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**Old Wine in New Bottles?**

**From the ‘Country of Origin Principle’ to ‘Freedom to Provide Services’ in the European Community Directive on Services in the Internal Market**

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## Old Wine in New Bottles? From the ‘Country of Origin Principle’ to ‘Freedom to Provide Services’ in the European Community Directive on Services in the Internal Market

Rachael Craufurd Smith\*

*This article considers the fate of the ‘country of origin principle’ in the Commission’s 2004 proposal for a services directive. It argues that although all references to this principle were removed from the final version of the Services Directive, it lives on under a new name ‘freedom to provide services’. The European Parliament was ultimately not prepared to amend this aspect of the Commission’s proposal in the radical way that Evelyne Gebhardt, rapporteur for the Committee on the Internal Market and Consumer Protection, advocated. Instead, the concerns voiced by the European Parliament over the deregulatory forces potentially unleashed by operation of the country of origin principle were addressed through the wholesale exclusion of a range of sectors and activities from the scope of the Directive. Questions regarding the legality of the particular form of negative integration created by the Services Directive remain: in particular, the suitability of Article 47.2 EC as a legal base for the Directive and the compatibility of the ‘freedom to provide services’ principle with Articles 12 and 50.2 of the EC Treaty.*

### 1. Introduction

The inclusion by the Commission of the European Communities of the ‘country of origin principle’ in its initial 2004 proposal for a directive on services in the internal market sparked heated controversy.<sup>1</sup> As originally formulated the country of origin principle, set out in Article 16 of the proposal, had two main limbs. Firstly, service providers were to be subject ‘*only* to the national provisions of their Member State of origin’, regarding access to and the exercise of their particular service.<sup>2</sup> The country of origin was thus empowered to establish requirements relating, among other things, to ‘the behaviour of the provider, the quality or content of the service, advertising, contracts and the provider’s liability’.<sup>3</sup> Secondly, the country of origin was also to be responsible for supervising the provider, even where the provider travelled to another Member State to supply his or her services.<sup>4</sup> Under Article 16 the country of reception would consequently have lost virtually all competence to regulate services falling within the fields coordinated by the directive provided from other Member States. Reports suggested that the introduction of a ‘one stop regulatory shop’ along the lines envisaged in the directive could boost Europe’s trade in commercial services by 30 to 60 percent and lead to economic gains to the order of 37 billion euros.<sup>5</sup> The Commission’s initiative was thus seen as an important component of its attempt

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<sup>1</sup> Article 16(1), Commission Proposal for a directive of the European Parliament and of the Council on Services in the Internal market, COM(2004) 2 final/3.

<sup>2</sup> *Ibid*, italics added.

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

<sup>4</sup> Article 16(2), Commission 2004 Proposal, n.1 above.

<sup>5</sup> Findings drawn from R. de Bruijn, H. Kox, A. Lejour, ‘The Trade-Induced Effects of the Services Directive and the Country of Origin Principle’, CEPS-INEPRI Working Papers no. 44, 24 April 2006 and Copenhagen Economics, *Economic Assessment of the Barriers to the Internal Market for Services – Final Report*, Copenhagen 2005, respectively.

to realise the Lisbon European Council objective of making the EU the most competitive and dynamic knowledge-based economy in the world by 2010.<sup>6</sup>

But the introduction of the country of origin principle in the proposal was also criticised as opening the door to social dumping. Businesses, it was argued, would be encouraged to relocate to the Member State with the most relaxed rules and to provide their services across Europe from there. The Committee of the Regions, for example, observed that ‘the country of origin principle may penalise honest businessmen and consumers, since it makes it possible to circumvent exacting domestic standards relating to professional qualifications or the quality of service provision’.<sup>7</sup> Hard won social welfare, labour, environmental and consumer protection rules could all be undermined by the operation of the directive, along with established public services. These fears were widely articulated and were even thought to have influenced the French rejection in 2005 of the proposed new Constitution for the European Union (‘EU’). Other commentators questioned whether the asserted economic benefits of introducing the directive would be realised in practice and expressed concern that it could have a potentially disproportionate impact on jobs traditionally done by women, for instance in the healthcare field.<sup>8</sup>

In the light of these concerns the Commission’s 2004 proposal was subject to close scrutiny by the European Parliament. In particular, the country of origin principle underwent a gradual metamorphosis. The initial draft report prepared for the European Parliament Committee on the Internal Market and Consumer Protection (‘IMCO’) by its rapporteur Evelyne Gebhardt, proposed significant modifications to both limbs of the country of origin principle as set out in the original proposal.<sup>9</sup> Notably, the report proposed that the country of origin principle in Article 16 should be replaced with another principle, the ‘mutual recognition principle’. IMCO, in its revised December 2005 report, supported the removal of the country of origin principle from the text of the directive but proposed that it be replaced not by the mutual recognition principle but by the phrase ‘freedom to provide services’.<sup>10</sup> This formulation was subsequently retained by the European Parliament in its first

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<sup>6</sup> Commission 2004 Proposal, n.1 above, pp.6-7.

<sup>7</sup> Committee of the Regions, Opinion on the Proposal for a...Directive on Services in the Internal Market, 30 September 2004, at para.2.8.

<sup>8</sup> See, for example, European Parliament Committee on Women’s Rights and Gender Equality, Opinion on the Proposal for a ...Directive on Services in the Internal Market, 4 May 2005 at: [http://www.europarl.europa.eu/comparl/imco/services\\_directive/default\\_en.htm](http://www.europarl.europa.eu/comparl/imco/services_directive/default_en.htm).

<sup>9</sup> Draft IMCO Report on the proposed services directive (25.05.2005), PE 355.734v04-00, available on the IMCO Services Directive website at: [http://www.europarl.europa.eu/comparl/imco/services\\_directive/default\\_en.htm](http://www.europarl.europa.eu/comparl/imco/services_directive/default_en.htm).

<sup>10</sup> Final IMCO Report on the proposed services directive (15.12.2005), PE 355.744v04-00, available as at n.9 above, amendment 110, new Article 16.

reading resolution<sup>11</sup> and incorporated into the Commission's revised proposal<sup>12</sup> before, ultimately, finding its way into the final version of the Services Directive<sup>13</sup>.

This paper examines the country of origin principle as first proposed by the Commission and its gradual modification during the adoption of the directive. Those involved in the legislative process clearly ascribed considerable importance to the particular terminology used and it is helpful to explore why. In particular, explicit recourse by the Commission to the country of origin principle brought to the surface fundamental disagreements within and between the various European institutions as to the desirable pace of future European integration and the mechanisms by which it should be pursued. The paper argues that although the directive in its final form differs significantly from the Commission's initial draft, notably through the exclusion of additional activities from its general scope and the inclusion of additional specific derogations from the principle of freedom to provide services, it has not modified the country of origin principle as fundamentally as some reports suggest.<sup>14</sup> Though the terminology employed is different, the general approach is very similar; leading one Member of the European Parliament to conclude that the revised directive, presented as a 'grand compromise', was nothing other than a 'misleading repackaging' of the original Commission proposal.<sup>15</sup>

## 2. The Country of Origin Principle in the Commission's 2004 Proposal

The country of origin principle in the Commission's 2004 proposal established, as indicated above, the twin presumptions that service providers would be subject solely to the rules of their country of origin and would also be supervised by that state. Article 16 confirmed that the country of origin was empowered to regulate both access to and the exercise of service activities, even when this activity was carried out by service providers under its jurisdiction in another Member State. The country of origin was defined as the Member State in whose territory the service provider was established (Article 4(4)).

But the country of origin principle, even in this initial formulation, established only a number of presumptions rather than absolute rules. For a start, the proposal excluded many activities and regulations either from the scope of the directive in general, or from the country of origin principle in

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<sup>11</sup> Position of the EP adopted at first reading on 16 February 2006 with a view to the adoption of Directive 2006/.../EC of the EP and Council on services in the internal market, PE 369.610, available as at n.9 above, proposed new Article 21.

<sup>12</sup> Commission, Amended Proposal for a Directive of the EP and Council on Services in the Internal Market, COM(2006) 160, Article 16.

<sup>13</sup> Directive 2006/123/EC of the EP and Council on Services in the Internal Market, OJ 2006 L376/36, Article 16.

<sup>14</sup> See, for example, S. Weatherill, 'Promoting the Consumer Interest in an Integrated Services Market', Mitchell Working Paper Series 1/2007, pp. 7-8 and 21. In relation specifically to the impact of the European Parliament amendments see Editorial comments, 'The services directive proposal: Striking a balance between the promotion of the internal market and preserving the European social model?' (2006) 43 CMLR 307-311.

<sup>15</sup> Sahra Wagenknecht (GUE, DE), quoted in IMCO press release (author's translation), '*La directive service de retour au Parlement Européen*' (05.09.2006) at: [http://www.europarl.europa.eu/comparl/imco/services\\_directive/default\\_en.htm](http://www.europarl.europa.eu/comparl/imco/services_directive/default_en.htm).

particular.<sup>16</sup> Areas completely excluded from the directive included financial services, as well as electronic commerce and transport services to the extent covered by other Community measures. Taxation was excluded, though in relation to the country of origin principle only to the extent covered by other Community instruments. In addition, Article 3 of the proposal stated that the directive would ‘not...prevent the application’ in relation to services ‘of provisions of other Community instruments’, so that such measures, including any jurisdictional rules, were to be given precedence over the general services directive.<sup>17</sup>

The specific derogations from the country of origin principle were of two kinds. Firstly, Article 17 listed particular types of services or regulations over which Member States would be unlikely to give up competence. In these instances the Commission had concluded that ‘too wide a divergence in national approaches or an insufficient level of Community integration may exist and prevent the application of the country of origin principle’.<sup>18</sup> Article 17 thus included key services such as postal services and electricity, gas and water distribution services. In addition, it listed a number of areas where Community legislation already afforded competence to the host country, for example, in relation to the posting of workers, social security and the transport of waste.<sup>19</sup> Secondly, Article 19 provided for derogations on a case-by-case basis, allowing states to argue for the continuing applicability of domestic regulations on certain specified grounds.<sup>20</sup> Finally, three areas were excluded from the country of origin principle on a transitional basis, pending the introduction of specific harmonising measures: cash-in-transit services, gambling activities and access to the activity of judicial recovery of debts.<sup>21</sup> All the activities and regulations covered by these various exemptions and derogations would thus have remained subject to the operation of the free movement provisions in the European Community Treaty, or specific Community measures, where relevant.

Two of the twenty three general derogations from the country of origin principle in Article 17 are here of particular interest. Both relate specifically to cases where the service provider re-locates to another Member State to supply services there on a temporary basis. The first covers services that are totally prohibited in the country of reception on grounds of public policy, public security, or public health (Article 17, paragraph 16). A state that chose, for example, to prohibit abortion services could thus take measures to prevent doctors from another Member State from providing abortions, on a

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<sup>16</sup> Articles 2 and 17, Commission 2004 proposal, n.1 above, respectively.

<sup>17</sup> This rather oblique provision was clarified in the final draft of the directive, Article 3.1 of which now confirms that where a Community measure deals with access to or the exercise of a service activity in specific sectors or for specific professions, those provisions are to prevail, see n.13 above.

<sup>18</sup> Commission 2004 proposal, n.1 above, p. 25.

<sup>19</sup> Arguably, regulation by the host country would here also have been guaranteed by Article 3 of the proposal, which deals with the relationship with other provisions of Community law.

<sup>20</sup> For further discussion see text accompanying n.25 below.

<sup>21</sup> Article 18, Commission 2004 proposal, n.1 above. These provisions have now been incorporated into general or specific derogations in the adopted Services Directive, see, in particular, Articles 2(b), 2.2(h) and 17.5, n.13 above.

temporary basis, in local clinics. The Commission's original proposal, it may be noted, did not exclude health care altogether from its scope and merely referred to the 'authorisation system applicable to the reimbursement of hospital care' in paragraph 18 of Article 17.

The second derogation covers restrictions imposed on a provider operating in the host state 'directly linked to the particular characteristics of the place where the service is provided' and indispensable for reasons of public policy, security, public health or the protection of the environment (Article 17, paragraph 17). The requirement of a direct link with the particular characteristics of the recipient state undoubtedly cuts down the potential scope of the provision but could be interpreted quite broadly to cover social, cultural, economic and environmental factors. Understood in this way it would have afforded Member States continuing scope to regulate and supervise service providers operating on their territory on the four grounds listed.

In addition, Article 19, as noted above, provided for case-by-case derogations from the country of origin principle 'in exceptional circumstances'. Member States were here authorised to intervene in relation to the safety of services, the exercise of a health profession and the protection of public policy. In order to exercise these derogations, the host state had first to ask the country of origin to take action against the service provider. Only if the country of origin failed to take action, or took insufficient steps to remedy the situation, was the host state to notify the Commission, explaining why it regarded the steps taken to be inadequate (Article 37). The Commission was then to consider what action the host state proposed to take and, if it concluded that this would be contrary to Community law, was required to adopt a decision 'asking' the host state to refrain from so acting. The case-by-case derogations were consequently more constraining for states than the general derogations provided for by Article 17(16) and (17), with a more limited list of grounds than those in Article 17(17), there being no mention of environmental concerns, and an additional notification and authorisation process.

It is apparent, therefore, that the Commission was proposing a somewhat more generous attitude to host state regulation in situations where the service provider was physically present in the host state's territory, than in situations where the service alone crossed the border. Restrictions on services of this latter type, for example, transborder television broadcasting and internet services, if not covered by a sector specific derogation, would have had to be supported using the more burdensome case-by-case system of derogations in Article 19.

In relation to supervision, Article 16(2), which ascribed to the country of origin competence to supervise both providers and their services, was also qualified by subsequent provisions. Article 36 of the proposal again related specifically to situations where the provider temporarily relocates to another Member State. In such cases supervision by the country of origin is less likely to be effective and Article 36 consequently authorised the country of origin to request the host country to carry out checks

or investigations on its behalf. In addition, however, the host country was also authorised to carry out investigations on its own initiative, provided these were non-discriminatory, justified by public interest considerations, and proportionate. Article 36 would thus have enabled the host state scope to monitor the activities of service providers from other Member States, though the article itself expressly precluded its use as a basis for subsequent intervention. Where problems were encountered with service provision, action had still to be taken by the country of origin or the host country on the basis of their respective powers set out in Articles 16-19.<sup>22</sup> The country of origin principle as originally proposed was consequently not the unqualified principle that an initial reading of Article 16(1) and (2) could have led one to conclude.

### **3. Was the Country of Origin Principle in the Commission's Proposal such a Radical Departure from the Pre-existing Legal Position?**

The furore over the Commission's inclusion of a country of origin principle along the lines set out in Articles 16-19 of its proposal was, on one view, surprising, in that the case law of the Court of Justice on the Treaty fundamental freedoms also establishes a presumption that the rules of the home state are to apply, a presumption that may be overridden only where the host state can show that its rules are justified on recognised general interest grounds, are applied in a non-discriminatory manner, are suitable for securing the attainment of those objectives and are otherwise proportionate.<sup>23</sup> The country of origin principle has also been widely employed in Community secondary legislation.<sup>24</sup>

The presumption in favour of home state regulation was initially developed by the Court of Justice in the context of the free movement of goods, in the seminal case of *Cassis de Dijon*.<sup>25</sup> Drawing on the earlier *Dassonville* ruling, the Court held that traders in the country of origin could challenge all rules enacted by the country of reception that impeded 'directly or indirectly, actually or potentially,' the importation of their goods.<sup>26</sup> Country of reception rules applicable indistinctly to both foreign and domestic goods could thus be challenged, as well as those that were overtly discriminatory, under what

<sup>22</sup> See Article 36.2(a), which stated that investigations 'must consist exclusively in the establishment of facts and...not give rise to any other measure against the provider', Commission 2004 proposal, n.1 above.

<sup>23</sup> See case 205/84, *Commission v. Germany* [1986] ECR 3755 and case C-76/90, *Säger v. Dennemeyer & Co.* [1991] ECR I-4221. This approach, which can be traced back to the *Cassis de Dijon* ruling discussed below has been applied fairly consistently in relation to goods, services, establishment and workers, on which see case C-55/94, *Reinhard Gebhard v. Consiglio dell'Ordine degli Avvocati e Procuratori di Milano* [1995] ECR I-4165, para.37, though *Keck's* exclusion of non-discriminatory selling arrangements from the sphere of the goods provisions has not been explicitly carried over into the field of services: Cases C-267 and 268/91, *Criminal proceedings against Keck and Mithouard* [1993] ECR I-6097.

<sup>24</sup> C-M. Jonsson, 'Comparing the Mutual Recognition Principle and the Country of Origin Principle with an Assessment of the Gebhardt Report for the Services Directive', Paper for the ETUC Working Group on Social Policy and Legislation 25.05.2005, p.10-14., available at: [http://www.epsu.org/IMG/pdf/Mutual\\_Recognition\\_prinEN.pdf](http://www.epsu.org/IMG/pdf/Mutual_Recognition_prinEN.pdf), and text accompanying n.41 below.

<sup>25</sup> Case 120/78, *Rewe-Zentrale AG v. Bundesmonopolverwaltung für Branntwein* [1979] ECR 649.

<sup>26</sup> Case 8/74, *Procureur du Roi v. Dassonville* [1974] ECR 837, para. 5.

is now Article 28 of the EC Treaty.<sup>27</sup> Nevertheless, the country of reception retains the possibility of justifying its restrictions on general interest grounds, applied in an effective and proportionate manner. Having found the German justifications for its minimum alcohol requirement for fruit liqueurs to be unconvincing, the Court concluded that there was ‘therefore no valid reason why, provided that they have been lawfully produced and marketed in one of the Member States, alcoholic beverages should not be introduced into any other Member State’.<sup>28</sup>

The development of a similar approach in relation to the free movement of services and persons took more time and initially it appeared that only those rules of the host state that discriminated on grounds of nationality could be challenged.<sup>29</sup> Subsequent rulings by the Court of Justice have, however, confirmed that it is now possible to challenge indirectly discriminatory and even non-discriminatory measures that impede a service provider’s or worker’s access to a particular market.<sup>30</sup>

Arguably, therefore, the similarities between the case law and the Commission’s proposal are more striking than the differences, but important differences remain. The most significant of these relates to the grounds on which states may continue to regulate non-domestic services. In the Commission’s proposal, states would have been limited to public policy, public security, public health and, where the service provider re-locates to the country of reception, environmental grounds. The justifications mentioned in the European Community Treaty for state restrictions in the field of services and establishment are in fact more limited to public policy, public security and public health, though this may be explained by the fact that the service provisions were initially understood as applying solely to discriminatory measures. As noted above, however, the Court of Justice has recognised a wider range of ‘general interest’ grounds that can be used by states to justify ‘indistinctly applicable’ measures, which do not overtly distinguish between goods, services or persons on grounds of their origin.<sup>31</sup> These general interest objectives have been held to include the fairness of commercial transactions as well as the protection of the environment, culture and consumers.<sup>32</sup> There is thus considerably more scope to justify indistinctly applicable measures under the Court’s case law than under the proposed directive. In addition, the availability of particular justifications does not appear to depend on whether it is the service provider or the service that moves.

<sup>27</sup> Subject to the qualification in *Keck*, n.23 above.

<sup>28</sup> *Cassis de Dijon*, n.25 above, para.14

<sup>29</sup> C-M. Jonsson, n.24 above at p.2; P. Craig and G. De Búrca, *EU Law, Text, Cases and Materials* (Oxford: OUP, 2003), pp.821- ; C. Barnard, *The Substantive Law of the EU, The Four Freedoms* (Oxford: OUP, 2004), pp. 238-240.

<sup>30</sup> See, for example, *Commission v Germany*, para. 26 and *Säger*, at para.12, which held that Article 49 could be contravened by any restriction ‘that is liable to prohibit or otherwise impede’ the activities of a service provider, both at n.23 above. For confirmation that even non-discriminatory measures could be caught see case C-384/93, *Alpine Investments* [1995] ECR I-1141.

<sup>31</sup> See text following n.27 above and n.32 below.

<sup>32</sup> *Cassis de Dijon*, n.25 above; case 302/86, *Commission v. Denmark* [1988] ECR 4607 and case 60/84, *Cinétèque v. Fédération Nationale des Cinémas Français* [1985] ECR 2605. For a more complete list see C. Barnard, n.29 above, p.109 and recital 48 of the Services Directive, n. above.

The absence, in particular, of any mention of consumer protection in the Article 17(17) derogation is striking. Although certain consumer protection measures may be justified on public health grounds, the Court has not been willing to extend ‘public policy’ to cover consumer protection concerns.<sup>33</sup> In many instances, therefore, the derogations listed in the proposal would simply not be relevant, for example, where controls are introduced to ensure a certain level of quality or prevent confusion.<sup>34</sup> Where the consumer is not already protected by pre-existing Community consumer protection measures such as the Unfair Commercial Practices Directive,<sup>35</sup> and there are no risks to public policy, health, safety or the environment, the host state’s hands consequently become tied.

The proposal can be seen as part of an established trend in Community law to favour regulatory competition in cases where consumers can obtain basic information on the goods or services provided and where their fundamental health and safety interests are not threatened.<sup>36</sup> It is often more difficult, however, for consumers to make an informed selection among service providers than goods, which can generally be inspected prior to purchase to assess their quality. In the services context professional qualifications and quality marks thus assume considerable importance.<sup>37</sup> The proposal seeks to support consumers by ensuring that information on the service provider is readily accessible and that, where the service presents risks not only to health or safety but also a ‘particular financial risk’, the provider takes out appropriate indemnity insurance.<sup>38</sup> In addition, the proposal envisages further action by states, albeit on a voluntary basis, to ensure the quality of service provision, either through encouraging the certification of activities by independent bodies or the introduction of quality charters or labels.<sup>39</sup>

Nor, as one would expect, is the country of origin principle a stranger to the field of secondary legislation. On one view it might seem inappropriate to refer to the country of origin principle in the context of secondary legislation, at least where the purpose of such legislation is to replace varied domestic rules with common minimum or exhaustive *Community* rules. As Weatherill notes, a ‘pure’ country of origin principle ‘would permit the supplier based in State X to do no more than comply with

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<sup>33</sup> Case 113/80, *Commission v. Ireland* [1981] ECR 1625 at para.8. Recital 41 of the Services Directive as adopted, n.13 above, states that the concept of ‘public policy’ includes ‘issues relating to human dignity, the protection of minors and vulnerable adults and animal welfare’.

<sup>34</sup> It appears, however, that regulations governing contractual terms in consumer contracts were to be excluded from the scope of the country of origin principle by Article 17(21), Commission 2004 Proposal, n.1 above. See S. Micossi, ‘Fixing the Services Directive’ CEPS Policy Brief, 100/April 2006, available at <http://www.ceps.be> at p.6.

<sup>35</sup> Directive 2005/29, OJ 2005 L149/22.

<sup>36</sup> As exemplified by the *Cassis de Dijon* case itself, n.25 above. Discussed further in S. Weatherill *EU Consumer Law and Policy* (Cheltenham: E.Elgar, 2005).

<sup>37</sup> S. Micossi, n.34 above, at p.6.

<sup>38</sup> Article 26 requires that information is made available as to the provider’s details, location and VAT identification number, together with any relevant authorisations obtained, professional bodies of which it is a member, general conditions and clauses employed, and the law applicable to the contract or courts competent to deal with disputes relating to the service. Article 28 requires that information on available after-sales guarantees be included in any information documents supplied by providers. Provisions on professional insurance and guarantees are contained in Article 27. For critical evaluation of these measures see Weatherill, n.14 above, pp.12-13.

<sup>39</sup> Article 31, Commission 2004 Proposal, n.1 above.

the rules of State X (if there are any) in order to gain access to the market of State Y'.<sup>40</sup> But the term is also used to indicate that it is the country of origin that is competent to regulate and supervise domestic service providers within a particular field, even though the rules that are applied may have a Community source.

The deference afforded to the country of origin in secondary legislation varies.<sup>41</sup> At one end of the spectrum are Community measures which allocate to the home state total, or virtually complete, competence to regulate and supervise domestic services, while ensuring compliance with the standards established in the measure. As a corollary of this, the host state loses any competence to regulate or supervise services coming from other Member States. This is illustrated by the Television Without Frontiers Directive, designed to facilitate the development of cross-border television services in Europe.<sup>42</sup> The directive establishes minimum standards in those areas where divergences in domestic rules were proving problematic for the providers of cross-border television services, for example in the field of advertising. All states are required to ensure that their domestic broadcasters comply with these minimum standards but remain free to subject them to more exacting standards if they so wish. They lose, however, all competence to regulate and supervise services coming from other Member States.<sup>43</sup> The country of origin principle can here be seen to operate quite differently from the way it does in the Article 49 EC case law. In the case law the principle establishes not an absolute rule in favour of home state regulation but merely a rebuttable presumption, with scope for states to continue to regulate non-domestic EU services on general interest grounds.<sup>44</sup>

Towards the middle of the spectrum, one can locate Community measures that are closer in approach to the existing services case law. Such measures tend to be adopted where it is not possible, or thought desirable, to agree common Community standards in all areas that could prove problematic in the field covered. They thus harmonise only partially and afford Member States competence, in the remaining areas, to restrict services from other EU countries on specified general interest grounds. A good example of such a measure is the Electronic Commerce Directive, which harmonised only a small section of the rules applicable to the information society services it covers.<sup>45</sup> Host states remain

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<sup>40</sup> N.14 above, at p.6.

<sup>41</sup> Jonsson, n. 24 above; N. Fichtner, 'The Rise and Fall of the Country of Origin Principle in the EU's Services Directive – Uncovering the Principle's Premises and Potential Implications', Essays in Transnational Economic Law 54/2006, available at: <http://www2.jura.uni-halle.de/telc/publikationen.html>; and consider also discussion by S. Weatherill, 'Supply of and Demand for Internal Market Regulation: Strategies, Preferences and Interpretation', in N. Nic Shuibhne, *Regulating the Internal Market* (Cheltenham: Edward Elgar, 2006) at pp. 29-60.

<sup>42</sup> Directive 89/552 on television broadcasting OJ 1989 L298/23, amended by Directive 97/36 OJ 1997 L202/60.

<sup>43</sup> Save in extreme cases where action is necessary to protect minors: Articles 2a and 22 of the Television Without Frontiers Directive, n.42 above.

<sup>44</sup> Consider, for example, the pre-directive case law on television services, in particular case C-288/89, *Stichting Collectieve Antennevoorziening Gouda v. Commissariat voor de Media* [1991] ECR I-4007, especially at para.23.

<sup>45</sup> Directive 2000/31 on certain legal aspects of information society services, in particular Electronic Commerce, in the Internal Market OJ 2000 L178/1.

competent under the directive to regulate services from other Member States on grounds of public policy, public health, public security and, interestingly, the protection of consumers (Article 3.4). Such measures do not, however, simply replicate the existing services case law in that they tend not only to limit the general interest grounds on which Member States can take action but also introduce notification and authorisation procedures.

At the other end of the spectrum are those measures that establish minimum standards but, unlike directives such as the Television Without Frontiers Directive, allow host states to continue to impose more exacting requirements, not only on domestic service providers, but also on those providing services from other EU countries.<sup>46</sup> They thus enable Member States not only to maintain higher domestic standards but also to prevent these standards being undercut by non-domestic providers. In specific areas relating to social policy, public health, consumer protection and the environment, the EC Treaty explicitly precludes the adoption of Community measures that do not allow Member States to impose more stringent requirements.<sup>47</sup> Such measures thus reduce the risk for traders that their services will be subject to further regulation in host Member States, but they offer no such guarantee, and it is thus questionable whether they should be considered to incorporate a country of origin principle at all. Finally, it is possible to point to what are sometimes referred to as ‘country of destination’ directives, where the country of origin principle is explicitly negated.<sup>48</sup> Here, regulatory competence is clearly ascribed, in certain instances, to the host state.

The Commission’s proposal for a services directive approximates most closely to the middle category exemplified by the Electronic Commerce Directive. Like the Electronic Commerce Directive it is ‘horizontal’ in scope, encompassing a wide range of services. Owing to the diversity of services covered, the adoption of common standards is difficult and harmonisation consequently limited. Both measures focus on facilitating consumer access to relevant information rather than establishing detailed quality standards. As with the Electronic Commerce Directive, the proposed services directive restricts the grounds on which the host state can regulate non-domestic EU services and introduces, where case-by-case derogations are sought, a notification and authorisation procedure.

Reviewing the Commission’s original proposal we can thus see that the country of origin principle was never the absolute rule it appeared from the text of Article 16. The impact of the principle was significantly modified by general exemptions from the scope of the directive as well as specific derogations from the country of origin principle itself. Seen in this broader context, the proposal was

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<sup>46</sup> An example here would be the directive on door-to-door sales, which explicitly states that Member States may adopt more favourable provisions to protect consumers in the fields it regulates: Directive 85/577, OJ 1985 L372/31, Article 8.

<sup>47</sup> Articles 137.4, 152.4(a), 153.5 and 176 EC, on which see discussion by Weatherill, n.41 above, at pp.39-42.

<sup>48</sup> As in, for example, the Posting of Workers Directive 96/71, OJ 1997 L18/1, which enables the host Member State to apply its own rules on working conditions to posted workers, and discussion by N. Fichtner, n.41 above, at p.11.

neither such a radical departure from the existing case law on Article 49 EC, nor that different in approach from directives such as the Electronic Commerce Directive that seek to regulate a broad field by harmonising in selective areas and structuring state discretion in those that remain. The most striking aspects of the proposal were its general reach; the limited grounds on which states would have been able to justify restricting non-domestic services, in particular, the absence of any mention of consumer protection; and the distinction that was drawn between situations in which the provider moves to the host state in order to supply services there and those where the service itself moves across borders.

#### **4. Review of the Country of Origin Principle in the European Parliament**

Why, given the fact that the country of origin principle is such an established part of the internal market landscape, did its inclusion in the Commission's proposal for a services directive cause such hostility? It is possible that certain commentators simply misunderstood the potential impact of Article 16, taking it at face value without realising the extent of its qualification by other articles. This may have been encouraged by confusion over the use of terminology. Some commentators apply the phrase 'country of origin principle' only in situations where the host country loses all competence to regulate non-domestic EU services, as under the Television Without Frontiers Directive, discussed above.<sup>49</sup> Thus, Claes-Mikael Jonsson argues that the country of origin principle establishes an 'unconditional obligation' and operates as a conflict of laws rule that ascribes competence to the home state. He contrasts this with the 'mutual recognition principle', applicable where the host state retains scope to restrict non-domestic services on general interest grounds.<sup>50</sup> The mutual recognition principle, he argues, imposes merely a 'conditional obligation' on the host state to respect the home state's rules. This requires Member States to trust that the regulatory standards that they each adopt, though to some extent different, will generally be adequate and sufficient. Where, however, this is found not to be the case, states remain competent to regulate the services supplied by individuals or companies established in other Member States. The mutual recognition principle, as defined by Jonsson, is reflected in the services case law of the Court of Justice, where reference to the country of origin principle would, on this view, be incorrect.

Although the term mutual recognition is usually employed in the case law context, this version of the principle might also be thought to operate in the context of secondary legislation, in that certain measures, such as the Electronic Commerce Directive and the present Services Directive, afford the

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<sup>49</sup> See text accompanying n.42 above.

<sup>50</sup> See Jonsson, n.24 above, p.4-5 and, for further discussion, Fichtner, n.41 above at pp.12-14; the Commission Communication on mutual recognition of 16 June 1999 at COM (1999) 299; and Opinion of the Economic and Social Committee on 'Mutual Recognition in the Single Market' of 29 November 2000, CES1402-2000\_AC\_EN.

host state continuing discretion to regulate non-domestic EU services on designated general interest grounds.<sup>51</sup> But the phrase ‘country of origin principle’ is also widely used in such circumstances: the Electronic Commerce Directive, for example, is generally regarded as having introduced a country of origin rule.<sup>52</sup> Moreover, the ‘mutual recognition principle’ is sometimes given a narrower meaning, as requiring Member States to consider whether the rules of a service provider’s home state are functionally equivalent to their own.<sup>53</sup> This principle of functional equivalence prevents the host state from unnecessarily duplicating requirements already established by the home state. Reference to the ‘country of origin principle’ in Article 16 of the proposal may thus have caused confusion as to what was actually being proposed and could easily have been understood as establishing an absolute, rather than a qualified, rule in favour of the home state.

Substantively, critics of the proposal questioned the balance struck between liberalisation, through the country of origin principle on the one hand, and the patchwork of exceptions, derogations and harmonising measures on the other. Without suitable harmonisation or the inclusion of appropriate exemptions and derogations, it was feared that regulatory competition, opened up by the country of origin principle, would lead to the undermining of professional standards and established social systems. These concerns were articulated particularly forcefully in relation to public services, labour law and health services. Thus, the EP Committee on the Environment, Public Health and Food Safety noted that the ‘proposal...subjects essential public services and services of general interest (including water and waste management, health services and residential care) to a largely unconditional liberalisation’.<sup>54</sup> The Committee concluded that ‘the vision’ of the directive was ‘of an internal market encumbered as little as possible by effective regulation in the interests of the citizen, the consumer, the worker, or the socially and environmentally responsible enterprise’.<sup>55</sup>

The Environment Committee responded to these concerns by proposing that Article 16 should be deleted in its entirety and, with it, the country of origin principle. This radical approach was also advocated by the IMCO rapporteur Evelyne Gebhardt. Gebhardt argued that the country of origin principle was in fact ‘more of a criterion’ because it was ‘not recognised as a principle in the Treaty or in the case-law of the Court’.<sup>56</sup> There was consequently no requirement that it be incorporated in Community legislation and it was possible to point to examples where the principle had been modified

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<sup>51</sup> See discussion accompanying n.27 above.

<sup>52</sup> See, for example, J. Hörnle, ‘Country of Origin Regulation in Cross-Border Media: One Step Beyond the freedom to Provide Services’, ICLQ vol.54, January 2005, pp.89-126. The May 2005 Draft Report for IMCO refers explicitly to both the Television Without Frontiers and Electronic Commerce Directives as containing a country of origin principle, see n.9 above, Amendment 114, p.66.

<sup>53</sup> As reflected in 279/80, *Webb, Criminal proceedings against* [1981] ECR 3305 at para.20.

<sup>54</sup> Opinion of the Committee on the Environment, Public Health and Food Safety on the Commission proposal for directive on services in the internal market, 17.3.2005, PE 350.110v02-00, p.3.

<sup>55</sup> *Ibid.*

<sup>56</sup> Justification for Amendment 111 of the May 2005 Draft IMCO Report, n.9 above, at p.63.

or even, as in the ‘country of destination’ directives, expressly reversed. Its presence could lead not only to the deliberate evasion of domestic regulation through strategic relocation by service providers and a consequent undercutting of standards but also ‘to stronger internal discrimination which is admissible but politically undesirable’.<sup>57</sup> By this she meant that operation of the country of origin principle would lead to service providers operating in the same Member State under different regulatory regimes, thereby consolidating differences rather than reducing them.

But Gebhardt attacked the Commission’s proposal not only on the basis of its potential impact but also in terms of its legality. Firstly, she argued that the Community should focus on tackling discrimination and creating a level playing field for service providers. By promoting liberalisation more generally across the various service sectors the Community risked going beyond its Treaty remit. This raises a familiar question about the scope of Article 49 of the EC Treaty: does it merely invalidate domestic measures that discriminate against services or service providers from other Member States or can it be used to challenge even non-discriminatory measures that hinder the cross border provision of services?

To support her point Gebhardt relied heavily on the second paragraph of Article 50 of the EC Treaty, which provides that ‘[w]ithout prejudice to the provisions of the Chapter relating to the right of establishment, the person providing a service may, in order to do so, temporarily pursue his activity in the State where the service is provided, under the same conditions as are imposed by that State on its own nationals’. This could be interpreted as identifying not merely one form of illegal state behaviour, discrimination by Member States against foreign service providers located on their territory, but as also setting a ceiling on the entitlements enjoyed by such service providers: a right merely to be regulated on the same basis as domestic providers. The strength of the argument lies in its reliance on the Treaty free movement provisions themselves to apply the brakes on the country of origin principle. It also ensures that any disparity in the treatment of service providers physically located in the same Member State is removed and displays greater sensitivity to domestic policy choices.

But such a constraining interpretation of Article 50.2 EC is controversial and not all the EP committees that considered the proposal agreed with it. The Legal Affairs Committee, for example, argued that Article 50.2 EC could not be seen as limiting the scope of Article 49 EC. The fact that it prohibits a Member State from imposing more unfavourable conditions on service providers from another Member State than on its own citizens, does not thereby exclude the application of the country of origin principle.<sup>58</sup> More importantly, the Court of Justice has, as noted above, over time come to

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<sup>57</sup> Working Document of the 21 December 2004 on the Commission’s Proposal for a Services Directive, prepared for IMCO by the Rapporteur Evelyne Gebhardt, PE 353.297v01-00, p.3.

<sup>58</sup> Opinion of the Committee on Legal Affairs on the proposal for a European Parliament and Council directive on services in the internal market, AD\573105EN.doc, 1.7.2005, p. 3-4.

interpret Article 49 EC broadly to cover not only measures enacted by the host state that discriminate against services supplied by individuals or companies established in other Member States but also measures which, though not discriminatory, impose unjustifiable or disproportionate restrictions on those service providers.<sup>59</sup> In framing the general principles governing the application of Article 49 EC, the Court has not distinguished between cases where the service moves and those where the service provider relocates to another Member States. To argue that the country of origin principle contravenes Article 49 EC where the service provider moves on the basis that it goes beyond tackling host state discrimination is consequently unconvincing.

Gebhardt is, however, correct that the second paragraph of Article 50 EC poses a problem for the country of origin principle in the Commission's proposal. This is because it prevents a service provider who wishes to take advantage of *more relaxed rules* in the host state from doing so: exactly what Article 50.2 EC appears, on a straightforward reading, to guarantee. For these service providers the principle consequently makes the exercise of their Community rights more, rather than less, difficult and renders reliance on Article 47.2 EC as a legislative base problematic.<sup>60</sup> Article 47.2 EC explicitly cross refers to Article 47.1 EC, which states that directives in the field of establishment should be designed to 'make it easier for persons to take up and pursue activities as self-employed persons'. Although this interpretation of Article 50.2 EC brings into question the legality of existing directives that adopt a country of origin approach, directives such as the Television Without Frontiers Directive and the Electronic Commerce Directive primarily cover situations where it is the service rather than the provider that crosses a border and consequently fall outside the stated scope of Article 50.2 EC.

To attempt to accommodate the Article 50.2 EC right within the context of the Commission's proposal would, however, create administrative chaos. It would require Member States to distinguish between service providers from other Member States that wished to be regulated on the same terms as domestic service providers – whom they would presumably regulate and supervise – and those that wished to remain subject to the rules of their home state – which they would not.<sup>61</sup> One way round these complexities would be for the directive to distinguish between different types of service provision and, where the service itself moves across borders, to apply the rules of the country of origin but, where the service provider relocates to the host state, to apply the host state rules. This would be to cut back the scope of the country of origin principle but not remove it altogether. It would ensure that any disparity in the treatment of service providers physically located in the same Member State was removed and displays greater sensitivity to domestic policy choices. Such an approach may also

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<sup>59</sup> See cases cited at nn.30 and 44 above.

<sup>60</sup> Working document, n.57 above, p.6.

<sup>61</sup> Though this appears to have been proposed in the 'country of destination' principle, discussed at text accompanying n.70 below.

correspond more closely to consumer expectations in that, even when information relating to a supplier is readily accessible, consumers may still expect that services supplied by operators physically located in their own country will be subject to the laws and regulations applicable to domestic suppliers. Where, however, a consumer seeks out a service to be supplied from another Member State, for example, over the Internet, they are likely to be alert to the fact that a different regulatory regime may apply.

Although distinguishing different types of service delivery in this way would reduce some of the inequalities between service providers it would not remove them altogether. Thus, providers of cross-border services, located in the home state, would be regulated differently from providers who relocate to offer an identical service, for example, a distance learning programme, from within the host state. They would also be treated differently to domestic service providers established in the host state. Perhaps more fundamentally, this approach would run counter to the Court's case law on Article 49 EC, which enables service providers who wish to continue to be governed by the rules of their home state when operating in other Member States to be able to do so, provided the host state cannot put forward a convincing general interest justification in support of its own regulations.

Gebhardt's second major criticism of the Commission's proposal was also Treaty based. It rests on the view that the appropriate way to pursue further integration in the services sector is through the coordination and harmonisation of domestic standards, not through the introduction of a horizontally applicable country of origin principle. She argued that the 'introduction of the country origin principle would even endanger progress towards harmonising European legislation, as it departs from the originally planned harmonisation of Articles 55 and 47(2), first sentence, of the EC Treaty...In the interests of fair competition, common rules, i.e. a combination of harmonisation and mutual recognition are essential.'<sup>62</sup> For Gebhardt, therefore, the choice facing the Community in the services context was essentially harmonisation, with the scope this affords Member States to argue their concerns in relation to specific sectors, or continuation with the existing case law approach. It is, moreover, questionable whether the Treaty provides a basis for incorporating into secondary legislation the negative integration/country of origin approach developed by the Court of Justice in the free movement field. Such legislation does not appear to '*coordinate*' domestic provisions within the terms of Article 47(2) EC, which provides the legal basis, together with Article 55 EC, for the Commission's original proposal and, ultimately, the Services Directive itself. Rather, it brings into play a system of competition between different legal orders.

The May 2005 draft report to IMCO, prepared in consultation with nine other European Parliament committees, reflected these concerns and proposed that the country of origin principle be replaced by a

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<sup>62</sup> Working document, n.57 above at p.4.

principle of ‘mutual recognition’, based on the concept of ‘equivalence’.<sup>63</sup> The mutual recognition principle starts with the premise that a service provider that complies with the rules of its home state should be able to provide its service ‘without hindrance’ in other Member States.<sup>64</sup> Its point of departure is thus remarkably similar to the Commission’s country of origin principle. Further amendments to the Commission proposal would, however, have afforded host states greater competence to regulate non-domestic EU services. Thus, the report proposed that legal or contractual provisions relating to consumer protection, environmental protection and labour law, as well as the rules applicable to reparation for loss and damage, should be excluded altogether from the scope of the mutual recognition principle.<sup>65</sup> As indicated above, these are areas where the EC Treaty expressly provides that Member States should be allowed scope to impose more exacting requirements where Community standards have been set.<sup>66</sup> Services to be covered by the principle were to be positively listed in separate annexes to the revised draft, thereby preventing any future unforeseen regulatory creep.

The draft report also reversed the approach adopted by the Commission in relation to supervision. Under the draft report the country of destination, rather than the country of origin, was to be responsible for supervising both services and providers of those services.<sup>67</sup> Most importantly, the host state was to remain competent to regulate services from other Member States on the whole range of general interest grounds recognised in the Court of Justice’s jurisprudence.<sup>68</sup> The report thus sought to bring the service provisions into line with the Commission’s proposals on establishment, which did not attempt to restrict the range of general interest justifications available for states.<sup>69</sup> Restrictions on the basis of consumer protection, or cultural concerns would thus have remained open to Member States.

In addition, a new Article 17 introduced a separate ‘country of destination’ principle, explicitly based on the second paragraph of Article 50 EC. This stated that ‘[i]n order to provide a service, the service provider may temporarily pursue his activity in the State where the service is provided, under the same conditions as are imposed by that State on its own nationals’.<sup>70</sup> Although establishing a right for service providers, the country of destination principle may also have been intended to underline that host states remain competent to apply their domestic regulations to all foreign providers operating in their territory, whether or not they wish to take advantage of Article 50.2. This finds some support in the

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<sup>63</sup> Draft IMCO Report, n.9 above, at Amendment 111, Article 16.1 The commentary on the proposed amendments to Article 16 indicate that a key objective of the mutual recognition principle was to prevent the host state duplicating requirements already imposed by the home state.

<sup>64</sup> Draft IMCO Report, n.9 above, Amendment 111, new 16.1.

<sup>65</sup> Draft IMCO Report, n.9 above, Amendment 111, new Article 16.1a.

<sup>66</sup> See text accompanying n.47 above.

<sup>67</sup> Draft IMCO Report, n.9 above, Amendment 111, new Article 16.2.

<sup>68</sup> Draft IMCO Report, n.9 above, Amendment 111, new Article 16.2a.

<sup>69</sup> See Article 15.3(b), Commission 2004 Proposal, n.1 above.

<sup>70</sup> Draft IMCO Report, n.9 above, Amendment 115.

next sentence, which states that consumer services, listed in an annex, are to be subject to the rules and administrative provisions of the country of destination. The consumer protection, environmental and labour laws explicitly excluded from the mutual recognition principle, are also stated to be subject to the country of destination principle.<sup>71</sup> Finally, the draft report sought to address Gebhardt's concern that adoption of the directive could undermine future attempts to harmonise domestic regulations by proposing a new Article 16b entitled 'additional harmonisation', listing areas where further harmonisation should be pursued.<sup>72</sup>

Gebhardt's observation that the Commission's proposal could consolidate differences among service providers rather than reduce them has been explored in depth by Gareth Davies.<sup>73</sup> Davies goes beyond Gebhardt, who considered any increase in 'internal discrimination' caused by the proposal to be 'admissible but politically undesirable', and argues that the disparities in treatment resulting from the country of origin principle contravene the prohibition on discrimination on grounds of nationality in Article 12 of the EC Treaty.<sup>74</sup> For Davies, the proposal's focus on regulatory competition is at odds with the growing emphasis in Community law on equality, particularly as an aspect of EU citizenship. He thus concludes that 'a strict country of origin rule not only creates discrimination, but it creates, in reality, irremediable discrimination. It is, one would think, *a fortiori*, a prohibited reading of Article 49'.<sup>75</sup>

At issue here is reverse discrimination, whereby individuals or companies operating in their own Member State are required to comply with domestic rules that are more exacting than those applicable to operators from other Member States, who remain subject to the rules of their host state. The resultant disparity in treatment has been the subject of considerable academic debate but the Court of Justice has adopted a fairly consistent line that individuals or companies cannot rely on Community law to challenge the operation of domestic rules in what are termed 'wholly internal situations'.<sup>76</sup> Thus, in the cases of *Uecker and Jacquet*, where the implications of the Treaty citizenship provisions for reverse discrimination were considered, the Court held that 'citizenship of the Union...is not intended to extend the scope *ratione materiae* of the Treaty also to internal situations which have no link with Community law ... Any discrimination which nationals of a Member State may suffer under the law of that State fall within the scope of that law and must therefore be dealt with within the framework of the

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<sup>71</sup> Draft IMCO Report, n.9 above, Amendment 115.

<sup>72</sup> Draft IMCO Report, n.9 above, Amendment 113.

<sup>73</sup> Davies, G., Services, 'Citizenship and the Country of Origin Principle', Mitchell Working Paper Series 3/2007.

<sup>74</sup> *Ibid.* and see text accompanying n.57 above.

<sup>75</sup> Davies, n.73 above, p.12.

<sup>76</sup> See, for example, Barnard, n.29 above, at pp.99-100 and 252-256; V. Hatzopoulos and T.U. Do, 'The Case Law of the ECJ Concerning the Free Provision of Services: 200-2005', (2006) 43 CMLR 923-991 at 943-946, N. Nic Shuibhne, 'Free Movement of Persons and the Wholly Internal Rule: Time to Move On?' (2002) 39 CMLR 731-771 and, for a rather different perspective, C. Ritter, 'Purely Internal Situations, Reverse Discrimination, *Guimont*, *Dzodzi* and Article 234' (June 16 2006), available at SSRN: <http://ssrn.com/abstract=954242>.

internal legal system of that State'.<sup>77</sup> The closest the Court has come to expressly accepting that Community law may be relevant in wholly internal situations was arguably in the case of *Pistre*, where the Court considered a preliminary reference brought by a French national regarding the legality under Community law of French regulations governing use of the designation 'mountain' on food products.<sup>78</sup>

There are sound reasons for the Court's reluctance to relax its stance on this matter. To allow individuals to challenge their own domestic rules on the basis of reverse discrimination would not only further erode what remains of domestic sovereignty, it also opens the door to an unprecedented deregulatory spiral. Although the operation of the Treaty free movement rules certainly encourages reflexive deregulation, whereby states deregulate to match the most relaxed rules operating within the EU, it does not mandate it. At present, Member States remain competent to decide whether to relax domestic standards in the face of foreign competition or continue to pursue the policy objectives that underpin those standards. They can also seek to remove reverse discrimination by harmonising domestic standards at the European level. But reverse discrimination is integral to the operation of the internal market where such harmonisation has not taken place. The internal market as developed by the Court looks to individuals to choose between goods and services produced or provided under different regulatory regimes. The country of origin principle drives this process, with reverse discrimination as its inevitable consequence. As the Court noted in *Jongeneel Kaas* 'a Member State may legitimately pursue a policy based on quality in order to promote sales even if that policy exposes its producers to the risk of price competition from the producers of other Member States who are not bound by the same standards of quality'.<sup>79</sup>

The harshness of this approach is tempered, as Davies acknowledges, by the ability of Member States to rely on a range of general interest objectives in order to regulate foreign goods and services in the same way as their domestic competitors.<sup>80</sup> But where states are unable to show that their measures pursue a legitimate objective or are proportionate they cannot apply them to foreign traders. In other cases, the Court has given the Treaty free movement provisions an extensive reach, enabling individuals who can show only an indirect or relatively contrived link to Community law to benefit from its protection.<sup>81</sup> Such decisions, suggest that the Court is not always comfortable with the implications of

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<sup>77</sup> Cases C-64 and 65/96, *Land Nordrhein-Westfalen v. Kari Uecker and Vera Jacquet v. Land Nordrhein-Westfalen* [1997] ECR I-3171, paras. 19, 22-23 and see materials referred to at n.76 above.

<sup>78</sup> Joined cases C-321/94 to C-324/94, *Criminal proceedings against Pistre and Others* [1997] ECR I-2342, though operation of the domestic measures at issue could have led domestic manufacturers to discriminate against non-domestic ingredients, thereby creating a link to Community law.

<sup>79</sup> Case 237/82, *Jongeneel Kaas BV v. Netherlands* [1984] ECR 483, para. 23. Discussed by C. Barnard, n.29 above, at p.99-100.

<sup>80</sup> Davies, n.73 above, at p. 12.

<sup>81</sup> See, in particular, case C-370/90, *R v. Immigration Appeal Tribunal and Surinder Singh, ex parte Secretary of State for the Home Department* [1992] ECR I-4265 and C-60/00, *Mary Carpenter v. Sec. of State for the Home Department* [2002] ECR I-6279. The broader implications of these cases are discussed in the materials cited at n.76 above.

the 'wholly internal situation' rule, but despite cutting back the circumstances in which reverse discrimination can arise, the Court has not so far been prepared to rule that it *per se* contravenes Article 12 EC.

Davies' concern to protect domestic autonomy in key policy areas means, however, that he is not advocating such a step. Instead, he seeks to prevent reverse discrimination from arising in the first place. Thus, rather than expand the reach of Community law by giving Community citizens rights against their own state in wholly internal situations, he argues that the reach of Community law should be drawn back by excluding the operation of the country of origin principle. This would limit the rights stemming from Article 49 EC to a right to provide services on the same terms as domestic providers, that is, to a right to equal treatment.

Davies' argument, if correct, would have far-reaching ramifications both for the operation of the free market provisions in the Treaty and for related Community legislation. Even the more limited application of Article 12 EC to the field of Article 49 EC would require significant revision to the Court's services case law, given its acceptance that non-discriminatory domestic rules may be challenged under Article 49 EC. Similarly, secondary legislation such as the Television Without Frontiers Directive, which deals with cross-border television services, could be challenged for creating a situation in which domestic broadcasters can be regulated more strictly than foreign broadcasters operating in the same market. The question for Davies then is how to keep the lid on the genie. When does Article 12 EC preclude the operation of the country of origin principle and when not?

Davies does not argue that reverse discrimination will be unlawful in all contexts and he suggests that the reason why it cannot be tolerated in relation to Article 49 EC is that Member States cannot realistically be expected to modify *their* rules in sensitive policy areas that they regard as important, such as employment protection or the skills of service providers, in order to level the playing field for domestic service providers. But even the more limited application of Article 12 EC to the field of services is unlikely to be convincing given the close parallels that exist between the provision of services and goods. Sensitive policy decisions can arise in relation to the sale of goods, for example regarding the sale of alcohol, just as they do in the field of services. Moreover, in the context of both goods and services the Court has been prepared, as noted above, to favour regulatory competition over the equality of traders and it may be possible to accommodate such policy decisions within the terms of Article 12 EC itself. Article 12 EC states that it is to operate 'without prejudice to any special provisions' contained in the Treaty, so that it is arguable that it cannot be applied to undermine the specific economic regime developed by the Court when implementing Title III of the Treaty, relating to the free movement of persons, services and capital, and Title I, relating to goods.

If one does not accept Davies 'uncontroversial' point that 'Article 49 must be read in a way that promotes the equality of nationalities and reduces differences on the basis of nationality', it is then necessary to consider when equality considerations should be allowed to trump regulatory competition.<sup>82</sup> The Court has provided its own answer to this by developing its case law on the mandatory requirements. The Court thus allows Member States to continue to enforce domestic regulations which pursue important general interests against foreign providers of goods and services. Domestic traders cannot here be undercut by foreign operators and are guaranteed a level playing field. The application of Article 12 EC, as a brake on the free movement provisions, where, as Davies suggests, a host state cannot 'realistically change...[its] domestic regulation to make it equivalent to that of the state of origin' or can do so 'only by abandoning other interests which they regard as important', comes very close to reinventing the existing mandatory requirements wheel.<sup>83</sup>

One might conclude from this that although the country of origin principle does not automatically contravene Article 12 EC, it will nevertheless do so where, as in the Commission's 2004 proposal, it does not accommodate the Court's mandatory requirements case law. Ultimately, the problem with the country of origin principle in the Commission's proposal was that it was to be applied generally across the whole range of service sectors without the usual checks and balances. On the one hand, the proposal introduced relatively few common standards, principally in relation to consumer information, while, on the other, it severely constrained the ability of states to regulate foreign services on the usual range of general interest grounds.

Criticisms of the proposal also reflected deeper structural problems within the EC Treaty itself. Not only would the proposal have cut back Member State competence under the existing services case law, with limited harmonisation in exchange, it would also have pre-empted the operation of those other Treaty articles, which afford states a greater measure of autonomy in specific fields, such as consumer protection and social policy.<sup>84</sup>

Despite these concerns, neither IMCO nor the European Parliament was prepared to cut down the country of origin principle as radically as Gebhardt had proposed.<sup>85</sup> The final IMCO Report and Resolution of the European Parliament at first reading made no mention of the mutual recognition or country of destination principles. A key problem for Gebhardt was always going to be that the mutual recognition principle effectively crystallised the existing case law position, raising the question why such a provision was needed at all. As in the Commission's original proposal, the Parliament's first reading Resolution started from the presumption that a Member State in which a service is provided 'shall

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<sup>82</sup> Davies, n.73 above, p.9.

<sup>83</sup> Davies, n.73 above, p.12.

<sup>84</sup> See text accompanying n.47 above.

<sup>85</sup> For a different interpretation of the impact of the Parliament's amendments see Editorial comments, n.14, above.

ensure free access to and free exercise of that activity within its territory.<sup>86</sup> It also provided for general and case-by-case derogations from the freedom to provide services on broadly the same limited range of general interest grounds, while greatly extending the exemptions from the scope of the directive as a whole in Articles 1 and 2.<sup>87</sup>

The European Parliament did not, however, retain the phrase ‘country of origin principle’. Instead, it introduced the expression ‘freedom to provide services’, a term that was carried through into the final version of the Services Directive.<sup>88</sup> The effect of the ‘freedom to provide services’ principle, as incorporated in the Services Directive, is considered in more detail below.

## **5. How Different is the Final Version of the Services Directive to the Commission’s Original Proposal?**

In terms of basic structure and approach, the principle of freedom to provide services in the final version of the Services Directive closely mirrors the country of origin principle in the Commission’s initial proposal. Both start with the presumption that the country of origin determines the rules governing access to, and the exercise of, services provided by individuals or companies primarily established in its territory.<sup>89</sup> Both also carefully restrict the general interest grounds on which Member States can regulate non-domestic EU services.<sup>90</sup> In particular, there remains no mention of consumer protection. In certain respects, however, the Services Directive is here slightly more generous to Member States. Article 16.3 of the Services Directive, for example, enables Member States to rely not only on public policy, public security, public health and environmental protection grounds to restrict service providers who have relocated to their territory, as under Article 17(17) of the Commission proposal, but also on ‘rules on employment conditions, including those laid down in collective agreements’. Moreover, it would appear that Member States do not need to go through the procedure for case-by-case derogations when they wish to rely on public policy, public security, public health and environmental protection grounds to restrict services provided from another Member State, save where safety issues are raised.<sup>91</sup> The notification and authorisation procedures applicable where case-by-case derogations are sought are similar in both documents.

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<sup>86</sup> European Parliament, First Reading Resolution, n.11 above, Article 21.

<sup>87</sup> European Parliament, First Reading Resolution, n.11 above, in particular at Articles 21.1(b), 21.3, 22(11)-(12) and 23.

<sup>88</sup> European Parliament, First Reading Resolution, n.11 above, Article 21.

<sup>89</sup> Articles 16.1 of the Services Directive, n.13 above and Commission 2004 Proposal, n.1 above.

<sup>90</sup> Articles 16.1 (b) and 3, 18, Services Directive, n.13 above and Articles 17(16) and (17), 18, Commission 2004 Proposal, n.1 above.

<sup>91</sup> Article 16.1(b) and 18 of the Services Directive, n.13 above. Demarcation issues may arise in the future given the potential overlap between these two provisions. It is not clear why more exacting requirements have been retained in the context of safety concerns.

It may, nevertheless, be more difficult to have recourse to the derogations in the Services Directive because of the requirement in Article 16.1(a) that derogations must be neither ‘directly nor indirectly discriminatory with regard to nationality’. If ‘indirect discrimination’ is assessed on the basis of the effect of a measure rather than the state’s intention, however established, the provision could be used to challenge domestic measures that are not overtly discriminatory but are nevertheless more onerous for foreign service providers to comply with than domestic providers. Provisions of this type may be introduced for a variety of reasons unrelated to nationality and the Court of Justice has in the past allowed Member States to rely on general interest justifications in this context provided their application can be shown to be proportionate.<sup>92</sup>

In relation to supervision the two documents are also broadly similar. Both render Member States primarily responsible for supervising service providers established on their territory but, where a service provider relocates to another state, the home state is authorised to request the host state to carry out any necessary checks or controls on its behalf.<sup>93</sup> Under the Commission’s proposal it was not entirely clear who was responsible for supervision where a host state wished to apply domestic rules to foreign providers under the derogations contained in Article 17, though supervision by the host state was envisaged when ‘objectively justified by an overriding reason relating to the public interest’.<sup>94</sup> The position has been clarified in the Services Directive, which confirms that it is the host state that is responsible for compliance with national requirements, imposed by virtue of the derogations in Articles 16 and 17.<sup>95</sup>

Although Member States were ultimately not prepared to ring fence their regulatory competence in the way Gebhardt had proposed, they were inevitably receptive to the concerns voiced within the European Parliament over the proposal’s potential deregulatory impact. These concerns were instead accommodated by excluding from the scope of the directive those sectors where regulatory competition was likely to prove most problematic. Thus, to the five areas excluded in Article 2 of the Commission’s proposal, the Services Directive adds: non-economic services of general interest; healthcare, audiovisual, gambling and social services; services of temporary work agencies; private security services and services provided by notaries and bailiffs.<sup>96</sup> Taxation is now completely excluded. The Directive also adds to Article 1 a list of fields of activity or measures that are expressly held not to be affected by its provisions. These include labour law, criminal law and ‘measures taken at Community level or at national level, in conformity with Community law, to protect or promote

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<sup>92</sup> Consider, for example, case C405/98, *Konsumenontubsmannen v. Gourmet International Products AB*, [2001] ECR I-1795.

<sup>93</sup> Articles 30-31, Services Directive, n.13 above and Articles 34-36, Commission 2004 Proposal, n.1 above.

<sup>94</sup> Article 36, Commission 2004 Proposal, n.1 above.

<sup>95</sup> Article 31.1, Services Directive, n.13 above.

<sup>96</sup> Article 2, Services Directive, n.13 above.

cultural or linguistic diversity or media pluralism'. The articles in the Commission's proposal relating to the posting of workers and assumption of health care costs have consequently been removed.<sup>97</sup>

The breadth of these general exclusions mitigates to a considerable extent the impact of the limited range of general interest derogations permitted under the Directive's services provisions. Indeed, the protection of linguistic and cultural diversity, mentioned in Article 2, is recognised by the Court to be a legitimate general interest objective.<sup>98</sup> The end result is, however, a measure which, in the words of the editor of the *Common Market Law Review*, bears more than a passing resemblance to Swiss Emmenthal cheese, a product that contains 'more holes than substance'.<sup>99</sup>

## 6. Conclusion

This article has argued that the country of origin principle far from being 'stripped out' of the Commission's original proposal by the European Parliament remains an integral part of the Services Directive as finally adopted.<sup>100</sup> The European Parliament ultimately chose not to make the substantive changes to the country of origin principle proposed by Gebhardt, they merely called it something else: freedom to provide services. The concerns voiced by the Parliament over the potential impact of the proposal were instead addressed by the wholesale exclusion of a range of sectors and activities from the scope of the Directive. The country of origin principle thus lives on but with a greatly diminished sphere of operation. The result is a complex document containing an intricate arrangement of exclusions and derogations scattered across its length.

The debates that took place within and across the various Community institutions over the Services Directive highlighted the existence of very different visions of European integration. Gebhardt argued strongly for the gradual co-ordination of domestic rules at the Community level, that is, for positive integration, with broad scope for Member States to continue to regulate services in the interim according to their own policy requirements. The Directive ultimately took a different approach, relying on negative integration but not in the form familiar from the case law of the Court of Justice. This is negative integration in its legislative guise, under which the residual regulatory competence enjoyed by states and preserved in the case law has been rigorously cut back.

Legislation of this type is not entirely novel, the 2001 Electronic Commerce Directive is a prior example, but the extraordinary breadth of the Services Directive stimulated a lively debate as to the legality of such measures.<sup>101</sup> Firstly, where they rely for their legal base, as does the Services Directive,

<sup>97</sup> Articles 23-25, Commission 2004 Proposal, n.1 above.

<sup>98</sup> As in case 379/87, *Groener v. Minister for Education* [1989] ECR 3967.

<sup>99</sup> Editorial comments, n.14 above at p.309.

<sup>100</sup> Weatherill, n.14, at p.8, notes that 'A tide of popular dissatisfaction washed away the Commission's initial plan. By 2006 the country-of-origin principle had been stripped out'.

<sup>101</sup> See n.45 above.

on Article 47(2) EC in co-ordination with Article 55 EC, can they be correctly categorised as *coordinating* ‘the provisions laid down by law, regulation or administrative action in Member States’? Rather than coordinate domestic regulations, they in fact allow the different domestic systems to operate side-by-side within a given Member State. As Gebhardt notes, although this may make it easier for some service providers to take up and pursue their activities within the meaning of Article 47(1) EC it is also likely to make it more difficult for others. Moreover, the legality of the Directive in the light of Article 50.2 EC, which offers service providers the right to provide services temporarily in another Member State ‘under the same conditions as are imposed by that State on its own nationals’, has not been satisfactorily explained. The resultant inequalities may also, as Davies suggests, run counter to Article 12 EC. Renaming the country of origin principle was a relatively straightforward matter; its legal status cannot be resolved quite so easily.