligations of notified bodies were clearly set out in Annex II of the Directive. TÜV had to inspect the quality management system and the product design dossier of PIP, but it was under no obligation to inspect products. Moreover, while the Directive obliged TÜV to carry out regular inspections, these inspections did not have to be unannounced. The Directive only provided that notified “may” carry out unannounced inspections, but they were under no obligation to do so. The LG Frankenthal made a clear distinction between the duties of notified bodies – which were merely assisting manufacturers to make the declaration required to place products on the market – and the duties of public supervisory agencies, which were responsible for the supervision of the market.⁸⁰⁵

The claimant appealed to the Oberlandesgericht (“OLG”) Zweibrücken, which dismissed her appeal in January 2014.⁸⁰⁶ However, the approach taken by the OLG Zweibrücken was significantly different from that taken by the lower court. The LG Frankenthal assumed that the obligations imposed on notified bodies by the Medical Devices Directive constituted the required duty of care in tort owed to women with breast implants and held that these obligations had not been breached. This was essentially similar to the approach taken by the Tribunal de Commerce de Toulon. However, the OLG Zweibrücken went one step back to consider *whether* a duty of care, either in contract or in tort, was owed by TÜV to women with breast implants at all. First of all, it held that the contract between TÜV and PIP was a contract for services which did not create protective effects for women with PIP breast implants. It constituted merely a “building block” for the manufacturers to show that they complied with the requirements of the Directive.⁸⁰⁷ As a result, TÜV did not owe a contractual duty of care towards the women. The responsibility for compliance with the requirements of the Medical Devices Directive remained with the manufacturer. Similarly, the OLG Zweibrücken held that TÜV did not owe a duty of care in tort to women with PIP breast implants. There was no general duty of care to prevent bodily harm. Such a duty of care could arise if a specific duty of care was imposed by way of legislation, but the Medical Devices Directive did not impose such a duty of care on TÜV – despite the reference to the protection of the interests of patients in the preamble of the Directive.⁸⁰⁸ The conformity assessment procedure undertaken by TÜV did not create a legal guarantee that the products complied with the requirements of the Directive. The OLG Zweibrücken reaffirmed the strong separation of duties between notified bodies and public supervisory agencies. Product certification could and should not be placed at the same level as market surveillance. Finally, and only in the alternative, it held that if a duty of care in tort was owed by TÜV to women with PIP breast implants, there had been no breach of the duty of care.⁸⁰⁹ Here, it essentially followed the reasoning of the LG Frankenthal. The victim appealed to the Bundesgerichtshof where her case was joined to a number of similar cases. The Bundesgerichtshof has now made a preliminary reference to the CJEU. It has sent three questions to Luxembourg.⁸¹⁰ First, is it the aim and purpose of the Medical Devices

⁸⁰³ *Ibid.*, 136.

⁸⁰⁴ *Ibid.*, 136-138.

⁸⁰⁵ *Ibid.*, 137.

⁸⁰⁶ Judgment of OLG Zweibrücken of 30 January 2014 – 4 U 66/13.

⁸⁰⁷ Judgment of OLG Zweibrücken of 30 January 2014, II 2.2 b) aa) and bb).

⁸⁰⁸ See G. Spindler, ‘Market Processes, Standardisation and Tort Law’, (1998) 4 *European Law Journal* 316, 331. The exact wording of the recital is as follows: ‘Whereas medical devices should provide patients, users and third parties with a high level of protection and attain the performance levels attributed to them by the manufacturer; whereas, therefore, the maintenance or improvement of the level of protection attained in the Member States is one of the essential objectives of this Directive’.

⁸⁰⁹ Judgment of OLG Zweibrücken of 30 January 2014, 2.2 e).

⁸¹⁰ See http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=pm&pm_nummer=0052/15, last accessed on 16 November 2015.

Directive that notified bodies act to protect individual patients with the result that notified bodies are directly liable to patients if they have breached their duties under the Medical Devices Directive? Second, are notified bodies required to inspect products under the Medical Devices Directive? Third, are notified bodies required to carry out unannounced inspections under the Directive?

The fundamental difference between the judgment of the OLG Zweibrücken and the judgments of the LG Frankenthal and the Tribunal de Commerce de Toulon is that the OLG Zweibrücken made a real attempt to translate the regulatory requirements imposed on notified bodies by the New Approach into national private law. This makes the judgment more convincing from the perspective of legal reasoning. At the same time, it also very clearly shows how the OLG Zweibrücken is struggling to understand the role of notified bodies in the EU's regulatory framework for goods and to decide what impact that role should have on liability on private law. Its interpretation of certification is based on "traditional" certification outside the New Approach – the kind of certification which does not create third-party effects. However, one of the key questions is whether the very construction of the New Approach requires that certification – as a way of providing access to the EU's internal market – creates third-party effects and requires that certification bodies can be held liable to users of defective goods. The approach of the OLG Zweibrücken is essentially a very formalistic national private law approach, which would have been convincing if it had not ignored the EU law dimension of the claims brought by victims of PIP breast implants.⁸¹¹ The challenge is to identify how national courts could or should approach the question of liability of notified bodies in the New Approach. It is clear that because the problems which have arisen in the PIP scandal go to the very foundations of the EU's New Approach to goods, the solution also has to be provided at the European level.

Translating EU law in national private law: towards a European approach

The judgment of the OLG Zweibrücken illustrates the difficulties national courts encounter in deciding what the impact of the regulatory requirements imposed on certification bodies by the New Approach should be on liability in private law. According to traditional German private law, an obligation to prevent harm could only be imposed on TÜV if it was expressly provided in legislation. The Medical Devices Directive did not expressly provide that TÜV's actions were taken with the aim to protect women with breast implants. The problem with this approach is that it takes a traditional perspective on certification and ignores the role the conformity assessment procedure has in the New Approach. A preference for coffee which has been produced in an environmentally friendly way cannot really be placed at the same level as an assessment of whether breast implants comply with the relevant European safety legislation. It has already been emphasised above that certification bodies have been given the power to decide whether products can be placed on the European market – their traditional function has been upgraded significantly. It is difficult to see how this key role in the internal market does not have a direct impact on the safety and interests of consumers and patients. In the framework of the New Approach, there is a direct link between certification and the possibility of harm to victims of defective products. This means that the EU becomes responsible for providing more guidance to national private law as to what the result of this upgraded kind of certification should be for the potential liability of notified bodies. The Bundesgerichtshof has now directly invoked the assistance of the CJEU to get guidance on what EU law requires from private law in cases where notified bodies are alleged to have carry out their obligations under the Medical Devices Directive in a negligent way. Two possible approaches to remedy the inadequacy of national private law could be envisaged. The first approach could be described as a bottom-up solution, while the second approach could be regarded as more of a top-down solution.

First of all, guidance to national courts could be provided by applying the principle of effectiveness of EU law. Private law remedies could be necessary to guarantee the effective application of EU law – in

⁸¹¹ B. van Leeuwen, above n 2, 348-349.

this case, the Medical Devices Directive – and national courts have to decide claims brought in the aftermath of the PIP scandal by taking into account what the effectiveness of the New Approach requires.⁸¹² Such an approach would still leave a significant amount of discretion to national private law – the only thing the CJEU would be required to do was to define the boundaries within which national private law should operate. However, national private law would still have to assess cases in light of the aim and purpose of the EU's regulatory framework for goods. This is the route chosen by the Bundesgerichtshof in the cases brought against TÜV. The challenge for the CJEU is now to define what the aim and purpose of the Medical Devices Directive are. This is not a simple question to answer. Although the recitals of the Directive explicitly refer to the fact that medical devices should provide a high level of protection to patients, the Directive itself is based on the EU's internal market competence (now Article 114 TFEU). The whole construction of the New Approach is very much focussed on free movement of goods. At the same time, it is clear that such free movement of goods can only be effective if the goods provide the required safety level and do not harm consumers who buy them. As such, it cannot be denied that it is also one of the aims of the New Approach to take all necessary steps to ensure that goods placed on the European market comply with the required level of safety. However, even if this is accepted, it is another matter whether the effectiveness of the regulatory framework also requires that consumer or patients have a direct claim against the notified body that performed the conformity assessment procedure. The EU has already adopted the Product Liability Directive to provide for the possibility of liability of the manufacturer. Is it necessary to create an additional type of liability for notified bodies? What would be its relationship with product liability? After the PIP scandal TÜV is being sued because the manufacturer has gone bankrupt and the Product Liability Directive does not offer a solution to victims. There is a valid case to be made that in such cases EU law should provide for an alternative type of liability. But what would happen if the manufacturer was still solvent? In such cases, could victims then choose between bringing an action against the manufacturer or the notified body? Or would they be required to bring a claim against the manufacturer? In practice, they are always likely to prefer the manufacturer, since liability under the Product Liability Directive is not fault-based.⁸¹³ As is clear from the questions referred to the CJEU by the Bundesgerichtshof, even if the effective application of the Medical Devices Directive requires that notified bodies could be held liable in private law, claimants will still have to show that they breached their obligations under the Directive. Because the Directive did not oblige notified bodies to carry out unannounced inspections and to inspect physical products, it is far from clear that TÜV breached the duties provided in Annex II.

Whatever the outcome of the case will be, the CJEU's judgment will provide a number of *ex ante* standards on *whether* notified bodies can be held liable and *in which circumstances* this can be done. The possibility of liability of notified bodies for failures in the conformity assessment procedure could encourage them to be more cautious and to invest in stricter and more regular supervision of manufacturers. At the same time, the potential liability could also make certification bodies less inclined to become a notified body under the Medical Devices Directive. This could ultimately act as an obstacle to the effectiveness of the New Approach. Therefore, it is also important for the EU to obtain clarification about whether and when notified bodies could be held liable.

A second possible approach would be to define more clearly in the directives adopted under the New Approach what duties or obligations private certification bodies have and what consequences these obligations should have in private law at the national level. A significant part of the dispute between TÜV and the victims of PIP breast implants is based on differences in interpretation of what notified bodies are expected to do under Annex II of the Medical Devices Directive. This is a problem which could be dealt with through the legislative procedure. An updated Medical Devices Directive is

⁸¹² B. van Leeuwen, above n 2, 349.

⁸¹³ Articles 1, 6 and 7 of the Product Liability Directive.

currently going through the European legislative machinery.⁸¹⁴ This Directive already defines much more precisely what the obligations of private certification bodies are. However, it does not provide adequate guidance on the liability of certification bodies in the New Approach. This is something which could be expressly provided in the Directive. At the moment, the only thing the Directive does is to oblige notified bodies to have insurance.⁸¹⁵ It could expressly provide that notified bodies are or are not liable to victims of defective products if they have breached their obligations under the Directive.

The advantage of the legislative approach is that it has more direct democratic legitimisation than solely relying on the CJEU and national courts. Moreover, this approach would lead to more uniformity across the EU. It would result in more clearly defined – and stricter – *ex ante* standards for private certification bodies. Exclusive reliance on the effectiveness principle would still mean that national courts would be required to determine *ex post* and on a case-by-case basis what standards notified bodies have to comply with. This would result in much more uncertainty – both for certification bodies and for victims of defective goods. Overall, it is likely that the two approaches will have to be combined to achieve a safer internal market for goods.

Conclusion

This paper has discussed three transformations of private law through an analysis of the PIP breast implant scandal. It has shown how technology, globalisation and societal developments have each contributed to changes both in the form and function of private law. In the EU, the New Approach provides a clear example of how private regulation and private law are being instrumentalised to build an internal market and to increase free movement of goods. However, the PIP scandal also shows that private law has not yet fully transformed to deal with follow-up cases brought by victims of defective products which were covered by the New Approach. While the EU has provided for liability of manufacturers with the Product Liability Directive, the regulatory framework for liability for potential failures in monitoring the market is still incomplete. This gap could be filled by the possibility of liability of notified bodies. At the same time, it raises the question how this kind of liability relates to the Product Liability Directive.

Ultimately, the PIP scandal illustrates the interdependence between private law and EU law. EU law needs private law to guarantee the effective application of EU law, but private law also needs EU law. It could be said that private law has to be regulated by EU law to be able to contribute to the effective functioning of the New Approach to goods. This regulation necessarily means that more standards in private law are provided by EU law. The aftermath of the PIP scandal has shown that courts in different Member States have reached different solutions on the basis of their interpretation of national private law. While this is not necessarily problematic, in this case EU law is at the roots of the problem and the EU law dimension of the cases cannot be ignored. More guidance is necessary as to what exactly is expected from private law to adequately fulfil its regulatory function in the New Approach. It has to be recognised that in the New Approach essential and important public obligations are fulfilled by private parties through private law tools. As these private law tools have been given a public function, this should also have consequences for liability claims in national

⁸¹⁴ Proposal for a Regulation on medical devices, and amending Directive 2001/83/EC, Regulation (EC) No 178/2002 and Regulation (EC) No 1223/2009 (COM (2012) 542) .

⁸¹⁵ Annex XI of the Medical Devices Directive.

courts.⁸¹⁶ Two strategies to provide more EU law input into national private law have been proposed – the bottom-up approach of relying on the principle of effectiveness of EU law and a top-down approach based on legislative amendments to the Medical Devices Directive. In the end, it is probable that a combination of both approaches will be adopted. This should guarantee adequate protection to patients or consumers who receive defective medical devices. In essence, this Europeanisation would constitute another transformation of private law.

⁸¹⁶ L. Azoulay, 'The Court of Justice and the Social Market Economy: The Emergence of an Idea and the Conditions for its Realization', (2008) 45 *CML Rev* 1335-1355.



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