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## Driving forces and changing goals of the EU competition law and policy

*Václav Šmejkal<sup>1</sup>*

*The current economic crisis has already had and will yet have an undeniable impact on the prevailing doctrine of competition law and policy. As the main canons of neoliberal economic theory have been shaken, inevitably the goals and principles of the competition policy are nowadays questioned too. Should the regulation of economic competition serve only the higher efficiency (in micro-economic terms) objective and disregard other economic and social needs of the society as a whole or should it be a part of the macro-economic policy in a market economy and serve as a means to secure broader goals of competitiveness, growth, jobs, balanced regional development etc.?*

*The European Union (hereinafter EU) has a long history of experience with debates of this kind and quite before the current economic crisis broke up it set for an internal re-orientation of its competition law and policy. In order to understand what the EU competition policy may become in the near future, it is necessary to look first more closely at from where it came and what influenced its development.*

### Impact of the U.S. antitrust

Even though there may be long debates whether the Anglo-Saxon liberal model of economy and economic competition is suitable for Europe, it can be hardly denied that competition policy in Western Europe had been influenced by the historically older U.S. antitrust. Leading EU representatives do recognize such an impact, although it erroneous to interpret the EU competition policy as a mere delayed imitation of the American model. (Monti, Speech 01/540, Gerber, 2003 p. 3) European integration as an international project of very "old"

nation-states with their well protected national markets and economic policies inevitably could not simply copy, not even in the competition policy area, the American experience. The EU antitrust has in its pedigree more resources and more objectives.

The influence of U.S. antitrust in Europe spread from a single source, but through two different channels - through the U.S. occupation zone in Germany and through the American support to integration initiatives of the founder of united Europe, Jean Monnet. The common source was personified by Robert R. Bowie, Harvard University professor who, during the post-war period, was a

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close collaborator and a legal advisor to the highest U.S. representatives in occupied Germany and later on in the FRG.<sup>1</sup> R. Bowie first played a key role in the division of the original six German steel groups controlling the Ruhr area to more than twenty-five separate companies. In the same vein he was behind the first antitrust legislation put, since 1947, into effect in the U.S.-occupied zone of Germany. (Witschke, 2001)

The leaders of the nascent West Germany, its first economic minister Ludwig Erhard and its first Federal Chancellor Konrad Adenauer, however, disliked the situation when a strict antitrust policy imposed under the occupation regime would have had constrained solely West Germany, because this would get its industry into a competitively disadvantageous position vis-à-vis the rest of Western Europe. This problem should have been addressed through the European Community Coal and Steel Community (hereinafter ECSC) project, and R. Bowie therefore, at the request of J. Monnet, proposed the first wording of "antitrust" Articles 65 and 66 of the ECSC's founding Treaty of Paris.

To understand the doctrinal focus of these antitrust provisions it is important to underline once more the "Harvard origin" of R. Bowie. The Harvard school was at that time (and until the early 1980s)

the dominant theoretical base of antitrust in the U.S. According to this school the economic competition was "a tool to achieve certain macroeconomic goals." (Munkova et al. 2006, p. 15) If an economic policy is to achieve its desired objectives, it must logically regulate competitive freedom of competitors. This regulation is a form of the state's power of intervention into the structure of markets when there is a functional causality between the market structure, the market behavior of business actors and the resulting state of the market, i.e. the prices charged, the profitability of business activity, the degree of efficiency achieved the pace of innovations etc.

This is the SCP paradigm "structure-conduct-outcome" of economic competition. Under the market structure the degree of market concentration is understood, i.e. the number of significant competitors, the degree of substitutability of their offers, the rate of market transparency, the barriers to market entry, etc. Jones, Sufrin, 2004 p. 21 -22) In a digest it can be said that this school focuses on the protection of fragmented - "polyopolistic" (more and relatively equal competitors) - market structure against any cartelization or monopolization that inherently threaten it.

## Domestic sources of European antitrust

Despite the undoubted input of the Harvard School, it should be emphasized that the leading role in designing conditions of European unification did not belong to the Americans, but to the French. It applied especially to the text of the ECSC Treaty of

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<sup>1</sup> Robert Richardson Bowie, famous in the U.S. more as a top political advisor and planner in the U.S. administration, international relations, was active in the years 1942-1980. In the U.S.-occupied zone of Germany, he worked in the years 1945-1946 (personal assistant to General L. Clay, military commander of occupation zone) in the years 1950-1952 (the main legal adviser to J. McCloy, the High Commissioner for Germany) and his main merit in the context of these missions was the formulation and implementation of antitrust measures first in the German Ruhr area and subsequently in preparations of the Treaty on European Coal and Steel Community. (McFadzean, 2003)

Paris, where the final wording of antitrust Articles 65 and 66 was entrusted to the French lawyer Maurice Lagrange, later on an Advocate General of the European Court of Justice (hereinafter ECJ) in Luxembourg. Thanks to him the two articles were not mere copies of Sections 1 (prohibition of cartels) and 2 (prohibition of monopolization) of the U.S. Sherman Act. He blended in the pre-war European tradition of cartel legislation.

The influence of M. Lagrange, according to historians of competition law, was the most significant in the wording of Article 65, paragraph 2, of the Treaty of Paris. This provision gave to the High Authority of the ECSC the power to authorize certain agreements between undertakings, if their positive effect on the production exceeded their negative impact on competition, or in other words, if a certain limitation of competition resulting from an agreement was actually necessary to achieve a positive socio-economic effect. In the interwar Europe, the agreements between competitors, which stabilized the market, solved the problems redundant capacities or shortages, promoted trade and exports, should not had been prohibited since their benefits prevailed over the harm caused.<sup>1</sup>

Expressed simply, it was about distinguishing between right and wrong cartels and a subsequent exemption from the ban of those that could be described as socially beneficial (i.e. the right ones).

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<sup>1</sup> Text of the Sherman Act, see <http://www.usdoj.gov/atr/foia/divisionmanual/ch2.htm#a1> and of Articles 65, 66 of the Treaty of Paris, see [http://en.wikisource.org/wiki/The\\_Treaty\\_establishing\\_the\\_European\\_Coal\\_and\\_Steel\\_Community\\_\(ECSC\)](http://en.wikisource.org/wiki/The_Treaty_establishing_the_European_Coal_and_Steel_Community_(ECSC)). A more detailed interpretation of sources and forces shaping of EU competition law, see also Martin, 2007; Gerber, 1998

This approach had been proper to the self-renewing Europe after the First World War and subsequently fighting with the impact of Great economic depression of the 30s. The tradition survived in the form of the war economy regulation during World War II and continued to be used by national governments to stimulate the post-war economic recovery and even to obtain political support for necessary "belt tightening". However, as the prominent historian of competition law, D. J Gerber, underlined, the role of competition policy and law in most of western European countries at that time was that of an ancillary support. In the form of administrative measures it had been used to pursue the pressing goals of day-to-day economic policy, without any deeper base in economic, legal or political thinking of that time. (Gerber, 1998 p. 6-8)

To this backbone frame of the post-war European competition regulation a new impetus was added in the first half of the 50s. New theoretical and practical doctrine of economic competition, not imported from overseas nor directly inherited from older traditions was delivered by Freiburg Ordoliberal School of economic thought. At that time it was undoubtedly the most comprehensive European theory of economic policy and competition. The leading representatives of ordoliberalism were economists (W. Eucken, W. Roepke, L. Miksch), as well as lawyers (F. Boehm, H. Grossmann-Doerth). An economic upswing of West Germany provided a politically compelling evidence of the success of ordoliberal theory and policy as "the father of German economic miracle", L. Erhard, was of the

same breed. The ordoliberal credo was also shared by the leader of the West German delegation to negotiations on the Treaty of Paris, Walter Hallstein, later-on the first and very successful President of the Commission the European Economic Community (hereinafter EEC), precursor of the EU. To complete the picture: the first EEC Commissioner for Competition was the like-minded German Hans von der Groeben. In 1957, the year of signature of the Treaties of Rome (EEC and Euratom), Germany adopted the first modern competition law in Europe, the Act Against Restrictions on Competition, and created a model antitrust authority, the Bundeskartellamt. The impact on the theory and practice of protection of competition in the context of integrating Europe was therefore inevitable.<sup>1</sup>

Within the ordoliberal school, there is typically a strong emphasis upon the legal framework as it determines economic processes developing within its limits. Equally typical, however, is its accent placed on personal freedom, assured at the level of economic processes by a firm protection of private property, as well as of the freedom of entry onto markets and the freedom of contract. This "disciplined pluralism" believed - under the influence of the tragic pre-war German experience – that the spontaneity of free markets needs to be supervised, since an absolute economic liberty tends to deteriorate (through cartelization and monopolization) to the denial of the freedom itself. (Kay, 2003, p. 334)

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<sup>1</sup> More details on the impact of ordoliberalism of the EU antitrust see, for example, Gerber, 2004; Martin, 2007; van Marissing, 2005; Gormsen, 2006; from Czech sources, for instance, Krabec, 2006; Munkova et al., 2006; Elias et al. 2004.

The protection of competition is thus, according to ordoliberals, also the "safeguard of an economic and social order based on freedom for businessmen, consumers, and workers" (as it was expressed in 1963 by H. von der Groeben), whose essence is the freedom of decision-making at the level of individuals. (Martin, 2007, p. 54) This basic freedom then underpins the free political system. If there should be no threats to free markets and consequently to the political freedom coming from cartels and monopolies, then there must be in place a state authority that guards the existence of framework conditions of market behavior and effectively sanctions their violations. In the ordoliberal vision of things the freedom to act on the market came first and free political regime as well as economic efficiency were very important, however sub-products of this fundamental freedom.

### **Original goals of competition policy in the integrating Europe**

From the above provided summary characteristics, it is clear that ordoliberalism was not in conflict, but in principal agreement with the Harvard School of economics and competition law. Both schools put the emphasis on open and fragmented structures of competition on markets, which should be maintained through administrative interventions against the founders of cartels and potential monopolies.

The effect of ordoliberalism on the focus of European competition protection can be evidenced by a series of the classic decisions of the EEC/EU competition authorities and surely by numerous key

provisions of EEC/EU documents. To a considerable extent this influence can be illustrated by the very text of Articles 81 and 82 of the Treaty, i.e. on the basic “commandments” of the whole corpus of the European competition law and policy. These Treaty provisions, faithful to the ordoliberal spirit, prohibit market practices that restrict economic freedom of competitors (see Article 81, paragraph 1, letter e, Article 82 letter d), discrimination against other competitors in the economic competition (Art 81, paragraph 1 letter d), stress the preservation of competition on the market (i.e. its open and fragmented structure) in all circumstances (Article 81, paragraph 3 letter b), prohibit discrimination between dissimilar trading partners (Article 82 letter c), etc.

From the first decades European integration several leading ECJ’s cases can be recalled, e.g. case C-48/69 Imperial Chemical Industries v. Commission, where the ECJ stated that the distortion of competition meant the restriction of “the effective freedom of movement of the products in the common market and of the freedom of consumers to choose their suppliers.” and pointed out that competitors may not remove themselves from the “risk, normally consisting in independent changes of behavior on one or more markets.”<sup>1</sup>

Truly ordoliberal has been the approach of the European commission and of the ECJ towards potential abuses of a dominant position. The stron-

gest undertakings should “not weaken the competitive market structure”, but rather they should help to maintain “an effective competition” on markets, as they bear on their shoulders “a special responsibility” for the maintenance of competition in the Common Market.<sup>2</sup> In the same spirit ordoliberals argued that the dominant market player has to behave “as if” the competition is not disturbed at all and the strongest company is exposed to normal competitive pressures. This means that such a dominant undertaking should almost see itself as sharing with public authorities the responsibility for safeguarding the healthy competition on the market concerned.<sup>3</sup>

No doubts, from its beginning the EU competition policy and law focused on the freedom to compete, ensured through a state interventions into the market structures. The then prevailing competition doctrine, drawing on Harvard Schools and ordoliberalism, fundamentally mistrusted the ability of free-markets to regulate themselves and wanted to protect their open and fragmented structure(s). Compared to the present moment this fundamental orientation was widely accepted. Free competition was in post-war Western Europe (with few exceptions) recognized as a means to a healthy economy and wealthy society. It was partly due to the “fascination of European leaders by an unprecedented boom of the U.S. economy based on the protection

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<sup>1</sup> Extracts from the judgments of the EU courts are cited from Ezrachi, A. 2008, full text, see the EU web <http://ec.europa.eu/competition/court/index.html>

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<sup>2</sup> Characteristic in this respect are the ECJ decisions in Cases C-6/72 Europemballage Co. and Continental Can v. Commission, C-85/76 Hoffman-La Roche v Commission and C-322/81 Nederlandse Banden Industrie Michelin v. Commission

<sup>3</sup> This is the so-called “as-if” approach advocated by the ordoliberal economist, Leonhard Miksch., forcing the dominant firm in the market to behave as if it had an exceptional market power. More details see Martin P. 2007 p. 47-48

of free competition." (Denoix, Klargaard, 2007, p. 2). An active role of public authorities in a market economy corresponded to "social-market" economic ideology of social democratic and Christian-social political forces that were dominating in the post-war Western Europe. Also the interest in the market structure and its impact on the process of competition inevitably led to "optimization" efforts providing, i.e. protection of "small" against "large" which always used to be quite popular among electorate.<sup>1</sup>

In this context, there is a remarkable conclusion of legal science, that the focus of competition policy and law on the protection of freedom and fairness (equal opportunity) is characteristic for the first stage of development of this particular area of law when the new type of legal regulation needs to get enough social support.<sup>2</sup> As the already quoted D.J. Gerber put it: "In the decades immediately after that war, social integration was a prominent concern, and competition laws were designed not only to foster economic growth, but also to demonstrate to the skeptical social classes that supported greater equality and democracy that large businesses would not be allowed to utilize their power to the

detriment of either consumers or competitors. Fairness was often a major objective in these laws, because they represented a means of securing political support for market ideas and of enhancing social integration." (Gerber, 2004, p. 7). This also explains why a certain orientation of competition policy and law enjoyed during many years in Europe a necessary socio-political consensus.

The competition policy efforts to protect the freedom of economic behavior which can be also described as a desire for providing equal opportunity to launch successful businesses were however neither the sole nor exhaustive goal of European competition policy and law in first decades of European integration. Quite naturally this freedom of market behavior could not be fully ensured in the conditions of still separated national markets, or if the behavior of competitors copied or sometimes even re-created gradually disappearing borders within the Common Market.

It was the classic decision of ECJ in joined Cases C-56 and 58/64 Consten SARL and Grundig-Verkaufs-GmbH v Commission where the Court found a breach of competition law in the EEC due to the fact that the "agreements between producer and distributor which might tend to restore the national divisions in trade between Member States might be such as to frustrate the most fundamental objectives of the Community." (Ezrachi, 2008, p. 56) This case of so-called complete territorial protection of an exclusive national distributor showed that European competition policy and law would also call anti-competitive any behavior or undertakings resulting in prevention of free movement of

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<sup>1</sup> Quite logically, this policy was not always liked by representatives of big business, but they were in Western Europe after the war for many years politically weakened, both due to their behavior during the war, but especially by then dominant ideas on the role of the state in social-market economy.

<sup>2</sup> In the 50th-70th of the 20<sup>th</sup> century the competition policy in Western Europe did not enjoy a similarly powerful position as in the next period. The national markets of member countries were only gradually liberalized and opened both internally and against each other. It was also typical for the period that among large and influential European economies, only the "ordoliberal" Germany had its own competition law. United Kingdom stayed out of the European integration project up to the 70<sup>th</sup>, France and Italy left for long the competition protection to the EU authorities and finally adopted their own modern competition rules only in the 80<sup>th</sup>, respectively 90<sup>th</sup> of the 20<sup>th</sup> century.

goods and services across the Common Market. A ban on parallel trade conducted by dealers against the will of their suppliers was called restrictive for the competition in the market regardless of its other potential effects for consumers, research and innovations, marketing support etc.

Article 81, paragraph 1 and also article 82 of the Treaty do mention the Common Market twice within its one sentence and the impact on trade between Member states produced by acts of undertakings is a criterion of their applicability. The strong linkage between the protection of competition and the goal of market integration is confirmed also by other Treaty provisions and numerous EEC/EU documents. Briefly, the European competition policy and law thus set its specific goal of protecting the market integration by supporting the removal of Common Market barriers.

Such a goal was considered fully complementary with the general one, i.e. the protection of economic freedom. The already quoted first EEC Commissioner for Competition, H. von der Groeben, enumerated in 1963 the interconnected objectives of competition policy as not only the protection of economic and social order based on freedom (so dear to ordoliberalists) but also, and with the same emphasis, the prevention of “firms or member states from erecting barriers to trade to replace those dismantled by the EC, to promote integration...” And there were no doubts that he saw these three goals – competition, integration, and freedom – as mutually consistent. (Martin, 2007, p. 54)

This twin targeting of the European antitrust was confirmed three decades later by the EU competition commissioner Leon Brittan (in charge between 1989-1993), when he declared that the promotion of the Single Market and of an undistorted competition remain related EU competition policy objectives. This policy could not therefore, according to the Commissioner, be subsumed under any single school economic analysis commonly used in other jurisdictions. (Lowe, 2007, p. 3) Closer to our days this organic link between the Single Market and protection of competition was stipulated for the future by the new Protocol to the Treaty of Lisbon and it is not hard to find other evidence for. And it is not surprising that the abundant existing literature on developments of European competition policy and law is in principal agreement that, at least until the end of the 1990s, during which time in the competition field, the EC followed two complementary priorities: economic freedom and market integration.

### **“Extra” competition goals**

In the history of European antitrust inevitably there have also been cases in which considerations of social realities have prompted the decision-making authorities to admit extra-competition goals when deciding (or at least justifying their decisions in) competition cases. This is not to share the position of ultra-liberal critics of any governmental intervention into markets that has to be, according to said ultra-liberal critics, led by unscrupulous lobbyists of influential interest groups.

Partially this was due to the continued involvement of competition policy with social-market political goals, which the policy had served in the immediate post-war period. The Harvard-ordoliberal basis of the EU antitrust allowed for a looser interpretation of the objectives. While it led the governments to conform their intervention with market principles, its emphasis on the protection of open and fragmented market structure, on the freedom of competitive processes, did not clash with inherently supportive measures, which could aim the protection of jobs (when for instance a takeover could save them) the fight against inflation (since price competition inhibits the increase in the price) or even the preservation of opinion and cultural diversity (which would be threatened by the disappearance of minor publishers).<sup>1</sup> In short, even measures that a micro-economist would have had ruled out as wasteful mismanagement could coincide with maintenance of fragmented market structure as the core of any free competition.

The EC Treaty, since its inception in 1957, contains an article (currently numbered Art 81, paragraph 3) which declares the general prohibition of cartels inapplicable to agreements between undertakings,

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<sup>1</sup> Extensive literature dedicated to the decision-making practice of the EU usually quotes such extra-competition objectives as maintaining high level of employment (e.g. authorization of a joint-venture between Ford and VW, in 1993), stabilizing the labor market (e.g. case C-26/76 Metro - SB-Großmärkte GmbH v. Commission), coordinated reduction of capacities in times of crisis in order to dampen social impacts (e.g. Commission Decision in Case Syntetic fibros, 1984), energy savings (e.g. Commission Decision in Case CECED, 2000), protection of public health (eg Commission Decision in Case Pasteur Mérieux, 1994), safety of products (e.g. Commission Decision in Case BMW, 1975), prevention of social impacts of personal insolvency (case C-238/05 Asnef-Equifax v. Ausbanc) and number of others. The competition in economic terms has never been completely denied there, however, parameters of its protection have been adapted to the other objectives pursued by public policy. For details of the range of the objectives of EU competition law, see Monti, 2007; Bejček, 2007; Whish, 2005; Schweitzer, 2007.

which (among the other three conditions laid down in this article): "contributes to improving the production or distribution of goods or to promoting technical or economic progress..." It is a legal provision opened to very broad and often contradictory interpretations, which may involve both reduction of buyer-supplier chain, as well as R & D and export co-operation between enterprises, as well as increased environmental protection or regards for the healthy development of the region.

In addition to the briefly explained doctrinal and legal background behind such flexibility, taking into account non-competition goals, there should also be mentioned the institutional aspect of it. The habitual EU standard (as well as that of the vast majority of member countries) is such that enforceable decisions in competition cases are taken first by an independent administrative body, which is also responsible for the supervision of competition in the markets, for the investigation, evidence and also for the eventual imposition of penalty.<sup>2</sup> In the case of the EU Commission, the DG Competition carries out almost of these activities however the decision itself is adopted by the Commission as a whole (college of Commissioners) at a simple majority of votes. Therefore the Commissioner for the competition must defend vis-à-vis other Commissioners, some of which, by nature of their portfolios in the Commission, upholds the interests of

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<sup>2</sup> The establishment of specialized independent administrative oversight of the competition may also be seen as heritage of ordoliberalism. In the context of all policies jointly managed by the EU, the Commission is in issues of competition actually the least dependent on political institutions of integration or on Member States. One can easily agree with the statement that "protection of competition policy is an area where the Commission has the largest power of its own." (Baldwin, Wyplosz, 2008, p. 290)

industry, workers, consumers, environment, regional issues...<sup>1</sup>

The courts of the EU (ECJ, in competition matters today, the Court of First Instance) as judicial review authorities (where a competitor can sue the Commission) are in their decision-making even more independent than the Commission, and always strictly charged not to run over the borders given by the EC Treaty. However, their practical role in the day-to-day running of competition protection affairs has to be considered. EU Courts have been far from playing a central role, similar to courts in the United States. In particular, up to May 1, 2004, when the reform of Articles 81 and 82 applications came into effect (laid down by Council Regulation 1/2003/EC) the most used and crucial - from the competitors' perspective - was the procedure of so-called notification. Any proposed-up action (contracts, changes in business strategy, etc.) that could have some impact on competition was addressed to the Commission with the request for a preliminary determination of their compliance with competition law. The Commission not only provided such a "negative clearance" of notified measures, it could also exempt the more problematic ones from the ban. In this way, thousands of decisions were made and in most of them the

Commission considered the possibility to apply the exemption to the prohibition (laid down by Article 81, paragraph 1, Article 81) allowed by the paragraph 3 of the same Article of the Treaty, i.e. the paragraph famous for its rubber formulations of "technical or economic progress".

In this note about the loosening of competition targets in the EU decision-making (process?) the fact that certain areas of economic life have been (by the will of the Member States, or based on interpretation provided by the ECJ) exempted from the application of competition rules cannot be ignored. This is because of the prevailing mood that competition "as usual" would eliminate other important values that are generated for society. The most important in this respect is the full exemption for social partners' negotiations between de facto "cartels" of employees and employers (the value of social peace). However, there is also a partial exemption of the common agricultural policy (hereinafter CAP) and thus of the national agreements between farmers that meet the CAP objectives (protection of strategic socio-economic-environmental effects of agriculture to society), and the exemption of the press distribution (the return of unsold copies of old issues). To some extent, there are also partial exemptions for liberal, albeit regulated, professions (such as the protection of expectations and interests of clients of lawyers, etc.). In all these areas it has become an accepted standard that the competition policy and law do not intervene against certain practices that would in other areas be identified as anti-competitive and therefore illegal.

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<sup>1</sup> Delegation of candidates for the post of Commissioner is an issue of national political choice. Among Commissioners traditionally dominate former Prime Ministers, Ministers and senior civil servants, i.e. experienced "political animals", from which many, at the end of their mandate at the Commission, want to return to domestic politics. Some penetration of national concerns into the Commission's decisions comes also, at a consultative and advisory level, from the Advisory Committee on restrictive practices and dominant positions composed of representatives of Member States, which was established by Council Regulation EC No. 1 / 2003 of December, 16 2002.

From the contents of the short sub-chapter it has to be clear that the EU competition authorities in the past neither protected any single goal or value, nor dogmatically imposed any narrow concept of competition policy. They are not far from the truth, those who argue that the EU has always treated the issue of competition in a more "elastic" way and that the protection of competition in Europe has just been a "part of economic policy, meaning a part of state interventions into economic processes, or - in other words - part of the state regulation of economy." (Bejček, 2007, p. 666)

## **Changing competition paradigm**

Bearing in mind the above described historical background, it has to be admitted that at least since the mid-1900s, again due to the overlapping of several effects, the paradigm underpinning the EU competition policy and law begun to shift. Commentators described this movement as the shift "from rivalry to efficiency", of "from fairness to welfare" (Padilla, Ahlborn, 2007, p. 3), or also from "a form to consequence" (Gormsen, 2006, p.19) alternatively "from legal normativism to economic pragmatism" (Bejček, 2006). All these designations indicate the same thing, that the antitrust in the EU should have got a stronger economic-analysis fundament, should have focused on the specific (quantifiable) contribution or harm caused a competitors' conduct to competition in the market. Any interference in the free acts of competitors should be strictly economic in the sense that it results in higher efficiency, that is ultimately in higher well-

being, whether of the society as a whole or of consumers.

As it was forty years earlier, it was possible to trace the impact of U.S. antitrust laws From the 1980s it came under the dominant influence of the Chicago School of economics and competition law, which, founded a decade earlier, stemmed from fundamental criticism of the previous Harvard school paradigm. Based on the neo-liberal interpretation of the perfect competition model the Chicago School rejected any institutionalized care about market structures and processes of competition as being necessarily biased and subject to ideological beliefs. It pressed for the narrow focus on the outcome of competition, which can be objectified in microeconomic terms as a contribution to total welfare, as greater efficiency of competitors' business. Interventions in the free market, according to this school, are justified only if shown to lead to greater allocation efficiency.

Self restraint in the enforcement (under- enforcement) of any competition rule is, according to the Chicago School, better than assertiveness in enforcement (over-enforcement) of competition law, since companies in general cannot afford to be irrational and therefore will act, in the long term, contrary to the logic of an efficient business. And even if they do, a truly free market in which the State does not protect the privileges of the selected few and does not tolerate barriers to entry of new competitors to it, will punish those with inefficient behavior without having to activate the costly State

machine and taking risk of its very natural errors and failures.<sup>1</sup>

The great advantage of this approach, which enjoyed a prominent influence on decision-making thanks to the administration of U.S. President Ronald Reagan, was the much more strictly defined, quantifiable, micro-economic basis for competition decisions. Such a merit was particularly valued in the optimistic 1990s, when it appeared that globalization brings more options and solutions than problems and pitfalls. Trust in development and profit-making due to market liberalization was growing and in proportion to it was strengthening of competition policy and law. If before the year 1990 only slightly more than a dozen of the most advanced countries had their own antitrust legislation, after 2000 this number exceeded one hundred, and now the law on protection of competition exists also in Russia, India and China.

From the perspective of the objectives of competition policy and law, this brought about not only the above mentioned shift of accents, but also an economically justified narrowing of the current palette of objectives and goals. The focus should have been made solely on efficiency creating higher welfare. Such "economization" led to a significantly more liberal regulation of the spontaneous development of competition in the market with less frequent interventions. However it also

transformed the antitrust law to a de facto part of economics. Microeconomic-based interventions of competition authorities could have been, at least in theory, more predictable and the supporters of this approach could promise to competitors more legal certainty.<sup>2</sup>

The Chicago School, as well as the whole neo-liberal economics and economic policy, have not been without influence in Europe. In addition to the indisputable and self-motivating fact that increased efficiency creates greater wealth, here was also a more direct incentive that the globalization of economic processes and actors in the form of multinational companies in the markets on both sides of the Atlantic, had been pushing for a certain convergence in approaches of competition authorities. Undoubtedly, on the EU side, there was also a certain matureness achievement effect. After several decades of post-war development the perception of competition and the role of competition law

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<sup>2</sup> Among the academics, let alone practitioners, there has never been unity as to what efficiency is exactly as stake. Efficiency in allocation, production, transaction, or even so-called dynamic efficiency is highlighted here and there. Likewise, no agreement has been achieved as to what kind of welfare to look for: the society in general (total welfare) or consumers' only (consumer surplus), and whether the consumer is only an end-user, physical person or rather extends to any customer (buyer, professional or not, regardless of his legal status). Logically there is a clash of economic calculations presented by the parties to competitive disputes that very often obscure the substance of the dispute and make it unclear for non-economists, as well as for judges and, quite particularly, for members of lay juries. The result was the unpredictability and a call for *per se* prohibitions, which clearly define what may and may not be done in the economic competition. At the same time, the entire legal sector became dependent upon one school of economic thinking and drifted away from the protection of justice in the sense commonly accepted, that always included certain equality in opportunities, and (in particular on the European continent) also a certain distributive aspect. The traditional normative requirements on any law as such, i.e. to ensure fairness, efficiency and security - rather than just the net economic income for society - are difficult to marry with views of some of the Chicago school's supporters, according to which the competition law "is identical with microeconomics" or has even become a "sector of the economy" (Bejček, 2007, p. 667, Sokol, 2007, p. 139-140, 233, Monti, 2006).

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<sup>1</sup> For details about the Chicago school, see the classic works of its founders, Robert A. Posner: *Antitrust Law* (Chicago, 1976) and Robert H. Bork: *The Antitrust Paradox* (New York, 1978), or commentaries on, such as Black, O. 2005; Jones, A. ; Sufrin, B. 2004; Ginsburg, D.H., 2008; Armentano, D.T. 2000 etc.

changed: the competition became a part of the socially accepted standard, political and legal practices accumulated empirical experience and the whole system naturally gravitated to a more analytical approach where formal recitals of per se prohibitions would be replaced by micro-economic assessments of positives and negatives of the competitors' acts (i.e. to some form of the rule of reason). Finally, it is likely that achieving a significant degree of unification of markets of member countries (the EU Single Market was officially inaugurated in January 1993, the EU Single currency came close to existence) allowed considering a certain re-orientation of the EU competition policy and law.

It is remarkable to observe how a neo-liberal anti-trust lingo, i.e. "allocation efficiency", "consumer welfare", "microeconomic analysis", gradually penetrated and finally almost dominated the programming speeches of Heads of EU antitrust. If in the IX. Report on Competition Policy in 1980, the Commission said the integration of markets as the "first and fundamental objective" of its competition policy, fifteen years later, in 1995 (XXV. Report) it was primarily the "optimal allocation of resources, technical progress and flexible adaptation to a changing environment" in an indivisible link to the "creation of the Internal market ". In 2001 (XXXI. Report) it was declared in the initial word of the Competition Commissioner M. Monti: "Our objective is to ensure that competition is undistorted, so as to permit wider consumer choice, technological innovation and price competition." Also in 2001, M. Monti, in Washington, said: "... today, after almost

50 years of application and development of antitrust rules in Europe, we can confidently say that we share the same goals and pursue the same results on both sides of the Atlantic: namely to ensure effective competition between enterprises, by conducting a competition policy which is based on sound economics and which has the protection of consumer interest as its primary concern." (Monti, Speech 01/540, 2001)

This "economization" of the EU competition policy and law has certainly undergone some development and its precursors in the decisions of the EU competition authorities can be traced back several decades. It cannot be said that in the ordoliberal period the decision-making in competition cases had consistently been in conflict with efficiency. Simply, until the 1990s, when compared to the US, in this EU this aspect was really marginal (Gerber, 1998, p. 420). However, the turning point is considered, by many commentators and analysts, the era of Commissioner Mario Monti in the first half of our decade. M. Monti himself was in that respect a significant "body of influence". He was the first professor of economics at the forefront of the EU antitrust policy, moreover he possessed experience from one of the Chicago School's strongholds, Yale University. Putting the competition decision-making on solid micro-economic basis was one of its main objectives when he was, in 1999, taking over the competition portfolio.<sup>1</sup>

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<sup>1</sup> In 2002, Philip Lowe's graduate in economics from Oxford was appointed the General Director of the DG Competition of the European Commission and in the same year in his Directorate the influential post of Chief Competition Economist was established. If, in the early 90s, the ratio of lawyers and economists in the Directorate was 1:7 in the second half of our decade's it used to be already 1:2 (Evans, L. 2008).

Within one year of Monti's mandate the Commission struck down three times of the EU Court of First Instance's rulings. The judicial review of the Commission's decisions stressed the lack of economic foundation of its reasoning in the competition cases.<sup>1</sup> At the same time, it was the prospect of more than ten new countries integration in to the EU, which practically (due to an expected far higher influx of notifications) ruled out any continuation of a traditional, centralized ex-ante assessment of the practices of competitors. It forced a transfer of the full responsibility for compliance onto competitors themselves and also decentralized the decision making regarding competition cases. The application of Articles 81 and 82 of the Treaty had to be for the future ensured not by the Commission only but to a great extent by national competition authorities and courts. This has led to logical efforts to place competition decision-making on the same and single interpretative basis that had to be provided by a microeconomic assessment of the benefits of competitors' behavior to efficiency and to consumer welfare. The previously existing breadth of the objectives identifiable in decisions of the EU competition authorities would threaten to degenerate into sheer inconsistencies and to cause a gradual disintegration of the uniform protection of competition in the EU.<sup>2</sup>

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No wonder that after the year 2000, commentators began to talk increasingly about the convergence of U.S. and EU antitrust, about the U.S. inspiration and ideas in the Commission's decision-making (Abbot, 2005; Wigger, 2006)

<sup>1</sup> The cases at issue were: T-324/99 *Airtours v Commission* T-310/01 *Schneider Electric v Commission* and T-5/02 and T-80/02 *Tetra Laval v Commission*

<sup>2</sup> No coincidence that the Commission issued in 2004 a detailed interpretative Guidelines to the application of Article 81, paragraph 3 (i.e. exceptions to the prohibition of cartels), where immediately in the

## Current goal(s) of the EU competition policy

Growing "economization" of the European competition policy and law, however, has never been its literal neither full "Americanization" in terms of any direct incorporation of Chicago standards into decision-making of the EU bodies. Full acceptance of American influence impedes not only the historical diversity of tradition, but foremost the fact that the legal basis for protection of competition in the EU has not changed. Nobody removed the link between the protection of competition and the goal to build the EU Single Market, and the wording of Articles 81 and 82 TEC, products of the Harvard-ordoliberal period, as shown above, also remained untouched.

Just enough to emphasize that Article 81, paragraph 3, disallows to exclude from the prohibition an agreement between undertaking, which would "afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question", i.e. of the market at issue. This means that if the question is posed whether the micro-economically efficient practice, beneficial to consumers should get the priority over the protection of fragmented market structure, in today's EU the answer must still be a negative one. A number of authors detect there the continued presence of the objective of protection of the economic freedom in the EU antitrust that can not

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first sentence of the section General remarks it declared straightforwardly: "The aim of Article 81 is to protect competition in the market as a means of enhancing consumer welfare and ensuring an efficient allocation of resources."(Document No 2004 / C 101/08, paragraph 13)

disappear without changes to primary legislation, even if it is not explicitly emphasized in political declarations. (Pera, 2008, p. 26; Monti, 2007, p. 48). The same article 81(3) also states as one of the conditions for exemption from the prohibition a “fair share” given to consumers of the benefits resulting from the cooperation of competitors. The Commission in its Guidelines to Article 81, paragraph 3, does not explain this condition in terms of total welfare (so dear to Chicago School economists), but as the welfare of buyers. The Commission even stresses that quantifiable effect for those who are directly affected by an agreement between competitors must be at least neutral. Thus, it is clearly about protection of the economic interests of identifiable groups of customers. This is again the same and traditional European approach, which during decades has had to ensure enough social support for free economic competition.

Similarly, it is doubtful whether the EU can entirely abandon the historical objective of protection of market integration. Although the EU Single Market has officially been in place since January 1993, in March 2008 the Competition Commissioner, N. Kroes, (in Washington while addressing American legal experts) said: “Imagine for a moment: that France hadn’t sold the Louisiana Purchase territories; that Spain quite liked the idea of keeping California or that Alaska wasn’t bought from Russia for seven million dollars; that the Sherman Act was passed in 1957, rather than 1890; and that Cuba had abandoned Communism and joined the United States... In short: imagine a different America of dozens of countries, rather than one. If that was what you woke up to tomorrow – how would you

react? And what would be the state of US anti-trust? That is the sort of complicated scenario we face in the European Commission every day.” (Kroes, Speech 08/154) And really, given the official green light for further expansion of the EU and given also the impact of the current financial and economic crisis that awakens the old-protectionist instincts, this specific objective of EU antitrust can hardly be set aside.

There are several EU Courts’ decisions in recent years, which suggest that the Commission’s efforts to micro-economize the competition policy and law have so far no clear results. The tradition of written continental law (civil law) never gave judges the discretion to easily draw inspiration from new paradigms of social sciences as judges can do in the system of judge-made (common) law in the USA.<sup>1</sup> Therefore, it is not surprising that a number of judgments delivered in the second half of our decade, caused controversy regarding whether the EU really injected any micro-economics in its competition decision-making or whether it would still protect the presence of more competitors in the market, regardless of economic efficiency and consumer welfare.

Decision such as T-201/04 Microsoft v. Commission can be an example. Microsoft, the dominant player in the PC operating system market, was forced to disintegrate from its widespread Windows

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<sup>1</sup> As highlighted by Bejček J.: “To carry out a teleological reduction of any legal norm is far easier for a judge in the U.S., than for his counterpart on the European continent, to say nothing about a civil servant at the antitrust authority.” (Bejček, 2006, p. 749)

system browser the Windows Media Player. Their bundling in a single product, although not complained about by users, squeezed out of the market the less successful competitors who also wanted to produce the application software for playing images and sound. From 2008, it is possible quote as an examples the Cases C-468/06 and C-478/06 *Sot. Lélos kai Sia EE v GlaxoSmithKline A EVE* in which the ECJ held there was abuse of a dominant position when the original pharmaceutical manufacturer decided to reduce the supply to pharmaceutical distributors who sold to "cheap" EU countries. While it was clear that the parallel trade was not efficiency boosting in the drug sector as the original manufacturer were losing incentives to invest in research and development, while consumers, for whom the price was given by the national health care policies, more than by the market, did not profit either, it was maintained that preventing parallel exports damaged Single Market by separating individual EU Member States.

U.S. antitrust officials themselves emphasize that the microeconomics, which the DG Competition of the European Commission uses is not a Chicago-style one, but the post-Chicago-one. This means that it is not built that much on the theoretical doctrine of market behavior, but rather prefers detailed analysis, modeling and searching of all the possible impacts of the behavior of competitors. Consequently, it is also more interventionist, since it fears less the so-called *false positives* of the interventions in the market, against which the

Chicago School steadily warned.<sup>1</sup> Historically the post-Chicago School got into the academic sunlight at the same time when the Commission just started its efforts aimed at re-orientation of the EU antitrust and also was by its contents more in line with the established application practice of the EU and its case law precedents.

## Epilogue

In the epilogue to the present analysis, it can be stated that the Commission may be suspected of tendency to profit from the "fat years" in the 90s when the liberal perception of competition was in vogue to push through the American inspiration and introduce more economics into its competition analysis and decision-making. What is certain however is that EU competition authorities have never fully abandoned their traditional approaches based on the protection of economic freedom and market integration. E this Commission's try provided the French President Nicolas Sarkozy with the opportunity to attack, in June 2007, the protection of competition "for the sake of competition itself" a "competition as a dogma" pushed in by "the nest of Anglo-Saxon liberalism", i.e. by the Commission in Brussels.<sup>2</sup> This accusation was not, as it was

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<sup>1</sup> The so-called false positives (or Type I errors) are the errors arising from an assertive enforcement of competition law (i.e. over-enforcement) to which the EU historically has had a tendency. The so-called false negatives (or Type II errors) are the errors due to a self-restrained enforcement (under-enforcement), which has been typical for the USA. For details of the influence of the Chicago school on the U.S. antitrust U.S. and that of the post-Chicago on the EU, see Rosch, 2007.

<sup>2</sup> See comments of the European press on the EU Summit in Brussels, June 21-22, 2007, for instance Charter, D. In *The Times*, June 22, 2007, Gow, D. In *The Guardian*, June 25, 2007, also Reuters, 22 Jun 2007 *La concurrence libre et non faussee and vecu dans l'UE*.

shown above, entirely supported by facts but from the perspective of 2009, Sarkozy's attack can be seen as a forerunner to the crisis of the neo-liberal model of capitalism which is now altering the balance between market and state, deregulation and regulation. It will be extremely interesting to analyze the goals of the EU competition policy and law once the current crisis is safely over.

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## European and national antidiscrimination regulations and their importance for elimination of various forms of discriminatory conduct

Lucie Cviklová<sup>1</sup>

*These reflections related to racial discrimination in the Czech Republic are, to a certain degree, pioneering. During the last twenty years European legislation as well as the agendas of concrete European and national courts/tribunals were preoccupied with various aspects of sexual discrimination. Sexual discrimination was not only the most important topic of public debates but also an object of new directives and regulations; in many important litigations the burden of proof was shifted and these processes induced the development of jurisprudence in the field.<sup>2</sup> The methodological approach to the relatively neglected topic of racial discrimination is the legal and social analysis of a number of various phenomena and processes: for example comparative analysis of recent judgments of the European Court of human rights has shown substantive differences between the nature of racial discrimination in postcommunist Czech Republic and Bulgaria. In this essay the issues of racial discrimination are documented by a number of empirical data which draw attention to the social exclusion and other negative processes which influence the lives of Roma people in the*

*Czech Republic. The concluding remarks delineate perspectives of prospective changes which could be based upon the redistribution of state resources, the formulation of new claims by both individuals and collectivities, and the implementation of new regulations such as The Race Directive and others.*

In the Czech Republic problems of racial discrimination are broad and therefore this essay has focused on the following issue:<sup>3</sup> Can we speak about the differences of racial discrimination in the Czech Republic and in other former socialist systems? What are specific Czech forms of discrimination?<sup>4</sup> What are the impacts of international, regional and national racial discrimination regulations upon litigation and the people in the Czech Republic?

What are the influences of international, regional, national norms and the corresponding legal institutions upon the labour market, access to education, housing and other public services?

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<sup>3</sup> This essay is based on the legal definition of discrimination. Nevertheless, it is also useful to mention the sociological approach which takes into account informal interactions among social groups. For example, it explains the relationship between prejudice and discrimination. Prejudices are very often the main cause of discrimination but these two phenomena can exist independently. See Giddens, Anthony. *Sociologie [Sociology]*. Praha: Argo, 2000, pp.231-236

<sup>4</sup> According to many participants in public life (public or political figures, including President Klaus) discrimination has not been an important issue in the Czech Republic. You can obtain elementary information about discrimination and its major attributes at the address [www.diskriminace.cz](http://www.diskriminace.cz)

What are the contributions of international, regional and national non-governmental organizations, such as Amnesty International, European Network against Racism, People in Need and others, for the elucidation of racial discrimination and formulation of new social policies? What are the effects of judgments resulting from strategic racial discrimination litigations? For example, how does the case *D.H. and Others versus Czech Republic*, adjudicated by the European Court of Human Rights, influence current Czech social policies? What strategies should be elaborated by Czech judges, legislators, proponents of social policies and other actors in the non-profit sector in order to prevent the vicious circle of racial discrimination?

## **International, regional and national regulations concerning racial discrimination and its explanatory force for recent developments in the Czech Republic**

The gradual integration of the Czech Republic into international and regional structures has brought about new obligations in the field of human rights – the passing and enforcement of various antidiscrimination regulations have been considered to be the most important means towards achieve equality for minorities in the labour market as well as in public life and other arenas<sup>1</sup> For example the Czech Republic ratified the International Convention on the Elimination of All Forms of Racial Discrimination

and therefore has to protect potential victims of racial discrimination by means of the national courts and other institutions – it also has to submit regular reports to the Committee on the Elimination of Racial Discrimination concerning implementation of judicial, legislative and other measures related to the Convention. According to the last report the most important problem in the Czech Republic has been Romani enclaves which have been formed by several generations of Roma population. The coexistence of Roma and Czech citizens is also complicated by the fact that a large number of Roma people are either indebted or unemployed. Municipalities are not able to provide alternative housing for economically weak citizens and thus a shortage of economic resources for living very often ends with the intervention of state authorities into family life and the placement of children in foster homes. The majority of adults in Roma communities are either unemployed, have very low incomes - often close to minimum wage - or are on welfare. In addition to this low integration of Romani adults, a large number of Romani children from Roma communities are placed in so called “special schools” with special curriculum.

An article about non-discrimination can be found in the European Convention on Human Rights and Fundamental Freedoms which as a regional norm is superior to Czech regulations and has been used during litigations adjudicated by European Court of Human Rights. Judgments of this court are very often made thanks to the strategic litigations of nonprofit organizations and they are also explained

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<sup>1</sup> For example, the European Commissioner for Employment, Vladimír Špidla, has assessed discrimination issues in the Czech Republic. Passing anti-discrimination regulations will enable Czech citizens to legally face this phenomenon and could lead to, at least, the elimination of direct discrimination in the Czech labor market.

to the general public through the reports of these organizations.<sup>1</sup>

At the national level applicants and appellants who file a discrimination complaint often use the Charter of Fundamental Rights and Basic Freedoms and, from September 2009, Czech citizens can also use a recently enacted antidiscrimination law which many politicians and representatives of civil society had argued over due to its perceived redundancy in light of the afore mentioned Charter of Fundamental Rights and Basic Freedoms.<sup>2</sup> According to the requirements of the European Union, the Czech Republic was obliged to pass the law against unequal treatment during its entry into the European Union – it was the last of the 27 members to do so and due to its long-term delay the Czech Republic faced legal proceedings and a fine from European Union. The law defines direct and indirect discrimination in business, education, medical care, social benefits, provision/sales of goods and services including housing – under the condition that they are offered to public. The anti-discrimination law not only prohibits racial discrimination, but also sexual discrimination (which includes pregnancy, motherhood and fatherhood, and sexual harassment), discrimination based upon sexual orientation, age, disability, religious affiliations, etc.<sup>3</sup> Principles of equal treatment of people

regardless of their race or ethnic origins are also rooted in The Race Directive/2000/43 EU from 2000.<sup>4</sup> According to European Union requirements the Czech Republic was obligated to implement directives in its national legal system no later than May 2004 - it has yet to do so.<sup>5</sup> According to public opinion polls Czech citizens have acknowledged the existence of age, sex and race discrimination in the Czech Republic. The attitudes of Czech citizens towards Roma people as well as an evaluation of the real possibilities of Roma integration were realized by the Center for Research of Public Opinion (Centrum pro výzkum veřejného mínění) in May 2007. The majority of Czech respondents were convinced that the modus vivendi of Roma and non-Roma population was very bad and a comparison of research projects spanning several years showed a gradual worsening of the situation. Various forms of racist discrimination directed towards the Roma population can also be found in the Report on Racism, Xenophobia and Anti-Semitism which was developed by the nonprofit organization People in Need (Člověk v tísni) and derived from national official and unofficial resources as well as the online resources of international organizations and networks dealing with discrimination such as Amnesty International and the European Network Against Racism (ENAR). For example, according to the ENAR report created by the non-profit organization the League of Human Rights – an organization which specializes in com-

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<sup>1</sup>[http://www.diskriminace.info/do-etnicka/209\\_1992.doc](http://www.diskriminace.info/do-etnicka/209_1992.doc)

<sup>2</sup>There have been many public debates related to the influence of the parallel existence of several regulations concerning discrimination upon strategic and other litigations. For example, the enforced passing of anti-discrimination law in Great Britain provoked many negative reactions.

<sup>3</sup>The anti-discrimination law was prepared for the government by Minister of Justice Pavel Němec in 2004, then it was passed by the assembly –and it was rejected by presidential veto. At the end the veto was outvoted by parliament in May 2009. Leftist political parties

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conditioned their support of anti-discrimination law by abolition of lustration law.

<sup>4</sup> <http://www.psp.cz/sqw/text/orig2.sqw?idd=11133>

<sup>5</sup> [http://www.diskriminace.info/do-etnicka/kubacka\\_neprovedenirasovesmernice.pdf](http://www.diskriminace.info/do-etnicka/kubacka_neprovedenirasovesmernice.pdf)

bating racism as well as in providing aid for victims of racism – racism or racial discrimination in the Czech Republic has not been “dramatic”.<sup>1</sup>

### Modus vivendi of Romani and non-Romani population is bad – comparison in %

	1997	1998	1999	2001	2003	2006	2007
Answers in %	81	78	66	68	78	69	79

Source:  
<http://www.cvvm.cas.cz/index.php?lang=0&disp=zpravy&r=1&shv=100331>

Regardless of the report, there have persisted various forms of both open and hidden racial discrimination with mainly Roma victims. The situation has not improved and Romani women, often the victims of multiple forms of discrimination, are the most important target group which has managed to formulate accusations concerning discrimination in the labour market. For example, in 2005 the Superior Court [Vrchní Soud] ruled in favor of a Roma woman who was discriminated against due to her race when she applied for a position as a sales person.

The European Social Fund has been a key institution fighting against the discrimination of Roma people in the labour market but the issue remains important today. The ongoing failure to successfully integrate Roma people into economic and social life has not been the only racially motivated issue as there has also appeared various forms of domestic terrorist attacks directed against the Roma. For example a Supreme Court judgment qualified as a racially motivated murder the following

sequence of events: a group of skinheads forced several Romani citizens into a river, took control of the riverbanks, and threatened the Romanis with violence when they tried to escape the water. One of Romanis drowned before the police arrived.

Michal Kocab, the current Minister for Human Rights and Minorities, has made efforts to improve upon the social exclusion of Roma citizens. In order to pursue this goal he, can draw upon the comprehensive report “Analysis of socially excluded Roma localities and absorption capacities in their environment” according to which, a basic factor of social exclusion of Roma people has been high rate of unemployment of citizens from socially excluded localities (ghettos). The average rate of Roma unemployment is estimated to be around 70% and in socially excluded localities it is almost 90% which is disproportionately high when compared to 8%, the average unemployment rate in the Czech Republic. The high rate of unemployment spread across nuclear as well as broader Roma families is prone to repetition and very often spans from six months to a period of years. Some identifiable reasons for Roma unemployment are low qualifications, lack of education and bad health condition. Other determinants contributing to Roma unemployment are intergenerationally transmitted cultural norms which are the result of family and social networks which pass on to new generations cultural messages regarding formal unemployment and participation in informal or shadow economic structures.<sup>2</sup>

<sup>1</sup> [http://www.diskriminace.info/do-etnicka/clovek\\_v\\_tisni\\_raxen.pdf](http://www.diskriminace.info/do-etnicka/clovek_v_tisni_raxen.pdf)

<sup>2</sup> Ibid.

## Number of cases registered by regional jurisdictions in 2002-2004

Region	Total Cases 2002	Racist Cases 2002	Total Cases 2003	Racist Cases 2003	Total Cases 2004	Racist Cases 2004
Praha	3 229	16 (0,5%)	3 207	7 (0,2%)	2 698	3 (0,1%)
Central Bohemia	2993	9 (0,3%)	2812	8 (0,3%)	2558	5 (0,2%)
South Bohemia	1970	2 (0,2%)	1993	4 (0,2%)	2208	8 (0,4%)
West Bohemia	3329	7 (0,2%)	3242	4 (0,1%)	3328	11(0,3%)
North Bohemia	5106	2 (0,0%)	4284	21 (0,5%)	4212	14 (0,3%)
East Bohemia	2834	14 (0,5%)	2931	12 (0,4%)	2791	12 (0,4%)
South Moravia	4284	7 (0,2%)	4503	19 (0,4%)	4970	18 (0,4%)
North Moravia	5546	18 (0,3%)	5393	27 (0,5%)	5638	16 (0,3%)
Total	29 291	69 (0,3%)	28365	102 (0,4%)	28403	87 (0,3%)

Source:  
<http://www.mvcr.cz/archiv2008/soutěže/2006/sod/extremismus/10-statistiky.pdf>

## “Landmark cases” of the European Court of Human Rights related to racial discrimination and their influence on regional social policies

Specific features of racial discrimination in the Czech Republic and in other former socialist systems can be illustrated by comparing two recent judgments of the European Court of Human Rights. Both final judgments, *D. H. and Others versus Czech Republic* and *Nachova and Others versus Bulgaria*, are critical of their national governments for their discriminatory practices based on racial grounds. Both judgments were issued by the Grand Chamber of the European Court of Human Rights and they brought about new interpretations of the European Convention on Human Rights and Fundamental Freedoms. Both of them acknowledged violations of Article 14 and referred to specific issues of “racial discrimination” but despite this common labeling of “prohibition of discrimination”

they have involved important structural differences. *“The enjoyment of the rights and freedoms set forth in this Convention shall be secured without discrimination on any other grounds such as sex, race, color, language, religion, political and other opinion, nation and social origin, association with a national minority, birth or other status”.*<sup>1</sup>

While the Czech complaint reflected upon the issue of equal access to education resulting from systematic shortages, the Bulgarian complaint criticized the murder of two citizens of Roma descent by public authorities – therefore the Bulgarian claimants referred not only to racial discrimination as addressed under Article 14 but also to the violation of right to life under Article 2. Given the different circumstances of the two cases the Grand Chamber found the existence of direct racial discrimination against Roma people in Bulgaria and indirect discrimination of Roma people in the Czech Republic. The litigations formulated by Czech citizens of Roma descent - based on racial discrimination concerning access to education - came through complicated developments. In 2006 the complaint *D.H. and Others* was rejected by the Senate on the basis of insufficient proof evidencing direct discrimination, but one year later the Grand Chamber allowed a substantial portion of the complaint submitted by eighteen Czech Roma applicants from Ostrava and the Czech government was charged with supporting mechanisms leading to indirect discrimination.<sup>2</sup>

<sup>1</sup> [www.hri.org/docs/ECHR50.html](http://www.hri.org/docs/ECHR50.html)

<sup>2</sup> Bobek Michal, Boučková Pavla, Kühn Zdeněk (eds.). *Rovnost a diskriminace [Equality and Discrimination]*. Praha: C.H.Beck, 2007. str. 43-44

The complaint *Nachová and Others versus Bulgaria* submitted to European Court of Human Rights was filed by the victim's relatives of Roma descent; they complained about the military police fatally shooting of two conscripts who, having recently absconded from a military construction crew, were known to be unarmed and not dangerous. *"The killing, by automatic weapon fire, took place in broad daylight in a largely Roma neighborhood. Immediately after the killing, military police officer allegedly yelled at one of the town residents "You damn Gypsies" while pointing a gun at him. In February 2004 the First Section of the European Court of Human Rights unanimously found out that both the shootings and a subsequent investigation which upheld their lawfulness were tainted by racial animus and that this constituted a breach of Article 2 (the right to life) and Article 14 (the right to non-discrimination) of the European Convention on Human Rights. This judgment was the first in the Court's history to find a violation of Article 14 on grounds of racial discrimination, and made clear that the right to non-discrimination requires States not to discriminate and to investigate allegations that discrimination has taken place."*<sup>1</sup>

The Bulgarian government protested and then the Court's Grand Chamber agreed to review the initial decision - in addition in November 2004 the Justice Initiative filed an amicus brief which addressed the obligation of states to thoroughly investigate potentially racist motivations for violent acts. The Grand

Chamber issued a judgment which to a large degree affirmed its landmark finding of racial discrimination in breach of Article 14. According to the Court's ruling European states have an obligation to investigate the possibility of racist motivation behind acts of violence. The Grand Chamber upheld the former decision that Bulgaria had breached the victim's right to life (Article 2) by failing to regulate the use of firearms by military police and by failing to properly investigate the young men's deaths – as far as the killings themselves, by a vote of 11-6 the Grand Chamber overturned the prior ruling that they had been motivated by racial hatred.

In the Czech Republic the complaint *D.H. and Others versus Czech Republic* ended with the submission of a constitutional complaint – the claimants had objected that they had been discriminated by Czech educational system which had placed them in so called "special" schools.<sup>2</sup> The claimants stressed the fact that they had been placed in the special schools according to the

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<sup>2</sup> Relatively soon after the fall of communist regime the newly established non-governmental organizations, independent researchers and teachers in the Czech Republic started to point to insufficient performance of Roma children in the Czech educational system and particularly to their high representation in special schools - according to statistics the worst situation has been in Ostrava. In the 90 there had occurred changes having positive influence on Roma pupils – for example according to directive of The Czech ministry for education from 1995 graduates of special schools have got possibility to complete their education. Special attention was also paid to preschool education in the sense that various educational institutions started to organize preparatory classes for children from socially disadvantaged environments. Czech elementary schools – in the same way as other elementary schools in East and Central Europe - institutionalized profession of Roma pedagogical assistants responsible to assist teachers and establish relations with Roma families. Under the condition that they fulfill conditions for admission which are demanded for chosen specialization, graduates of special schools can continue their studies at the secondary schools. See Laubeová, Laura. *Inclusive School-Myth or Reality*. In Cahn, Claude (ed.) *Roma Rights : Race, Justice and Strategies for Equality*. Amsterdam-New York: IDEA, 2002. pp.86-95

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<sup>1</sup> [www.justiceinitiative.org/db/resource2?res\\_id=102633](http://www.justiceinitiative.org/db/resource2?res_id=102633)

standard application of respective legal norms – they alleged that they were victims of de facto racial segregation and discrimination. The dissatisfaction of the appellants with the decision of the Czech courts induced non-governmental organizations to start strategic litigation which was finally adjudicated by the European Court of Human Rights; after five years the applicant’s complaint was declared admissible and the Court asked for oral proceeding concerning investigation of racial segregation in Czech schools. In between 1996-1999 the applicants, after some time spent in “normal” elementary schools, they were transferred to “special” schools.<sup>1</sup> The strategic litigation in favor of Czech citizens of Roma descent was administered by the European Center for Human Rights and important institutions involved in the case, the Open Society Justice Initiative in conjunction with the Roma Education Fund. <sup>2</sup>*“On their grounds of appeal, the applicants explained that they had been placed in special schools under a practice that had been established in order to implement relevant statutory rules. In their submission, that practice had resulted in de facto racial segregation*

*and discrimination that were reflected in the existence of two separately organized educational systems for members of different racial groups, namely special schools for the Roma and “ordinary” primary schools for the majority of the population... Arguing that they had received an inadequate education and an affront to their dignity, the applicants asked the Constitutional Court to find a violation of their rights, to quash the decisions to place them in special schools, to order the respondents (the special schools concerned, the Ostrava Education Authority and the Ministry of Education) to refrain from any further violation of their rights and to restore the status quo ante by offering them compensatory lessons.”<sup>3</sup>*

### Romani children in remedial special schools in Ostrava, Czech Republic, Spring 1999

School	Total student body	Romani pupils	%
Kapitána Vajdy	193	31	16,06
U Haldy	166	27	16,26
Čkvalovova	191	49	25,65
Na Vizině	190	110	57,89
Karasova	156	121	77,56
Těšínská	159	135	84,9
Ibsenova	136	128	94,11
Halasova	169	161	95,26
Total	1360	762	56,03

Source: Laubeová, Laura. *Inclusive School-Myth or Reality*. In: Cahn, Claude (ed.) *Roma Rights: Race, Justice and Strategies for Equality*. New York: IDEA, 2002. page 87

The complaint claimed violations of several articles of the Convention and it was on the agenda of the European Court of Human Rights two times: in both 2006 and 2007 the Court was to decide whether

<sup>1</sup> By its decision of admissibility the European Court of Human Rights rejected argumentation of the Czech government that certain claimants had been transferred from special schools to normal ones and therefore they had not been victims who had merited judicial review.

<sup>2</sup> Open Society Justice Initiative (Justice Initiative) is a programe which focuses on education of activists/specialists/in the field of human rights and makes efforts to constitute open communities all around the world. It tried to develop strategic litigation related to national criminal liability, international justice, freedom of expression, equality and citizenship, etc. The Roma Education Fund is a foundation with the goal to eliminace educational differences between Roma and non-Roma citizens by means of new social policies and establishment of programs which deal with quality of education among Roma. The foundation also provides advice to governments and organizations which deal with Roma education processes and financial programmes which were introduced by non-profit organizations and local and central governments and which have been defending institutional changes of social policies in the educational systems trying to improve Roma inclusion. Foundation has been financed by European and Northamerican governments as well as by other means.

<sup>3</sup> <http://www.unhcr.org/refworld/docid/473aca052.html>

the disproportional placement of Roma children in inferior separate schools was discriminatory as defined by European Convention of Fundamental Rights and Freedoms. In the original complaint (except regarding the violation of article 14) the claimants used various arguments in order to support their claims that various articles of the Convention had been violated; they mentioned Article 3 and claimed that placement of Roma pupils in special schools could be classified as “degrading or humiliating treatment”; they mentioned Article 6 and claimed that rejection of judicial review was a denial of the right to a fair trial. Nevertheless these original claims were dismissed during the admission procedure. In February 2006, the First Chamber of the European Court of Human Rights found no evidence of discrimination against the applicants: the system of special schooling was not established solely for Romani children but with the legitimate aim of assisting children as they obtain a basic education; tests for placement in the schools were administered by professionals; individual psychologists had not adopted a discriminatory approach to these particular children; and the applicant’s parents did not protest by appropriate means. *“On 13 November 2007 the Grand Chamber held by thirteen votes to four that there had been a violation of Article 14 (prohibition of discrimination) of the European Convention on Human Rights read in conjunction with Article 2 of Protocol No.1 (right to education). The decision’s cornerstone finding was that the prejudicial impact of the special school system on the Roma children applicants was an unlawful discrimination in violation of fundamental rights guaranteed by the European*

*Convention. However, perhaps the most groundbreaking element of the Court’s decision was that it explicitly embraced the principle of indirect discrimination, upholding the principle that a prima facie allegation of discrimination shifts the burden to the defendant state to prove that any difference in treatment is not discriminatory. This ruling places interpretation of the European Convention in consonance with the standards set out in the European Union’s Directives on burden of proof in cases involving sex and racial discrimination and discrimination in employment on diverse grounds.”<sup>1</sup>*

In the judgment the Court decided only upon compensation for eighteen citizens but its impact upon racial discrimination in the Czech Republic, as well as in other East and Central European countries, has had a large-scale symbolic meaning. The judgment together with reports developed by Amnesty International concerning unequal treatment of racially diverse children in the Czech Republic and Slovakia were important elements which have contributed to a new power interplay between the Council of Europe and Czech Republic.

The Constitutional Court has been the highest Czech institution which can decide in the area of discrimination issues - - its elementary attitude towards racial discrimination has been framed by concepts of equality and to large degree has been influenced by cultural habits and traditions. Nevertheless, complaints concerning racial discrimination have been marginal issues on the agenda of the

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<sup>1</sup>Ibid.

Constitutional Court as the majority of legal proceedings have been realized by municipality courts. Many Czech experts are convinced that municipal courts know how to deal with complaints concerning discrimination, but concrete decision making has been disturbed by insufficient legal definitions of what was and what was not discrimination.

For example the regional court in Hradec Králové heard a case of racial discrimination which was finally resolved by alternative dispute resolution/private arrangement (before the release of judgment). The claimant was registered at the Labour Office and after some time she was recommended for a position as an auxiliary unqualified worker in a canteen. After a short interview at the canteen she was told that she was not going to be employed due to her Roma descent. The worker responsible for recruitment also communicated this “cultural message” in written form to the respective Labour Office. On the basis of this discriminatory approach the appellant claimed a violation of Article 3 of the Charter of Fundamental Rights and Basic Freedoms which guarantees freedoms regardless of ethnic origins. She also mentioned employment law, including the right to mediation concerning the exercise of work regardless of race, color or ethnic origin, the Civil Code, and Articles 5 and 6 of International Convention on the Elimination of All Forms of Racial Discrimination.<sup>1</sup>

A similar case of racial discrimination related to the labour market was adjudicated by Městský soud in

Prague and the complaint was again formulated by a Roma woman. In June 2003 she entered a drugstore in order to apply for a job which was advertised on the door of the shop. “We are looking for shop assistant”. After a short discussion with the shop assistant she was told that that “place has been occupied.” Shortly after the claimant left the shop a member of the majoritarian society – using a method of individual testing - entered the shop and pretended that she was looking for a job. In contrast to the experience of the Romani woman she was very well received, was offered a job and obtained complementary detailed information concerning the position. The Romani appellant claimed protection of her person against discrimination as rooted in the Civil Code. On the basis of this claim the court decided that the conduct towards the Romani woman was an infringement upon her personal rights and that she had the right to financial satisfaction due to the severity of the violation.

### **Concluding remarks: new ways to face racial discrimination in the Czech Republic**

Comparative analysis of various sources related to national, regional and international regulations and judgments has shown that –compared to Bulgaria – racial discrimination in the Czech Republic has not concerned right to life issues. While in Bulgaria race motivated murder was initiated by state military structures, in the Czech Republic racially motivated attacks have been the result of domestic terrorism and have been prosecuted by police and other state structures. The efficiency of recently passed

<sup>1</sup> [http://www.diskriminace.info/do-etnicka/rozsudky\\_cr.pdf](http://www.diskriminace.info/do-etnicka/rozsudky_cr.pdf)

antidiscrimination law would definitely depend on prospective empowerment of Czech citizens to formulate their claims on the one hand, but on the other, one should be critical of popular ideas that the new law would lead to a “contamination” of the Czech legal system due to the parallel coexistence of antidiscrimination regulations. The above mentioned cases of racial discrimination heard by various courts have shown that multiplicity of antidiscrimination regulations also offers to claimants more options as they can consider the use of various articles of international, regional as well as Czech norms – the parallel existence of antidiscrimination regulations thus also enlarges number of legal and other institutions that could deal with the case and thus indirectly multiplies the possibilities of winning litigation.

In the Czech Republic the fight against racial discrimination and particularly new options of strategic litigation can also be ameliorated by implementation of The Race Directive – it does not limit the effectiveness of prohibition of discrimination in regards to employment, but rather it extends the prohibition to education, training, social security, health care, access to goods and services including housing. The Directive takes also into consideration procedures for sanctions and the enforcement of rights should there be an alleged violation – these procedures include “shifting the burden of proof”. The implementation of The Race Directive in the Czech Republic should also be accompanied with screening processes, this means implementing measures that would be able to abolish any lawful, semi-lawful or administrative regulations

in contradiction with the principle of equal treatment – these “flaws” have very often been part of individual or collective contracts, directives at the level of enterprises, in the rules of profit and non-profit associations, independent professions and organizations of workers and employers. The Race Directive enables various legal subjects including nongovernmental organizations to participate in litigations as a friend of the court or on the victim’s behalf, and it has introduced concepts of direct and indirect discrimination – for example it is very difficult to objectively justify fluent knowledge of a language for the profession of cleaner and thus it can be considered to be discriminatory requirement against Romani citizens and others. The Race Directive also supports states’ efforts to intensify social dialogue among various social partners and nongovernmental organizations in order to address discriminatory forms of conduct.

Facing discrimination in the Czech Republic could also be facilitated by the institutionalization of innovative elements such as the introduction of prosecutors who would specialize in discrimination, the creation of special tribunals or chambers focused on discrimination similar to the Equality Tribunal in Ireland, or specialized entities with quasi-judicial competences such as the Commission for Racial Equality in the United Kingdom. Thus the integration of The Race Directive into the Czech legal system could open cultural space to new and wider strategic litigations which appear in legal practice ad hoc and which are “transcendental” in the sense that they are much more influential than one concrete case. For example the above mentio-

ned case D.H. and Others has not only modified interpretation of discrimination according to the Convention but it has also open new questions concerning social policies and redistribution of resources at the national level: according to Czech laws Roma assistants can be employed at various levels of educational system, with the elementary level being the actual focal point. Nevertheless, financial costs for their performance have not been covered by state budget and therefore their wages have been paid by schools themselves.

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## The building-up of EU Law in the domain of Accounting: from the “Directive period” to IFRSs.

*Pier Andrea Podda<sup>1</sup>*

*This paper aims at providing an overview of the recent evolution of EU Law in the area of accounting through a critical examination of the main steps which led towards the acceptance of International Financial Reporting Standards (IFRSs) as the source of accounting principles for various types of companies. Nowadays, according to EU Regulation 1606/2002, the consolidated financial statements of EU companies listed in financial markets must be prepared in accordance with these particular standards. Moreover, EU Law leaves to Member States the freedom to extend the obligation or the possibility to adopt IFRSs beyond these cases.*

*The application of uniform accounting standards to consolidated statements of listed companies, as well as the possibility that these standards could also be used in other types of statements, stems from a long-lasting process. Since 1978 the EU, and the EEC before 1992, have passed several legal acts in order to harmonise the rules at the basis of the preparation of financial statements. The process is far from completed as several proposals are being formulated on an ongoing basis in order to extend the application of IFRSs as well as modify the standards themselves.*

*The present paper provides an insight into this topic.*

### Introduction

In the last few years, the European Union has thoroughly overhauled the discipline of Accounting Standards to be followed by companies operating within EU. The subject has been going through an intense set of changes, carried on with an increasing rhythm, in view of the necessity to introduce and enforce a common set of standards in a strongly integrated area like the EU. In particular, the endorsement of International Financial Reporting Standards (IFRSs) by EU authorities has been a major step in the direction of reducing, insofar as it can be achieved, inter-country differences in accounting standards.

The high pace of the modifications in the EU legislative framework has required constant attention from both academics as well as practitioners, as keeping up-to-date with the state of the art of the relevant legislation has not been straightforward. It is possible that a certain level of confusion still persists among operators at various levels.

This paper aims at providing a critical summary of the main steps which led to the build-up of EU Law in the area of accounting. The main focus will be on

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the most recent developments in the area, taking Regulation 1606/2002 as a ground-breaking stage in the field. This particular Regulation requires that financial statements of consolidated accounts from financial market-listed EU companies be set up according to the IFRSs. This is in order to overcome inter-country differences in accounting principles which are likely to jeopardise the understandability of the specific information provided by financial statements.

None the less, in order to better appreciate the underpinnings of Regulation 1606/2002, it is necessary to understand its background. The Regulation chronologically follows a set of Directives which had previously been issued with the aim to introduce common accounting practices across the EU. However in view of the considerable discretion left to the Member States, the legal instrument used, namely the Directive, was not sufficient in that it did not result in the achievement of the objectives set. It was for this reason that the EU shifted towards the use of a Regulation, which restricts the possibility of differing enforcement amongst the member nations.

The present paper is structured in the following way. The first section (1.1.) will provide an overview into those initiatives taken by EU before issuing the Regulation. The second (1.2.) will discuss the innovations brought by the Regulation.

## SECTION ONE

### THE EARLIER ATTEMPTS OF EEC (EU) TO INTRODUCE COMMON ACCOUNTING STANDARDS.

This section will be divided into two parts. The first (1.1.) will highlight the importance of devising a set of common accounting standards within EU. The second (1.2.) will present the main acts introduced by European authorities before the Maastricht Treaty (1992) and, at the same time, highlight their limitations.

#### 1.1. The necessity of common accounting standards

The EU, and incorporating by reference also the EEC, has always considered the economic and financial integration of its members as one of the fundamental aims of its own existence, if not the most important goal. An obstacle-free economic and financial integration is feasible only in the presence of a harmonised framework of rules governing economic activities, otherwise, the absence of a common set of criteria devised to regulate economic exchanges would increase the costs of information-searching and information-interpreting, with a considerable surge in transaction costs (Coase, 1960; Parada, 2002). Finally, the difficulty of finding and interpreting relevant information may lead economic agents towards giving exchange up even when transacting would entail benefits to both parties (North, 1990). Consequently, as a general rule, it is possible to conclude that the availability of a shared regulatory system is a factor which con-

tributes to curb transaction costs in a market (Podda and Tsagdis, 2006).

Financial markets make no exception to the general rule outlined above. Agents operating in such a market benefit from the existence of clear and well-enforced regulations in order to carry on their activities safely. In cases where the regulations' provisions are not clear, unable to be found in a straightforward manner, or are hard to interpret, the convenience of an exchange may be jeopardised and financial investors may reduce their activity in the market.

Accounting information, contained in various types of financial statements, provides information to financial and direct investors regarding the state of health and the capacity of a given company to continue its operations, distribute dividends, honour its debts and generate profits (Nobes and Parker, 2008). The availability of such type of information is central to the decisions of investors to commit equity in/ acquire bonds of a business or even to the decision of a manager to work for a given company (Choi and Meek, 2008). Therefore, investors need to be able to understand the meaning provided by accounting posts in financial statements and make sense of numerical data presented in these particular statements. In this respect, difficulties may arise because accountants convey information using their language, which is normally alien to non-accountants. Thus, the first complication investors face relates to the need to learn how to read financial statements.

A second complication exists (still nowadays) because the standards governing the collection and representation of accounting information are far from being harmonised at a worldwide level. Accounting standards tend to differ because of historical, cultural and political factors, which are peculiar to single countries. For example, in general, German-speaking countries constantly tended to present detailed rules, typical of a Civil Law system, whereas Common Law Anglo-Saxon countries proposed a more relaxed set of standards, leaving space for practice-established authority. However, these differences are a major problem in an international economy where investors are used to shifting their capitals from one country to another, especially in an area like the EU which aims at facilitating all sorts of internal cross-border transactions. The existence of multiple accounting systems across the EU became a matter of concerns for EU authorities when the EU was still organized into three communities of which the EEC was the most important (1992 was the ground-breaking year seeing the re-structuring of European organisations with the official creation of EU).

## 1.2. The Fourth, Seventh and Eighth Directive

It was in 1978 that European authorities started intervening with the aim to reduce those differences in the accounting systems which complicated the interpretation of relevant information whenever transactions involved parties from two or more different countries. The Directive 78/660/EEC (known as Fourth Directive) represents an attempt to introduce „provisions concerning the presenta-

*tion and content of annual accounts and annual reports, the valuation methods used and their publication in respect of all companies with limited liability“*

<http://europa.eu/scadplus/leg/en/lvb/l26009.htm>

Moreover, member states were free to allow derogations and/or special provisions for small-medium sized companies.

As seen, the instrument chosen to introduce a certain degree of harmonisation was the Directive. The type of legal act used reveals that European institutions did not opt for a detailed set of prescriptions companies were strictly forced to follow. Rather, they preferred to rely on a broader framework, with member states left free to devise and follow their own way to achieve the aims the Directive intended to pursue. For example, the choice of the layout was left to the single state. Such an approach is not surprising if one is reminded of the fact that during the 70s the process of European unification was certainly not as advanced as now and that a push towards accelerating this process was still to come. Hence, European states were quite oriented towards retaining their sovereignty in many matters, to a much higher extent in comparison with these current days. None the less, several points in the Directive contained quite detailed prescriptions, leaving little space for Member States to devise their own ways.

The Directive 78/660/ EEC was followed by various amendments and other Directives. The aim was to further promote the harmonisation of accounting standards, taking into consideration the evolution of European integration and the challenges that this

process created to operators in international EU markets. For this purpose, the Seventh Directive (83/349/EEC) aimed at establishing common principles governing the conditions at the basis of the preparation of consolidated accounts. In particular, the Directive prescribed that consolidated accounts must be checked by an auditor, namely an independent expert in charge of verifying the regularity of financial statements. Following on the same path, the Eight Directive (84/253/EC) aimed at setting criteria regulating the activity of auditors. These latter are qualified experts required to control the financial statements provided by companies. The main related principle is that auditors must be independent from the company whose accounting they are going to check

In view of the above, it is noticeable that the European authorities attempted to regulate the sector of accounting and to establish principles valid across the whole of EEC (since 1992, the EU). Obviously, as time went on, the intensification of economic integration within the EU, and also worldwide, posed new challenges and required an updating of the provisions previously set by EEC (EU) authorities. In particular, the necessity to introduce a set of international common accounting standards was not determined only by the international intra-European activity of direct or financial investors. Indeed, international activity of EU-based firms and investors has traditionally stretched also over the European borders. Moreover, extra-EU economic actors have constantly operated in Europe, with the constant need to refer to reliable accounting information to manage their activities. This constraint

called for the definition of accounting standards followed worldwide.

## SECTION TWO

### IFRSs AND THEIR ENDORSEMENT

This section will be divided into two parts. The first (2.1.) will describe IFRSs and the authorities in charge of defining them, whereas the second (2.2.) will explain how IFRSs are transposed into EU Law and, consequently, become law in all member states.

#### 2.1. What IFRSs are and how they are created

The IFRSs are a set of accounting standards devised with the aim to be used internationally to solve the complications that differences in nation-specific accounting systems create to global investors and general users of accounting information. Since 2001, the IFRSs has been gradually substituting their antecedents, the so called International Accounting Standards (IAS) which had been in place since the 70s. The standard-setter is the so called International Accounting Standard Board (IASB). This latter, in turn, is formed by a group of international experts, with a representation of high-levels academics and practitioners. Members of the Board are appointed by the International Accounting Standards Committee Foundation (IASCF), which is an international not-for-profit private organisation. The Foundation “is committed to developing, in the public interest and through its standard-setting body, the International Accounting Standards Board (IASB), a single set of high quality, international financial reporting stan-

dards for general purpose financial statements.”(<http://www.iasb.org/About+Us/About+the+ASC+Foundation/About+the+IASB+Foundation.htm>). IASCF supervises the work of the Board but does not directly participate in the creations of the IFRSs. Both IASCF and IASB are independent, or supposed to be independent, from national governments. The IASB presides over the introduction of new accounting standards and the modification/cancellation of existing ones. The IASB holds a permanent dialogue with national standard-setters and with all the various authorities eventually interested in the development of IFRSs (i.e. national governments). Moreover, the public is also allowed to contribute to the process of IFRSs development as the IASB publishes its projects and invites any interested party, or private person, to post comments, feedback and advice. The aim of IASB and of its supervisor IASCF is to render the process of definition of IFRSs as transparent as possible. Nowadays IFRSs covers a broad set of topics in the field of accounting. A list of specific standards is provided below:

#### IFRSs:

- **IFRSs 1** First-time Adoption of International Financial Reporting Standards
- **IFRSs 2** Share-based Payment
- **IFRSs 3** Business Combinations
- **IFRSs 4** Insurance Contracts
- **IFRSs 5** Non-current Assets Held for Sale and Discontinued Operations
- **IFRSs 6** Exploration for and evaluation of Mineral Resources
- **IFRSs 7** Financial Instruments: Disclosures

- **IFRSs 8** Operating Segments

This list needs to be considered together with that of the still surviving IAS, in particular:

- **IAS 1** Presentation of Financial Statements
- **IAS 2** Inventories
- **IAS 7** Cash Flow Statements
- **IAS 8** Accounting Policies, Changes in Accounting Estimates and Errors
- **IAS 10** Events After the Balance Sheet Date
- **IAS 11** Construction Contracts
- **IAS 12** Income Taxes
- **IAS 16** Property, Plant and Equipment
- **IAS 17** Leases
- **IAS 18** Revenue
- **IAS 19** Employee Benefits
- **IAS 20** Accounting for Government Grants and Disclosure of Government Assistance
- **IAS 21** The Effects of Changes in Foreign Exchange Rates
- **IAS 23** Borrowing Costs
- **IAS 24** Related Party Disclosures
- **IAS 26** Accounting and Reporting by Retirement Benefit Plans
- **IAS 27** Consolidated and Separate Financial Statements
- **IAS 28** Investments in Associates
- **IAS 29** Financial Reporting in Hyperinflationary Economies
- **IAS 31** Interests in Joint Ventures
- **IAS 32** Financial Instruments: Presentation
- **IAS 33** Earnings per Share
- **IAS 34** Interim Financial Reporting
- **IAS 36** Impairment of Assets

- **IAS 37** Provisions, Contingent Liabilities and Contingent Assets
- **IAS 38** Intangible Assets
- **IAS 39** Financial Instruments: Recognition and Measurement
- **IAS 40** Investment Property
- **IAS 41** Agriculture

An oversight into the rationale of all these IFRSs and IAS would definitely go beyond the scope and the space of this paper. However, just to provide some examples, information regarding the scope of the first 3 IFRSs is provided below:

**IFRSs 1 First-time Adoption of International Financial Reporting Standards** – this standard sets the requirements that companies using IFRSs for the first time must respect, including, for example, the relevant dates and the treatment of previous financial operations.

**IFRSs 2 Share-based Payment** – it states how a company should recognise its eventual payments for goods/services received through its own equity instruments or cash-based on the value of these particular instruments

**IFRSs 3 Business Combinations** – it deals with the directives a company must respect whenever acquiring control of another company

As said, the IASCF is a private sector organisation. Hence, it lacks the authority to render its own standards mandatory. Insofar as an organisation is a private and not a public type, it has no sovereign powers over any other entity. Therefore the acceptance of IFRSs rests on the acceptance of

those parties which are supposed to use them. Alternatively, it is up to sovereign public organisations to adopt IFRSs and render them obligatory for certain categories of providers of business information.

The path described above has been followed by several countries worldwide. An increasing number of Governments has so far accepted to endorse IFRSs, thus forcing at least some of the companies responding to the various local legislations to respect IFRSs when preparing their financial statements.

## 2.2. The endorsement of IFRSs into EU Law

The EU Regulation 1606/2002, as already said, establishes that consolidated statements of EU listed companies must be prepared in accordance with IFRSs (however, not EU companies listed in EU markets are allowed some types of derogation until, at maximum, 2011). In addition, member states retain their freedom to allow/impose the use of IFRSs in all other cases (i.e. separated statements, consolidated statements of un-listed companies). The EU Regulation does not need any type of national act to acquire validity in the member states and enters directly into their own internal set of legal prescriptions. However, there is an important aspect of the use of IFRSs that must be stressed. The European Union retains the right to check the compatibility of all the prescriptions of the various IFRSs with the main principles, aims and objectives of EU Law and can eventually make modifications to the standards released by IFRSs. This does not mean that the official version of

IFRSs changes according to the steps taken by EU main bodies. Nevertheless, in this case EU listed companies must apply rules slightly different from those set in the IFRSs. The risk of such an eventuality is not extreme, as EU maintains a dialogue with IASB, this latter having an incentive in listening to EU arguments given the discretion of the EU not to endorse a particular standard, *in toto* or in part. Nonetheless, EU institutions may force EU listed companies to prepare their statements in accordance with the EU modified version of the IFRSs. Such modifications are rare but still occur in some cases (the European Union, in 2003, did not endorse the version of IFRSs 32 and 39 as released by the IASB). The endorsement by the EU of new-released IFRSs, or of modifications of previously existing standards, goes on through a process known as “Comitology” which requires the Commission to collaborate with three Committees. These Committees are:

- 1) the Accounting Regulatory Committee (ARC) is in charge of evaluating the proposals of the Commission. It is composed by representatives of Member States and is chaired by the Commission itself. The ARC needs a qualified majority to approve the proposals of the Commission, otherwise matters are referred to the Council of EU and to the European Parliament
- 2) the European Financial Reporting Accounting Committee (EFRAG) is composed by technical experts and is in charge of providing advice and comments about IFRSs to the European Commission.

- 3) Standards Advice Review Group (SARG) in charge of providing advice to the Commission regarding the activity of EFRAG

This particular procedure, where the statutory links between controllers and controlees leaves room for confusion, reflects the complexities typical of the "Comitology" procedure. A further complication is given by the fact that within the EU all Member States' official languages enjoy the status of EU official languages. It ensues that the IFRSs, originally released in English, are translated into the various EU official languages, all of which having legal force in their respective country. Therefore, given the major difficulties involved in uniformly rendering hundreds of pages of provisions in a number of languages, there is a wide room for differences in the interpretation/application of the IFRSs by the relevant authorities in the 27 Members of the EU. Still this problem does not seem solvable in the present, as multi-linguism is a precise choice of the States part of EU. Moreover, given the fact that officials of national market authorities and especially national courts are not obliged to know English, an eventual exclusive endorsing of the original English version would

probably complicate rather than solve the issue (without even mentioning constitutional constraints in individual countries regarding the validity of legislation written in a foreign language).

## Conclusion

The adoption of the IFRSs and the successive endorsement by EU authorities has created the basis for a uniform accounting language within the integrated market of EU as well as outside the EU in those markets where the IFRSs are used by companies in the preparation of their financial statements.

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## “Foreign s.r.o.” – for the purpose of interpreting of §105 (2) of the Commercial Code

*Ingrid Ambruzová<sup>1</sup>*

The issues relating to the prohibition of chaining<sup>2</sup> single-member limited liability companies in the Czech Republic and its potential extension to foreign corporate owners has been discussed many times in legal reviews and articles. The prohibition on chaining single-member limited liability companies was enacted on the basis of Article 2.2 of the Twelfth Council Company Law Directive on single-member private limited liability companies<sup>3</sup>; however, it remains an issue of Czech law that does not find much resemblance in many other Member States of the EU.

Article 2.2 of the Twelfth Directive laid down the possibility for Member States to impose restrictions on chaining single-member limited liability companies in cases where one single-member entity wants to create another one as the sole owner.

Based on this provision, Czech legislators enacted a prohibition on the chaining of společnost s ručením omezeným<sup>4</sup> with a single member.<sup>5</sup>

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<sup>1</sup> AAU Prague 2009 BA (Honors) in Comparative law graduate, best student of her class, this text is an excerpt from her thesis.

<sup>2</sup> One single-member limited liability company creates another limited liability company and controls that company as the sole owner. In this way, a chain of a number of companies, in fact controlled by only one person, can be created.

<sup>3</sup> Twelfth Council Company Law Directive 89/667/EEC of 21 December 1989 on single member limited liability companies, hereinafter “Twelfth Directive”.

<sup>4</sup> Czech version of private limited liability company, hereinafter “s.r.o.”.

<sup>5</sup> Commercial Code, §105 (2).

Such an implementation would not raise major concern; however, when interpreting this provision, an argument arose whether the prohibition should also have effect on single-member limited liability companies, incorporated under foreign law, that wish to create a s.r.o. in the Czech Republic.

So far, Czech legal scholars have been inconsistent in the interpretation of the prohibition found in §105 (2) of the Commercial Code. Due to the lack of jurisprudence on this matter, the Czech Republic remains without a strong judicial authority as to the possible extension of this clause to foreign companies. The only courts that really deal with this issue are the registration courts. It seems that, in their current practice, those courts do not examine whether a foreign company creating an s.r.o. has one or more owners. However, their attitudes differ. The argument is then left to lawyers and legal scholars, whose opinions vary.

It is certainly beyond the scope of this article to analyze all the arguments that form part of the discussion. This article will focus on only one of these issues - the subject of the prohibition, “s.r.o.”, and the term “foreign s.r.o.” that most likely were the source of the confusion in interpreting § 105 (2).

The provision precluding the chaining of single-member companies first appeared in Act No.

370/2000 Coll.<sup>1</sup> At that time, the restriction had a general character and was applicable to any company: “A company can be founded by a single person. A single member company cannot become the single founder or single member of another company. A natural person can be a single member of a maximum of three companies.”

This provision raised a question as to which companies should be affected. The term “company” was criticized for being too broad and creating legal uncertainty on this point.<sup>2</sup> In order to clarify the application of §105 (2), another amendment of the Commercial Code was adopted, Act No. 501/2001 Coll.<sup>3</sup>, changing the term “company” to “limited liability company” (s.r.o.).<sup>4</sup>

Although the application of §105 (2) seemed to have been clarified, another question arose: should the prohibition on chaining single-member companies also be applied to foreign legal entities willing to create an s.r.o. in the Czech Republic?

This thought appeared for the first time in the commentaries to the Commercial Code by Jan Dědič *et al.*<sup>5</sup> and later was adopted in the commentary by Ivana Štenglová *et al.*<sup>6</sup> as well. The authors of these commentaries believe that, based on §24

(1)<sup>7</sup>, there is no reason to exclude foreign persons from this prohibition. In addition, they use the list of corporate forms of Article 1 of the Twelfth Directive as a tool to determine which corporate forms should be included in the prohibition assuming that, by the simple fact that EU legislators listed these companies together with the Czech s.r.o., it can be inferred that those companies can be considered equivalents to this Czech entity. Therefore, the prohibition on chaining should be applied also to those foreign equivalents of the Czech s.r.o.

In both commentaries, the term “foreign s.r.o.” is used extending the scope of application of the prohibition on chaining. However, the authors do not deliver an exact definition of what such a term should mean and which types of companies should be included in it. The authors of Štenglová’s Commentary conclude that in cases of companies that are not listed in Article 1 of the Twelfth Directive, the actual characteristics of each particular company in question will have to be examined.<sup>8</sup> The authors, however, fail to clarify what kind of examination they mean and which characteristics should be, in their opinion, decisive.

The analysis of §105 (2) in Dědič’s Commentary is somewhat more detailed, however, it is based on the term “foreign s.r.o.”, which in fact does not exist under Czech or any foreign law. The authors gave their own definition as followed:

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<sup>1</sup> Act No. 370/2000 Coll., amendment to the Commercial Code. §105

(2)

<sup>2</sup> Rychlý, at 211.

<sup>3</sup> Act No. 501/2001 Coll., amendment to the Commercial Code.

<sup>4</sup> Rychlý, at 211.

<sup>5</sup> J. Dědič *et al.*, *Obchodní zákoník Komentář*, Polygon, Prague, 2002, hereinafter “Dědič’s Commentary”.

<sup>6</sup> Štenglová *et al.*, *Obchodní zákoník Komentář*, C.H.Beck (11<sup>th</sup> edition), 2006, hereinafter “Štenglová’s Commentary”.

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<sup>7</sup> Commercial Code, §24 (1) – non-discrimination principle; foreign persons (without any further specification) are allowed to found companies under Czech law or participate as partners in already existing companies under the condition that these persons are subject to the same rights and obligations as Czech persons.

<sup>8</sup> Štenglová’s Commentary, at 369

A foreign s.r.o. is “a foreign legal person that is

- a) a corporation,
- b) its members are liable only up to the amount invested (eventually the obligation to the investment) and its future valuation; and, at the same time, the share of the member in the corporation cannot be represented by a bond (commercial paper), whereas what is or is not a bond shall be determined according to the appropriate foreign law.”<sup>1</sup>

Nevertheless, it is not clear on which authority the authors rely in their definitions. In addition to that, their elaborated definition does not answer the main issue regarding the term “foreign s.r.o.”, which asks whether it “is possible, from the point of view of Czech law, to allege that something like a ‘foreign limited liability company’ exists”.<sup>2</sup>

The term “s.r.o.” has an exact meaning under Czech law.<sup>3</sup> It is “a legal entity which is separate from the personalities of its members” which are liable for its debts only up to the amount of the individual deposits they each made when the company was founded.<sup>4</sup> Even though there exist foreign equivalents to the Czech “s.r.o.” (German Gesellschaft mit beschränkter Haftung, Spanish sociedad de responsabilidad limitada, UK company limited by shares or guarantee etc.), besides the common principle of limited liability of its members, they each have different characteristics in their respective legislation. One such differences is the ability

of a private British company limited by shares to issue shares and offer them publicly<sup>5</sup>, which a Czech s.r.o. cannot do. It is questionable whether these similarities can form a strong enough basis for including all those corporate forms into the term “foreign s.r.o.” especially when no jurisdiction (including the Czech one) knows and recognizes such term. Furthermore it is disputable whether it can be alleged that the term “s.r.o.” used by the Commercial Code also encompasses these foreign corporate forms.

The Commercial Code imposes a prohibition explicitly upon the s.r.o. as opposed to “any company, or limited liability company, including any foreign companies, that has as a main characteristic limited liability”.<sup>6</sup> Thus, in order to extend the applicability of §105 (2) to foreign companies, the term “s.r.o.” would have to have a double meaning within one sentence.<sup>7</sup> In the first part of the stipulation, it would mean a Czech s.r.o. plus certain foreign limited liability companies, which are not easy to define. In the second part of the provision, it would only represent the Czech “s.r.o.”<sup>8</sup> In addition, once such double meaning would appear in one provision, the same term could be interpreted consistently throughout the whole Commercial Code. That would give rise to an enormous inconsistency and legal uncertainty, because anywhere in the Commercial Code the term “s.r.o.” would appear, it would be unclear which meaning should be applied.

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<sup>1</sup> Dědič's Commentary, at 961.

<sup>2</sup> Rychlý, at 212.

<sup>3</sup> Commercial Code, §105 (1).

<sup>4</sup> Faldyna, at 317.

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<sup>5</sup> Rychlý, at 214.

<sup>6</sup> Spáčil, at 66.

<sup>7</sup> *Ibid.*

<sup>8</sup> Rychlý, at 213.

In situations like the present one it is interesting to take into account the classical methods of interpretation of law. According to the Constitutional Court of the Czech Republic, it is always necessary to start with the literal interpretation of the provision in question.<sup>1</sup> Only in cases of ambiguity, contradiction, or incomprehensiveness it is possible to use other methods of interpretation. The most important method is the teleological interpretation that analyzes the provision (or the entire legal act) according to its purpose.<sup>2</sup> The teleological approach should always be present when a legal provision is construed because “the linguistic contents does not always reflect the purpose” of the law.<sup>3</sup>

Construing §105 (2) following the steps laid down by the Constitutional Court, the literal meaning of the provision has to be considered first.

The first sentence of §105 stipulates that one person can lawfully found an s.r.o. The second sentence states that a company owned by only one person cannot be the sole owner/founder of another single-member s.r.o.

The key term of §105 (2) is “single-member limited liability company”, which is a well established legal term that is clearly specified by the same legal act.<sup>4</sup> It can hardly be claimed that the terms used in §105 (2) are unclear or ambiguous; the literal

meaning of the stipulation leaves no doubts as to what the legislators say. As for the literal interpretation, there seems to be no reason for an extensive interpretation that attempts to modify the law by adding foreign limited liability companies to the term “s.r.o.”

In examining the provision according to its purpose rather than its literal meaning, several points have to be mentioned. A long discussion could be held regarding the importance of such a provision for the attainment of the purpose mentioned by the legislators: the protection of creditors and third parties. This article will not discuss this part of the issue in depth. Briefly, the interpretation according to the purpose gives rise to doubts whether the protection of creditors could be efficiently secured by imposing the chaining restriction on Czech corporations only, while a relatively large number of foreign companies establish their subsidiary companies in the Czech Republic. On the other hand, the legislators have already adopted a number of other measures<sup>5</sup> to safeguard the interests of creditors and third parties *vis à vis* companies with limited liability; the prohibition on chaining s.r.o.s thus appears to be of minor importance.

As for other relevant points regarding interpretation according to purpose, the amendment of the Commercial Code can serve as an indicator of which direction the interpretation of 105 (2) should follow. The legislators have adjusted the wording of

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<sup>1</sup> L. Hanuš, *K argumentaci teleologickým výkladem (vázanosti soudce zákonem)*, *Právní rozhledy*, 7/2007, at 34.

<sup>2</sup> *Ibid.*

<sup>3</sup> *Ibid.*

<sup>4</sup> Commercial Code, § 105 (1).

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<sup>5</sup> EU Directives, competition laws on mergers and acquisitions, bankruptcy law, § 66a of the Commercial Code regulating the law of concerns, or §196a on transfers of property among affiliated companies.

105 (2) motivated by the uncertainty of the previous wording that only used the word “company” with the sole aim of specifying which corporate forms the prohibition shall apply.<sup>1</sup> Because of the term used in the amended version, it is possible to infer that the legislators’ aim was not to limit the chaining of any type of company with limited liability from all around the world. On the contrary, it indicates that they chose to limit only the s.r.o.

As shown by the discussion above, the solution to the question whether the chaining of single-member limited liability companies should be extended to foreign corporations is not easy to ascertain.

From the interpretation point of view, §105 (2) seems to be satisfactorily clear and unambiguous as for its literal meaning. The interpretation according to its purpose gives rise to doubts whether the protection of creditors could be effectively secured by imposing the chaining restriction on Czech corporations only, while a relatively large number of foreign companies establish their subsidiary companies in the Czech Republic. On the other hand, the legislators have already adopted a number of other measures to safeguard the interests of creditors and third parties *vis à vis* companies with limited liability; the prohibition on chaining s.r.o.s thus appears to be of minor importance.

It appears that the theory supporting the extension of the prohibition to foreign corporate owners relies on many controversial points that decrease its

applicability in practice, especially as there is reference to the nonexistent term “foreign s.r.o.”, the term which was probably the source of the confusion. Using such terms notably undermines the seriousness of the argument mainly because it signals that more space was given to creative assumptions, carrying certain aspects of “law-making” rather than “law-commenting” that oftentimes lack a stronger base in the law.

Although the arguments presented in this discussion by legal scholars are of great strength and importance, they are not strong enough to settle this issue completely. For the sake of legal certainty let us hope that a judicial decision clarifying the interpretation of § 105 (2) will be delivered soon.

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<sup>1</sup> Rychlý, at 211.