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# Who owns the public interest in Europe? implications for health policy and system restructuring

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## 1 Introduction

The continuing tension between Member States and the European Union creates practical, interpretive and legal issues in understanding large-scale problems, such as the restructuring of social protection systems. In many cases either state monopolies or oligopolies operate under government sanction ensure the provision of health services. And indeed, while there is general acceptance health services are outside the jurisdiction of Union law, there remains the question whether, with wide-spread public sector reform, this jurisdiction might be extended.

The root of the problem lies with the interpretation of public interest as it has evolved through a number of legal cases which have eroded the foundations on which Member State's interests may over-ride Community interests. The question is whether there are any implications within the European arena for increased public sector reform of health systems and whether, perhaps inadvertently, reform may put the health service activities of Member States within the scope of Community law.

The focus of attention is Article 90 EC, concerned with *public undertakings* which are granted by Member States *special privileges*, or *exclusive rights* to operate outside of the normal competitive market. This Article seeks to remove barriers to trade in these areas if public interest objectives are not demonstrated.<sup>1</sup> In keeping with the objectives of a single market and the four freedoms<sup>2</sup> anti-competitive activities become a problem where the public undertaking pursues activities better pursued competitively. It is important to understand, then, the difference between a public undertaking which provides a service which might be of economic interest, and one which is not, and why the difference is important to Member States and the Community. It is the interaction between these considerations that frames the debate over the public interest. It is also important to understand that Article 90 is seen as a derogation from the relevant articles concerned with enhancing competition within the community which of necessity entails a very strict interpretation of when States' interests are compelling.

While little has emerged to directly implicate health systems, the main objective of this monograph lies in exploring potential future arenas which may have an impact on health systems, and thereby become much more relevant for policy than hitherto thought.<sup>3</sup> Various legal cases are used to explore the efforts to define the public interest within Europe, within the scope of public undertakings under Article 90 EC.

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<sup>1</sup> The pursuit of economic and public interest objectives through public undertakings instead of using market forces and competition represents a challenge to Articles 85 and 86 EC.

<sup>2</sup> Freedom of movement of goods, services, people and capital.

<sup>3</sup> In Tremblay, "Telemedicine: Legal Issues", for the UK Department of Health, European legal considerations are clearly relevant in the UK which emanate from the wider European dimension.

## 2 The public interest balancing act: Member States v The Court and Commission, *case to be convened*

Within the Community, determining the public interest involves specific tests or criteria.<sup>4</sup> The issue is whether they are sensitive enough to respond to the reasons presented that Member States may use to create public undertakings in the first place, and whether the Court or Commission have acknowledged these reasons.

Many aspects of health care industries are removed from the scope of competitive markets, and states generally granted autonomy over how they choose to manage or structure their health systems, as in the European Community. However, the fine balance between the objectives of the Community and Commission and of the Member States are often in considerable conflict.

While services may be excluded, they are excluded partly because of the issue of how they are funded; there may be a wider interest if the health system did not provide sufficient level of service to meet European public health objectives, or where the flow of health goods, rather than services, is involved. And if health systems become increasingly private-like, with competitive forces at work, can health services still be considered non-economic activities?

Article 90 tolerates public undertakings to the extent that they

- are non-economic or provide service of general economic interest
- are essential
- act in the public interest
- are applied without discriminatory effect
- are in proportion to the desired objective.

Additionally, there are the Article 36 EC derogations concerning public health, safety, and security which are intended to give Member States a public-interest opt-out.

The development of the competition rules may not completely reflect Member States' interpretations of the public interest and may not produce the public good. However, the Court has in effect argued that public undertakings must meet an additional test to avoid falling foul of the Treaty, namely, they must meet the social needs which justified granting the exclusive right in the first place. This includes offering to consumers choice, price competition, portability of benefits or service across national markets, and embody a defined sense of the public good.

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<sup>4</sup> Canada, for instance, regulates its broadcasting industry through "promises of performance" statements, which reflect a corporate commitment to public interest objectives.

Article 90 is effectively restricting the anti-competitive behaviour of public undertakings and of their Member State masters. It remains to be seen whether Member States may become more adept at defining legitimate public interest in ways that reflect sound economic reasons (to create quasi-markets) and to frame those arguments in ways which do not fall foul of the Treaty. Let us now turn to these considerations in greater detail.

### 3 The Public Interest

Public undertakings embrace vertical restraint as a tool,<sup>5 6</sup> either to control distribution channels<sup>7</sup> (e.g. telecommunications connection equipment), market entry of competitors through monopoly control of licenses or quotas (e.g. alcohol distribution), or concentration of buying power (e.g. procurement of vaccines).

Buying power, concentrated in a few (or single) public undertakings, is monopsony power. For states contemplating public sector reform, this may be a more effective approach than monopoly control of service delivery since it gives the state the power to control the market logic more firmly, by establishing a threshold level of capability other than market contestibility. For public health<sup>8</sup>, states are often the only legal purchaser of care<sup>9</sup> the state being a price-setter (monopsony power at work) and not a price-taker (competitive forces at work).

Vertically integrated public undertakings integrate the supply chain, from manufacture and procurement to service provision. As liberalisation and privatisation have progressed (where they have progressed...) it has often started at the manufacturing end with states yielding control over steel manufacturing, coal production, even travel services. Service provision, the next obvious target, is more controversial as it is here that monopolistic actions of states are often justified.<sup>10</sup> Disease management strategies by pharmaceutical companies, for instance, represent efforts to “force” apart these integrated (vertical and horizontal) supply chains characteristic of health care systems and offer other forms of service provision.

Paul Davies’ conclusions on *Macrotron* and *Merci* concern the unwillingness of the Court to overtly assess the legitimacy of national social policies in the context of Community law.<sup>11</sup> It is these social processes which led to the creation of

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<sup>5</sup> First European Competition Forum, 1995.

<sup>6</sup> John Kay, **Foundations of Corporate Success**. OUP, 1993.

<sup>7</sup> Martin Howe, and Francois Vaisette, cited in Laraine Laudati, *The First European Competition Forum: Vertical Restraints*, **EC Competition Policy Newsletter**.

<sup>8</sup> An Article 36 derogation.

<sup>9</sup> The Canadian health system at the provincial level involves monopsony purchasers as the legal purchaser of health care. Many countries’ “sickness funds” are monopsony purchasers for their membership and operate within occupationally defined enrolment categories. The UK’s Department of Health is the only legal purchaser of vaccines from manufacturers; vaccines are distributed nationally through a company having an exclusive license.

<sup>10</sup> Scott, p 197.

<sup>11</sup> P. Davies, *Market Integration and Social Policy in the Court of Justice*, **International Labour J**, 24(1995)49-77.

monopolies, though, and it seems strange for the Court to ignore the compelling logic of Member States.

We should not be surprised, however, since the Court is not concerned with understanding this logic, only to ensure the integrity of the Community's over-arching competition rules. On one view, then, the Court is not balancing the interests of the Member States and the Community (that is, it is simply interpreting Community law to achieve market integration) and where there is an apparent conflict, Community law applies. If there is no conflict, the social position of the Member State is, however, irrelevant for the Court's purposes.

On another view, the Court is being covert in its balancing by concealing its reasoning within how it defines the scope of the applicability of the Articles and not in explicit criteria for arriving at decisions in the first place. If the latter were indeed the case, it raises serious concerns about the extent to which Member States can fully link their actions in the public interest to competition policy. Davies notes that if Member States' social policies were ignored by the Court, it would restrict the jurisdiction of Article 90 over the anti-competitive behaviour of state monopolies.<sup>12</sup>

Either way the judiciary cannot resolve the balancing act of deciding the public interest objectives of individual Member States; the Court should only "review"<sup>13</sup> the acts of the legislature, or correct manifest error. Edward and Hoskins<sup>14</sup> seem to find this position unappealing as it would limit judicial control over legal monopolies. But surely that is the point of having an over-riding argument of public interest concerns.

States generally enjoy a monopoly in creating applicable laws and regulatory mechanisms and Community accession treaties have granted sovereignty to Community law and its institutions where applicable. But if states do enjoy residual powers it must be in those areas of state interest which are irreducible and essential. If states are more widely empowered to define and act in the public interest, then narrow restrictions on sovereignty are incompatible; if the principle of subsidiarity is to work, devolution must go to the level which has the authority to act. Presumably, this is one point of the principle of subsidiarity.

On the other hand, though, this raises issues of re-regulation<sup>15</sup>. Scott suggests that there has been a failure to institutionalise the liberalisation of telecoms markets through a European regulatory framework or body.<sup>16</sup> And regulatory power is now coveted by Bangemann<sup>17</sup> for the Commission. There is a precedent in the European Medicines Evaluation Agency, which, while not necessarily a monopoly evaluator,

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<sup>12</sup> Davies, pp 66-69.

<sup>13</sup> Edward and Hoskins, citing *Stoke-on-Trent City Council v B&Q plc* Case 169/91.

<sup>14</sup> *Article 90: Deregulation and EC Law*.

<sup>15</sup> Scott, pp 213-214.

<sup>16</sup> Scott, p 202.

<sup>17</sup> *Ibid.* and The Bangemann Report, electronic version from Europa.

does have a monopoly on granting a Community marketing license for pharmaceutical products.<sup>18</sup>

Scott notes that TENs run counter to the liberalisation policy of the Community and may represent re-monopolisation at the Community level.<sup>19</sup> What is to stop Member States from colluding to create an interconnected system, monopolistic at the Community level, using TENs as the vehicle; after all, a TEN would seem to enjoy some sort of monopoly status. This logic prevails where infrastructure compatibility and standards are needed (exactly the areas in which natural monopolies emerge). It remains a question how Article 90 might apply to cross-border monopolies or Community oligopolies such as we see arising from deregulated telecoms or energy markets.<sup>20</sup> Either way, re-regulation looks set to expand under Article 90(3).

The Court has not felt able to define the “public good” at the Member State level, except for the achievement of Community objectives. However, the Court’s view is that the public good is what emerges from the competitive behaviour of market players. In contrast, the Commission acknowledges<sup>21</sup> that some activities are clearly non-economic such as health services, and education. It remains unclear whether these non-economic activities will persist as such, given that, for example, some 9% of the Community’s GDP is spent on health services, and probably up to 15% of GDP is accounted for through health services, medical devices and pharmaceutical activity<sup>22</sup>. This is surely of significant economic impact and it remains only a matter of time before the distinction is drawn between the non-economic *service* and the economic *product or good*.<sup>23</sup>

Article 90(3), which permits the Commission latitude of action, defines the tolerance of Article 90. The Commission’s statements on telecommunications and postal services, and in **The Bangemann Report** (particularly the reference to regulatory powers) suggest a low tolerance level. The observation that more situations in the anti-trust arena are dealt with by regulatory bodies<sup>24</sup> reveals the second strand of

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<sup>18</sup> EMEA is established under Article 235 EC and Council Regulation 2309/93. Its regulatory authority derives from Council Directive 65/65/EEC which laid down the principle of pre-marketing authorisations for medicinal products in all Member States. EMEA issues a “Community Marketing Authorisation” which permits a medicinal product to be marketed in all Member States without further approval. EMEA also undertakes pharmacovigilance, which effectively can remove products from the market, even if it has not been approved through EMEA (Council Directive 75/319/EEC).

<sup>19</sup> C. Scott, *Changing Patterns of European Community Utilities Law and Policy: an institutional hypothesis*, p 202.

<sup>20</sup> This is actually not so far-fetched a consideration. Some technology companies enjoy virtual monopoly status within multi-national markets in virtue of their control of an industry standard (Microsoft is an example); the EU and the US agreed a common position with respect to Microsoft in this case. But can Article 90 adequately deal with multi-state anti-competitive behaviour?

<sup>21</sup> European Commission, *Communication on services of general interest*, 1996.

<sup>22</sup> OECD Health Data Base, 1996. (author’s copy)

<sup>23</sup> Health *services* are specifically excluded from the Treaty, but is the service, for instance, the hip replacement operation including the artificial hip appliance, or is it the surgeon’s time only, with the appliance being a good. It naturally leads to the unbundling of services and goods, providing the service free with a charge for the appliance.

<sup>24</sup> C.D. Ehlermann, “The European Experience with Merger Guidelines”, Competition Law and Policy Institute, Wellington, New Zealand.

challenge to anti-competitive public undertakings, the Commission acting under Article 90(3) in developing regulatory machinery.

Taken together, the rulings of the Court, and the Commission's actions toward liberalisation of the Community's institutions, reduce the freedom of action of Member States considerably.

## 4 What is the purpose of Article 90 EC

### 4.1 The objectives of Article 90 EC

State monopolies were seen in Europe as appropriate mechanisms for achieving social objectives, including but not limited to:<sup>25</sup>

- practical requirements of post-war reconstruction
- compatibility with the European ideological and political *zeitgeist*
- a natural consequence of many small states competing for a continental market, and a way to increase national capacity to compete globally.

Article 90, framed in that context, clarifies Articles 85 and 86 by saying that public undertakings are captured by the competition rules, if not acting in the public interest. Article 90(1) defines the elements which characterise public undertakings with 90(2) as a limiting derogation. Article 90(1) is addressed to Member States, while Article 90(2) is addressed to the undertaking, itself.

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<sup>25</sup> Nicholas Moussis, *Access to European Union: Institutions and Policies, 1994*, p 259.

The Table 3.1. summarises the relevant sections.

4.2 Table 3.1: Summary of key elements in Article 90(1) and (2)

Clause	90(1)	90(2)
<b>scope</b>	public undertakings and undertakings granted ...	undertaking entrusted with ...
<b>elements</b>	special rights  exclusive rights	operation of services of general economic interest  having the character of a revenue producing monopoly
<b>Member states shall...→</b>	...neither enact nor maintain in force any measure contrary to ... Articles 6, 85 to 94	
<b>Undertakings shall...→</b>		...be subject to the [competition rules]...as long as [they do not] obstruct the performance, in law or in fact, of the particular tasks assigned to them.

These two clauses may be paraphrases of each other. It is conceivable that natural monopolies may emerge and receive state sanction (i.e. the state may not choose to do anything about it).<sup>26</sup> Ehlermann<sup>28</sup> considers that inaction by Member States may be a problem; the determination of exclusive rights, however, is the prerogative of the Member State. Can they then be faulted for apparent inadequacies of their regulatory regimes? Van Miert thinks so<sup>29</sup> and his suggestion that European regulatory machinery is needed represents the next stage of Commission activity and may represent yet a new arena for framing the public interest debate.

What is critical here is that after *Sacchi*<sup>30</sup> there is nothing in the Treaty from preventing Member States from determining the public interest for non-economic reasons. And

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<sup>26</sup> Natural monopolies are a problem for any competition policy as they emerge within communities and range from the local bread supplier to companies whose products represent a *de facto* standard.

<sup>27</sup> It is equally unclear whether a state which ignores monopolistic behaviour is actually maintaining in force a measure contrary to competition rules.

<sup>28</sup> C.D. Ehlermann, *Managing Monopolies: the role of the state in controlling market dominance in the European Community*, E.C.L.R. 2(1993)61-69.

<sup>29</sup> Karel Van Miert. *The Competition Policy of the New Commission*, EC Competition Policy Newsletter.

<sup>30</sup> *Sacchi*, Case C 155/73.

after *Corbeau*<sup>31</sup>, Member States must decide whether there are compelling general economic interests for creating public interest monopolies.

The purpose of Article 90 rests on whether the intent of the Article is either to define an opt-out from the competition rules for Member States, or to restrict public undertakings to what is compatible with the competition rules.

#### 4.3 How has Article 90 EC been interpreted?: Defining meaning through the European Court of Justice

Article 90 is increasingly important for liberalisation within the competition rules, as the infrastructure of the internal market is put in place, mostly through Article 100 EC. Since 1973, a number of important cases have been decided relating to Article 90. Table 3.2. summarises the rulings of all main cases since 1973. Details of each case are in the Appendix of cases presented.

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<sup>31</sup> *Corbeau*, Case C 320/91.

4.4 Table 3.2: Important Article 90 Cases since 1973

Case	Decision
<i>BRT v SABAM</i> Case 127/73	Article 90(2) must be interpreted specifically as a Treaty derogation
<i>Sacchi</i> Case C 155/73 [1974] ECR 409	states can decide non-economic public interest
<i>CBEM v CLT and IBP</i> Case C 311/84 [1985] ECR 3261	statutory monopolies have a dominant position
<i>Bobson v Pompes Funèbres des régions libérées</i> Case 30/87 [1988] ECR 2479	states may not use a dominant economic position to fix prices and restrict market entry of competitors
<i>RTT v GB-INNO</i> Case C 18/88	public undertakings operating public infrastructures abuse their dominant position by excluding third-party service and content competitors
<i>Ahmed Saeed Flugreisen v Zentrale zur Bekämpfung unlauteren Wettbewerbs</i> Case 66/86 [1989]	natural monopolies are not subject to Article 90(2) protection unless specifically tasked by the state
<i>Mercati Convenzionali Porto di Genova SpA v Siderurgica Gabrielle</i> Case C 179/90	dominant positions are not in illegal, but undertakings may not be created which cannot help but abuse that dominant position in what they are tasked to do by the state
<i>France v Commission</i> Case C 202/88 [1991] ECR I-1223	the Commission has the power to issue Article 90(3) directives
<i>Procureur du Roi v P. Corbeau</i> C 320/91	definition of public interest within Article 90(2)
<i>ERT v Dimotiki</i> Case C 260/89 [1991] ECR I-2925	internal market and competition objectives cannot be infringed by the operation of public undertakings
<i>Commune d'Almelo v NV Energiebedrijf IJsselmij</i> Case C 393-92	definition of public service obligations
<i>Hofner and Elser v Macrotron GmbH</i> Case C 41/90 [1993] 4 CMLR 306	states may not create economic entities with dominant positions that are unable to meet the demand for services, or distort the competitive structure of economic markets

#### 4.5 Expanding regulatory impact through the European Commission

Apart from the interpretation of Article 90, the Commission is empowered to act under Article 90(3) to achieve the Article's objectives. The Commission will interpret its powers in a specific way since<sup>32</sup> this article extends the Commission's role beyond its Article 100(a) powers, limited by Article 189(b), relating to the internal market. Since 1980, the Commission has issued a variety of directives aimed first at establishing transparency in financial relationships<sup>33</sup>, then moving on to telecommunications markets.<sup>34</sup>

The Commission is also extending its interventions into the workings of public undertakings under Article 90(3). In June 1995, the Commission issued a decision<sup>35</sup> that discounts on landing fees at Brussels Airport constituted a state measure within Article 90(1) read in conjunction with Article 86, and to which the Article 90(2) exemption did not apply.<sup>36</sup> The system favoured Belgian airlines in its operational thresholds for the landing discounts and accordingly the Commission requested the Belgian officials to end the system.

The Commission is increasingly issuing Green Papers, followed by a legislative programme and is issuing more consultation documents interpreting its powers.<sup>37</sup> In 1995, it issued draft notice on its interpretation of Article 90(2), and dismantling postal monopolies<sup>38</sup> including its interpretation of an Article 90(2) exemption, Article 86 powers of investigation and intervention, and a definition of the partitioning of national markets between general interest service (in postal services) and the area open to public competition.<sup>39</sup>

From the Commission's perspective, Article 90(3) is indispensable. Van Miert has said "...I would like to make it quite clear that the Commission will energetically defend its right to issue directives under Article 90(3) against any attempt at obstruction."<sup>40</sup>

The Commission is pursuing a sector specific strategy where state monopolies exist and hinder trans-European networks (TENs) and network infrastructure development

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<sup>32</sup> Scott, pp 103-215.

<sup>33</sup> Directive 80/723/EEC on the transparency of financial relations between Member States, as amended by Commission Directives 85/413/EEC and 93/84/EEC.

<sup>34</sup> Directive 88/301/EEC on competition in the markets in telecommunications terminal equipment; Directive 90/388/EEC on competition in the markets for telecommunications services; Directive 94/46/EC on liberalising satellite services; Directive 95/51/EC on the abolition of restrictions on the use of cable television networks for the provision of already liberalised telecommunications services

<sup>35</sup> Commission Decision relating to a proceeding pursuant to Article 90(3) of the Treaty (Brussels Zaventem Airport) OJ L 216.12.09.1995, p 8.

<sup>36</sup> European Commission, **Report on the Application of the Competition Rules in the European Union**, 1996.

<sup>37</sup> Scott, pp 103-215.

<sup>38</sup> Draft notice on the application of the competition rules to the postal sector and in particular on the assessment of certain state measures relating to postal services.

<sup>39</sup> Partitioning is not permitted in competitive markets but is an unavoidable feature of the public/private divide.

<sup>40</sup> Karel Van Miert, *The Competition Policy of the New Commission*, **EC Competition Policy Newsletter**.

(such as telecommunications, transport, energy, postal service); certainly it remains to be seen whether other networks may emerge, but there is already considerable interest in defining public health networks.

As such, the Community position must be formally neutral on whether those services are provided by public or private providers so long as their actions are not anti-competitive and in particular do not prohibit third-party access to public infrastructures.<sup>41</sup> The issue of third party access is particularly important as exclusive distribution, vertical integration and cartels are forms of anti-competitive behaviour typical of monopolies and oligopolies.<sup>42</sup>

## 5 How and why Member States may have good reasons to create or sanction anti-competitive behaviour

There are five main reasons<sup>43</sup> why states create monopolies or undertakings to act in the public interest, and which present a challenge in understanding the potential scope of Article 90. Generally, states intervene where there might be market failure within the competitive system in areas of public or general economic interest and various judgements have been handed down by the European Court of Justice which are relevant here.<sup>44</sup> The following works through each of the five reasons supported with references to relevant judgements.

It is particularly relevant in this analysis to note that the cases cited have largely eroded state control in pursuing public interest objectives. The great fear in this analysis is that as states embrace private sector ideas such as the introduction of competition-like behaviours into social markets, the public interest protections may fail to be compelling when put up against the Court's own pursuit of the Article 85 and 86 competition objectives. In this way, member states may be creating a policy rod that the Court can then beat them with.

### 5.1 Allocative efficiency

Governments may prefer allocative efficiency over technical efficiency where equity, quality and the access of citizens to a service are particularly important. For example, the US model of healthcare markets is not popular in Europe, where Member States maintain policy control over the allocation of health resources outside of a competitive market. The emerging exception, of course, is the development of public

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<sup>41</sup> European Commission, *Communication on services of general interest*, 1996.

<sup>42</sup> J.T. Lang *Defining Legitimate Competition, Companies' duties to supply competitors, and access to essential services*. Fordham Corporate Law School. G. Monti, *Oligopoly: Conspiracy? Joint Monopoly? Or Enforceable Competition?* **World Competition**, 19(1996)76-94.

<sup>43</sup> Le Grand J. and W. Bartlett, **Quasi-markets and Social Policy**, Macmillan, 1993.

<sup>44</sup> Reference may be made to the tabular summary of these findings in Appendix 2.

managed markets such as in the UK, where increasing use of competitive methods are used in the public arena.<sup>45</sup>

Other examples where states have felt this was important include rural postal routes, ensuring passenger travel services on uneconomical routes, and price-maintenance to control basic costs of essential services such as pharmaceutical products, water and energy supplies. While health and social service financing and operation are excluded from the Treaty, the Community does have a real concern about allocative efficiency<sup>46</sup> and may come to view its own powers over technical efficiency as relevant to reduce regional disparity.

The Court in *RTT v GB INNO* decided that restrictions in access to public networks by third parties was an abuse of a dominant position. Member States, however, will still need to ensure that wide spread network availability respects public interest requirements of accessibility and price equity. The Commission's pursuit of TENs demonstrates the correctness of state concern for allocative efficiency where important infrastructure requirements prevail. *RTT v GB INNO* succeeded in establishing the principle of third party access which effectively unbundled the vertical integration characteristic of state controlled infrastructure providers, and which restricted third party service, and hence restricted commerce on these networks.

States seeking to ensure allocative efficiency will now be faced with deciding whether to invoke *Sacchi* to establish their right to create a public interest or ensure that issues of technical efficiency are not bundled with the public undertakings. *Merci* and *Bobson*, however, restrict the extent to which price structures can be used to protect non-economic interest as the Court is of the opinion that price or fee structures are definitive of economic activities and which automatically create an abuse of a dominant position. To avoid falling foul of *Corbeau*, public undertakings will need to be very specifically defined to ensure that cherry-picking does not occur, or that the public undertaking can offer services across a broad economic spectrum.

## 5.2 Enlightened self-interest

Member States have intervened when there was serious concern that the public good will not be produced by private vice (i.e. enlightened self-interest). Indeed, it is the institutionalisation of selfishness that makes competitive forces work in the public interest, and regulation is one way to ensure this. The focus on the public good is distinctive here, since a Member State might argue that private vice, in principle, does not necessarily produce the public good. It is the prerogative of Member States to decide how they choose to interpret the public good and whether the profit motive

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<sup>45</sup> The question is whether they are managed, and whether they achieve technical efficiency at the expense of allocative efficiency – i.e. forsake equity and quality for competitive ideology. Certainly, as quasi-markets they are designed to achieve private sector market discipline through competition without privatisation or loss of essential government control. See Richard Saltman and Caston Von Otter, **Planned Markets and Public Competition**, Open University, 1992; M. Tremblay, *Finding Winners: on enhancing the performance of internal or managed markets*. **British Journal of Healthcare Management**, forthcoming, 1997.

<sup>46</sup> Council Recommendation, 27 July 1992.

will be allowed to set prices and service thresholds in areas of general economic interest.

Where demand for a service is not met, states must ensure that public undertakings do not restrict access to those markets, even if the reason for creating that public undertaking was created on the belief that private activities would not necessary produce the desired benefits.

All the Article 90 cases reflect this concern, but the Court uses the principle of proportionality to ensure the best match between the duty to provide general interest services and the way in which the services are actually provided, i.e. that the means are in proportion to the ends.<sup>47</sup> *Hofner* reflects the German concern that private companies might not act in the unemployed person's best interest. *Corbeau*, too, reflects this concern that the private sector may only pursue the profit-motive at the expense of public service.

### 5.3 Gaming

Gaming is always a problem of competitive markets. It can undermine the public good when it arises in labour markets, or within regulatory regimes, where definitional or jurisdictional games can be played. States develop regulatory frameworks or nationalise industries to achieve the public good.

It might be argued that one reason why there is considerable attention to harmonisation and convergence within the Community is to eliminate gaming by the Member States; the UK's opt out of the Social Chapter may permit UK companies to game the internal market rules in Europe. Similarly, states may game the European system through their tax system where differences may bestow a competitive advantage.

The great concern in any market is the potential abuse of individual positions by manipulation of selective rules within the regulatory environment. The UK, for instance, has been largely successful in creating a monopoly system of drug pricing which manages gaming, and provides sufficient incentives for pharmaceutical companies to play by the rules, and continue to invest in research in the UK.

The Commission's desire for Europe-wide regulatory powers may reflect their concerns that trans-border gaming will now occur and that companies, for example, may "forum-shop" for the most attractive economic environment.<sup>48</sup> The Commission's current powers to enforce the development of the single market may be understood as reflecting a concern that Member States may encourage trans-national gaming – 'the pursuit of politics by other means'.

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<sup>47</sup> European Commission, *Communication on services of general interest*, 1996.

<sup>48</sup> The proposed "posting directive" reflects presumed gaming of the rules by companies recruiting in a low wage country for work in a higher wage country, but meeting terms and conditions of the low-wage country. It is fair to say that generally, no Member State should game the rules in Europe to achieve an economic competitive advantage over the rest; this, of course, is not the case.

Companies, too, seek state protection (to become free-riders) and subsidies (pork-barrels) but the Court may have stemmed this in *Abmed Saeed*; this ruling may prohibit Member States from subsidising loss-making industries unless specifically tasked with a public interest role, but only if the activity is either of general economic interest, or clearly non-economic. Though given the Commission's progressive liberalisation programme, this non-economic arena may be getting smaller.

#### 5.4 Market entry

When market entry is difficult, the costs high, or contestability unlikely, states often intervene through state aids, or types of state control.<sup>49</sup> Market consolidation, through mergers, reduces contestability by increasing the scale of the industries in the same way that states would create critical mass through vertical integration or "national" industries. Vertical and horizontal integration practised by governments represents a significant response to market failure, but its existence eliminates the possibility of market entry, and raises the costs considerably; after all, how many companies want to compete with governments?<sup>50</sup>

In *CBEM*, *Merci* and *Bobson*, the Court acknowledged that state enterprises automatically had a dominant position that could not be used to restrict market entry of private enterprise. Creating a public undertaking in the first place assumes that private companies may not be able to meet the demand or need or indeed may not enter the market anyway should the state endeavour to create one.

Member States will need to be more careful in deciding that there is no interest in the private sector to contest specific markets before committing public funds through state controlled or owned monopoly undertakings<sup>51</sup> and increasingly careful not to provide subsidies to private companies which may fall foul of Articles 92 to 94 EC on state aid.

#### 5.5 Market structure and regulatory effort

Markets themselves may not produce the desired structure, or where the cost of regulation to achieve the desired structure is too high. This is a trade-off states must make between achieving market discipline and achieving the desired service. Since the operative assumption in competitive markets is that the former achieves the latter, its perceived failure is an important consequence which the EC Treaty seems not to consider. Where macro-economic performance is important, regulation should ensure spare capacity, without surplus capacity; unfortunately, this particular discipline

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<sup>49</sup> See John Kay, *Foundations of Corporate Success*. OUP, 1993, p 196 on the automobile industry in Europe for a good example; there are, of course, many others. H.H.P. Lugard, *Vertical Restraints under EC Competition Law: a Horizontal Approach?* *E.C.L.R.* 3(1996)166-177.

<sup>50</sup> T. Soames, *An Analysis of the Principles of Concerted Practice and Collective Dominance: A Distinction without a Difference*, *E.C.L.R.* 1(1996)24-39.

<sup>51</sup> This would include capital markets for public infrastructure projects where state treasuries usually enjoy a monopoly on financing public infrastructure projects; the Channel Tunnel is a notable exception from the UK perspective, not France's though.

may be harder to achieve in public undertakings and may require market discipline. Allocative efficiency needs spare capacity<sup>52</sup> particularly where public undertakings must cross-subsidise uneconomical areas of service from economical areas of service (e.g. rural postal deliveries) and in which competition could create inequity in service availability or distribution.

States can decide what is in their public interest, according to *Sacchi*, but cannot subsequently infringe the broader objectives of the internal market and competition objectives, according to *ERT*. And *Corbeau* has moved the Court a long way toward clarifying public interest as did *Almelo* in raising the issue of transparency of state undertakings in the context of import and distribution controls of electricity. Member States are now faced with considerable challenge to the usual vertical integration where import and distribution is controlled by the public undertaking. Sweden and Finland are faced with their import and distribution controls of alcohol being challenged, and Austria has restrictions on the distribution of salt, and manufactured tobacco.

*RTT*, by creating the requirement of third party access, also established the principle that state enterprises must be unbundled to distinguish between the essential state interest and those of economic interest. *Almelo* raised the same issue, but left it to the state to decide if it really needed exclusive distribution to achieve its public interest objectives. At present, no Member State has suggested that the effort at regulating a market is greater than directly controlling it through a public undertaking, though they would probably need to do so through Article 36 derogation to define the public interest.

One possible conclusion here is that the Court will view the public interest as the residue that remains of a service of general economic interest after all the bits have been identified under Articles 85 and 86, and this might be taking the political arguments for the minimal state too far.<sup>53</sup> The Commission's liberalisation plans suggest some sensitivity here, but the meaning is unclear in this context, especially since, not surprisingly, no attention is paid to the macro-economic efficiency of Member States, themselves.<sup>54</sup>

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<sup>52</sup> It may be argued that states may need to provide subsidies to ensure excess capacity in strategic industries.

<sup>53</sup> Ross in *Beyond Francovich*, (cited in Pollard and Ross, **European Community Law**, London: Butterworths, 1994. pp 711-714) asks whether *Francovich* raises the issue of liability against Member States for the public interest choices they make. It rests in part on intent: if a Member State restricts competition through public undertakings to avoid market entry by the private sector, e.g. a reaction to strong take-over threats from other Member States' companies (protective nationalisation), then it would seem a matter of competition played out within the Community and Articles 85 and 86 would seem to apply, rather than the *Sacchi* defence: there is a market and the state has taken it away through its action. Damages would seem appropriate. This is quite different from the presumption that there is not a market in the first place. However, protective nationalisation is a legitimate response by states to foreign economic threats that has been lost in the Treaty.

<sup>54</sup> See European Commission, *Communication on services of general interest*, 1996.

## 6 Implications for social protection systems

Progressive reform of the public sector, and of public sector policies may remove the protection that health service organisations enjoy from the European level. Since the Court has arrived at its own responses to the reasons States may use to justify public undertakings, it now seems clear that continued unbundling of health systems (either through progressive introduction of managed internal markets, or increased use of private sector management practices such as tendering, or self-governing status) may bring the behaviour of these institutions within relevant European law.

If that is the case, on what basis are health systems non-economic? If opening up public procurement is a Community objective compatible with increased competition, how can internal markets, which explicitly exclude private bidders, be justified – has not the State created an activity of economic interest?

Does this suggest that efforts to control spending on social protection may create the situation where private providers may choose to enter the market to offer services being curtailed? Would this undermine priority setting or rationing of services?

The integrity of the Member States' interests lies in the extent to which the reasons they give for their actions are compelling. The European Court of Justice has taken a particular view on these reasons, and eroded their scope substantially.

The risk is that Member States will undertake public sector reform which will open up hitherto excluded areas for wider Community interest, and which may undermine national interests. It is now clear that this is potentially high-risk route which of necessity plays national politics off against the Commission's pursuit of the single market and market integration.

From the Court's perspective, the public interest is what is left when the private interests have all been pursued, unless compelling logic can be brought to demonstrate overriding public interest objectives. At this stage in the Union's development, the debate is only beginning and the outlines of the argument only just becoming clear.

## 7 Appendix 1: Summary of Cases Cited

### ***Ahmed Saeed Flugreisen v Zentrale zur Bekämpfung unlauteren Wettbewerbs* Case 66/86 [1989]**

It was accepted that airlines operated in the public interest when they provide service to routes that are not commercially viable. Unless they are specifically tasked with the specific responsibility by the state, they may not argue that Article 90(2) protects them in their economic affairs when they enjoy the position of a natural monopoly on these uneconomic routes. The Court did not rule on the claim of price-fixing, in the absence of further details.

### ***Bobson v Pompes Funébres des régions libérées* Case 30/87 [1988] ECR 2479**

Where a public authority dominates a market, in this case granting exclusive rights to local authorities to conduct funerals, and fixes prices, it violates Article 90(1) read in conjunction with Article 86 since other funeral contractors are restricted in their competitive response.

### ***BRT v SABAM* Case 127/73**

This case established that Article 90(2) was a derogation from the Treaty and must therefore be interpreted specifically.

### ***CBEM v CLT and IBP* Case C 311/84 [1985] ECR 3261**

Public undertakings which are statutory monopolies have a dominant position in their market within the meaning of Article 86 EEC.

### ***Commune d'Almelo v NV Energiebedrijf Ijsselmij* Case C 393-92**

Restrictions on competition are acceptable if they are necessary to the public interest task of ensuring an uninterrupted and continuous supply of electricity. The case defines public service obligations in the electricity field, *viz.* ensure on demand a continuous supply of electricity to all types of consumers on the basis of uniform tariffs and without discrimination in the area of the concession.<sup>55</sup>

While the restrictions involved failed the Article 85/86 tests<sup>56</sup>, Article 90(2) justifies them if they are necessary to fulfil the public interest task.<sup>57</sup>

### ***ERT v Dimotiki* Case C 260/89 [1991] ECR I-2925**

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<sup>55</sup> *Almelo*, at paragraph 48.

<sup>56</sup> This included the use of an exclusive purchasing clause in supply contracts

<sup>57</sup> The Court left it up to the national court to decide if this was the case. The case permits public undertakings, where necessary, to require exclusive purchasing agreements and thus prohibit parallel import (of electricity). The Court did not address whether competition would cause market failure.

The organisation of radio and television monopolies, or oligopolies<sup>58</sup>, may infringe Articles 90(1) and (2). The case pays special attention to the European internal market, namely, free movement of goods and services.

***France v Commission Case C 202/88 [1991] ECR I-1223***

Directive 88/301 required Member States to eliminate exclusivity in the market of telecommunications terminal equipment. France objected on the basis that Article 169 was the proper route since it permitted Council action where the vested interests of Member States were involved. The Court's ruling, on the force of Article 90(3), permitted the Commission, where exclusivity cannot be justified, to act under its Article 90(3) powers to achieve compliance with the competition rules of the Treaty. The Commission's position was bolstered by *Dassonville*, ruling that "... measures having an effect equivalent to quantitative restrictions ... appl[y] to all trading rules enacted by Member States ..."<sup>59</sup>.

***Hofner and Elser v Macrotron GmbH Case C 41/90 [1993] 4 CMLR 306***

It is unlawful for a state to restrict supply such that private contractors endeavouring to meet the demand for services are forced to violate Article 86; Article 90(1) is violated since the monopoly, in the Court's opinion, was a commercial entity (since recruitment services is an economic activity), and the Member State maintained rules, that all employment recruitment be undertaken through the state employment service, restricting other economic operators from meeting demand. It is worth noting that the German authorities had turned a blind-eye to the operation of private recruitment agencies since it was obvious that the state could not meet the demand.<sup>60</sup>

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<sup>58</sup> As Weatherill and Beaumont note, at page 602, oligopolies present a unique problem as a well-run oligopoly effectively partitions markets, making contestability virtually impossible. However, like monopolies, oligopolies may work in the public interest. *Almelo* presents just such a situation, as the principles underlying the oligopoly must be found to be anti-competitive, not the individual regional suppliers, since a monopoly operates within an oligopoly granted exclusive regional rights.

<sup>59</sup> *Procureur du Roi v Dassonville Case C 8/74*

<sup>60</sup> Weatherill and Beaumont note that the case is really about the "distortive effect of inadequate supply" in a monopoly environment. Page 757.

***Merci Convenzionali Porto di Genova SpA v Siderurgica Gabrielle Case C 179/90***

It was not illegal for there to be a dominant position whereby the Port was granted an exclusive license to unload ships, per se, but that in exercising that dominant position, the Port was unable to help but abuse its position by charging fees which discriminated against foreign ships, and provided no added value.<sup>61</sup>

***Procureur du Roi v P. Corbeau C 320/91***

*Corbeau* defines what an Article 90(2) exception would be like, and what might be in the public interest. The creation of a dominant position through exclusive rights is not incompatible with Article 86 EC, but measures which deprive this Article of its effectiveness are unlawful. The Court ruled that Article 90(1) requires public undertakings not to maintain any measures or rules contrary to Treaty competition rules. Article 90(2) subjects public undertakings to the competition rules so long as they do not obstruct the tasks assigned.

Corbeau offered a complementary postal service, i.e. services which the postal monopoly did not offer, specifically local pick up. The Court stated that permitting competition with the holder of exclusive rights in areas chosen by the competitor opened up the risk of cherry-picking the profitable services since having exclusive rights includes cross-subsidising uneconomical services from more profitable services. Competitors would naturally be drawn to the more profitable parts. Specific services can be dissociated from the general interest service unless they “compromise the economic equilibrium of the service of general economic interest performed by the holder of the exclusive right.”<sup>62</sup>

***RTT v GB-INNO Case C 18/88***

The Belgian telephone monopoly was found to abuse its position by excluding access to the public network of suppliers of third-party telecoms connection equipment. There was no objective justification given apart from the claim of exclusivity for the state to act.

***Sacchi Case C 155/73 [1974] ECR 409***

The EEC Treaty does not prevent Member States from removing radio and television broadcasting from the field of competition and granting exclusive rights to any number of bodies. This suggests that Member States do enjoy some control over what they deem to be in the state’s interests.

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<sup>61</sup> Weatherill and Beaumont suggest that this case may imply that abuse is a natural result of “the absence of the stimulus of competition caused by exclusivity”.

<sup>62</sup> *Corbeau*, at paragraph 19.

7.1 Appendix 2: Tabular summary of quasi-markets and court rulings

7.2 Allocative efficiency<sup>63</sup>

public interest action	market problem	Court or Commission response
restrict market access; control or license third parties	vertical restraint, vertical integration, selective or exclusive distribution	<i>RTT v GB INNO</i>
own the infrastructure	inter-state inequity	Trans-European Networks
set fee <i>nomenclature</i> (price = cost)  ensure access or service not price equity	lack of transparency in cost and price structure	<i>Merzi, Bobson</i>
cross-subsidies unrelated to economic activities	cherry-picking	<i>Corbeau</i>

7.3 Enlightened Self-interest

public interest action	market problem	Court or Commission response
own infrastructure or control market logic	vice versus virtue	<i>Sacchi, Hofner</i>
license third parties, ownership, regulate	profit motive at the expense of public service	<i>Hofner, Corbeau</i>

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<sup>63</sup> See also Lang, *Defining Legitimate Competition: Companies' duties to supply competitors, and access to essential services*.

#### 7.4 Gaming

public interest feature	market problem	Court or Commission response
regulate or own	interstate “forum-shopping”	get European regulatory power for Commission
	the “competitive advantage of nations”	create “The Single Market”
license	free-rider problem and subsidies (“pork-barrel funding) for loss-making activities	<i>Ahmed Saeed</i>

#### 7.5 Market entry

public interest action	market problem	Court or Commission response
create public undertaking	lack of scale, or interest	<i>CBEM, Bobson, Merzi</i>
provide subsidies		invoke Articles 92-94

#### 7.6 Market structure and regulatory effort

public interest feature	market problem	Court or Commission response
define public interest	no public service ethos	<i>Sacchi, ERT, Corbeau</i>
bundle services and infrastructure and use vertical integration to produce efficiencies	vertical integration, selective or exclusive distribution	<i>Almelo, Corbeau, Bobson, Merzi, Hofner</i>
seek macro-economic objectives	fragmented, high cost operation, micro-economic inefficiency	<i>Bobson, Almelo, Hofner</i>

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Commission Directive 88/301/EEC on competition in the markets in telecommunications terminal equipment

Commission Directive 90/388/EEC on competition in the markets for telecommunications services, as amended by Commission Directives 96/2/EC and 96/19/EC

Commission Directive 94/46/EC on liberalising satellite services

Commission Directive 95/51/EC on the abolition of restrictions on the use of cable television networks for the provision of already liberalised telecommunications services

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*Hofner and Elser v Macrotron GmbH* Case C 41/90 [1993] 4 CMLR 306

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*Sacchi* Case C 155/73 [1974] ECR 409

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