

## PRELIMINARY RULINGS IN INTERNAL AFFAIRS: A FRAMEWORK FOR ANALYSIS

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Article 234 of the EC Treaty covers a reference-based preliminary ruling procedure which is the principal procedural link between the European Court of Justice and Member States' courts within the Community legal system. Under this provision, the Court has jurisdiction to give preliminary rulings on the validity or interpretation of certain Community rules which the referring national court seeks to apply in the main proceedings. However, there are disputes before domestic courts to which national legislations make Community measures more or less applicable, but otherwise falling outside the scope of Community law (purely internal situations). In these cases the effects of Community law are extended by force of national law beyond the reach envisaged by the Community legislation itself. The wording of Article 234 EC leaves open the question of whether or not the Court may give preliminary rulings in such disputes on the interpretation of the Community measures that are indirectly applicable only on the basis of non-Community rules.

In most of such cases, first in *Thomasdünger*, the Court has assumed jurisdiction to give a preliminary ruling.<sup>1</sup> The reasons for the Court's position were first set out in some details in the *Dzodzi* ruling<sup>2</sup> that is why these cases are called the "*Dzodzi* line of cases".<sup>3</sup> However, it would not be easy to read consistency into the *Dzodzi* case-law. At least four standards or tests for assessing the nature and directness of the link between purely internal situations and Community law and for determining the threshold of admissibility can be discerned from the cases forming part of this jurisprudence.<sup>4</sup>

First, in *Dzodzi* the Court required the national law to refer to the Community measures to be interpreted by the Court in its preliminary ruling (plain reference test).<sup>5</sup> Second, in its *Kleinwort Benson* judgment the Court taking a somewhat narrower view of the bounds of

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<sup>1</sup> Case 166/84 *Thomasdünger GmbH v Oberfinanzdirektion Frankfurt am Main* [1985] ECR 3001.

<sup>2</sup> Joined Cases C-297/88 and C-197/89 *M. Dzodzi v Belgium* [1990] ECR I-3763. For the summary of the *Dzodzi*'s reasoning, see e.g. *Oliver*, p. 36. or see *O'Keefe*, p. 518. The Court put a double-limitation on the plain reference test, see par. 40., and see further Case C-118/94 *Associazione Italiana per il World Wildlife Fund, Ente Nazionale per la Protezione Animali, Lega per l' Ambiente - Comitato Regionale, Lega Anti Vivisezione - Delegazione Regionale, Lega per l' Abolizione della Caccia, Federnatura Veneto and Italia Nostra - Sezione di Venezia v Regione Veneto* [1996] ECR I-1223, par. 15.; Case C-85/95 *John Reisdorf v Finanzamt Köln-West* [1996] ECR I-6257, par. 16.

<sup>3</sup> See Case C-130/95 *Bernd Giloy v Hauptzollamt Frankfurt am Main-Ost* [1997] ECR I-4291, par. 23. and Case C-28/95 *A. Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2*. [1997] ECR I-4161, par. 29.

<sup>4</sup> For the discussion of the consistency of *Dzodzi* case-law and the different tests used by the Court, see Blutman, points 2-5.

<sup>5</sup> Joined Cases C-297/88 and C-197/89 *M. Dzodzi v Belgium* [1990] ECR I-3763, paras. 41-43.

Article 234 EC jurisdiction and clearly departing from the *Dzodzi* decision set up the "direct and unconditional *renvoi*" test to measure the applicability of Community rules in purely internal situations.<sup>6</sup> Third, the "direct and unconditional *renvoi*" test has clearly been abandoned by the Court in the *Leur-Bloem* case and the broader "same solution" approach was introduced.<sup>7</sup> Here, not requiring explicit reference to Community law by national law, the Court held that "where in regulating internal situations, domestic legislation adopts the same solutions as those adopted in Community law in order, in particular, to avoid discrimination against foreign nationals or, as in the case before the national court, any distortion of competition, it is clearly in the Community interest that, in order to forestall future differences of interpretation, provisions or concepts taken from Community law should be interpreted uniformly, irrespective of the circumstances in which they are to apply..."<sup>8</sup> Since *Leur-Bloem* (and *Giloy*), the "same solution" approach has been the most significant factor in the Court's decisions on its jurisdiction in *Dzodzi*-like cases.<sup>9</sup> Fourth, in the subsequent *Guimont* case the Court appeared to give up the *Leur-Bloem* test, including the same solution approach, and introduced the "useful answer" doctrine, to date only in the so-called reverse discrimination cases.<sup>10</sup>

These tests are not easy to apply in certain circumstances. A good example for the problem is the recent *ETI* case.

### 1. The *ETI* case

In *ETI*<sup>11</sup> by its decision the Italian Competition Authority imposed fines on some companies in the tobacco sector after having found that they had formed and implemented a

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<sup>6</sup> Case C-346/93 Kleinwort Benson Ltd. v City of Glasgow District Council [1995] ECR I-0615, par. 16.

<sup>7</sup> In fact, the "same solution" requirement is only the first prong of the three-pronged *Leur-Bloem* test, see Blutman, point 5.

<sup>8</sup> Case C-28/95 A. Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2. [1997] ECR I-4161, par. 32. See Betlem, p. 172. and also Case C-130/95 Bernd Giloy v Hauptzollamt Frankfurt am Main-Ost [1997] ECR I-4291, par. 28. *Lefèvre* is unconvincing in maintaining that *Leur-Bloem* did not give up the test of direct and unconditional reference, *Lefèvre*, p. 505.

<sup>9</sup> Case C-1/99 Kofisa Italia Srl v Ministero delle Finanze, Servizio della Riscossione dei Tributi - Concessione Provincia di Genova - San Paolo Riscossioni Genova SpA [2001] ECR I-0207, par. 32., Case C-300/01 Doris Salzmann [2003] ECR I-4899, par. 34., Case C-267/99 Christiane Urbing-Adam v Administration de l'enregistrement et des domaines [2001] ECR I-7467, par. 27., Case C-43/00 Andersen og Jensen ApS v Skatteministeriet [2002] ECR I-0379, par. 18., Case C-222/01 British American Tobacco Manufacturing BV v Hauptzollamt Krefeld [2004] ECR I-4683, paras. 40-41., Case C-3/04 Poseidon Chartering BV v Marianne Zeeschip VOF, Albert Mooij, Sjoerdte Sijswerda, Gerrit Schram [2006] ECR I-2505, par. 16., Case C-280/06 Autorità Garante della Concorrenza e del Mercato v Ente Tabacchi Italiani – ETI SpA and others [2007] ECR I-10893, paras. 21., 23., Case C-217/05 Confederación Española de Empresarios de Estaciones de Servicio v Compañía Española de Petróleos SA [2006] ECR I-11987, par. 20.

<sup>10</sup> Case C-448/98 Ministère Public v Jean-Pierre Guimont [2000] ECR I-10663, par. 23.

<sup>11</sup> Case C-280/06 Autorità Garante della Concorrenza e del Mercato v Ente Tabacchi Italiani – ETI SpA and others [2007] ECR I-10893.

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cartel infringing Italian competition law. The decision was challenged in administrative court, and in the end the case was brought by appeals to the *Consiglio di Stato* (State Council), the supreme administrative court of Italy. The *Consiglio di Stato* referred two questions to the Court for a preliminary ruling. Those questions concerned the interpretation of Articles 81 and 82 EC and the general principles of Community law.

The referring court did so, in spite of the fact that the dispute in the main proceedings entailed entirely a purely internal competition matter, falling clearly outside the scope of Community competition rules. However, Article 1(4) of the applicable Italian Law of No 287/90, on adopting provisions for the protection of competition and the market, contained a general reference to the Community law in the following manner: "The provisions in this Title shall be interpreted in accordance with the principles laid down in the competition law of the European Communities." The *Consiglio di Stato* took the view that it needed some clarifications on the Community rules in light of the facts of the dispute in order to be able to provide correct interpretation on the applicable Italian competition law.<sup>12</sup>

In these circumstances, a *Dzodzi*-like situation has arisen before the Court. There is an internal legal dispute lying outside the reach of Community law, but the applicable national law refers to Community rules, or in other way, provides the same solution as do those rules. In such situations the Community law is applicable not by its own force, but on the basis of the Member State's domestic legislation. The national court dealing with such a dispute has sometimes no other choice but to interpret Community rules in order to make correct decision and to resort to preliminary ruling procedure pursuant to Article 234 EC.

Although not challenging the central rule of *Dzodzi* holding, that is the possibility of the Court's assuming jurisdiction for a preliminary ruling in purely internal situations, the Commission contended that the Court had no jurisdiction to answer the two questions asked by the Italian court. Its reasoning was principally based on the facts that the Italian competition authority had applied exclusively national competition law in its decision, without using Community rules in the dispute, and furthermore, the Community measures that the referring court sought to be interpreted were irrelevant to the facts of the dispute. Third, following the conclusions made by the Court in the *Kleinwort Benson* judgment, it added that the Italian Law at issue did not require national courts to apply absolutely and unconditionally those interpretations that the Court provided in its preliminary ruling.<sup>13</sup>

The Commission's arguments proved to be unavailing for the Court. Citing a line of previous cases, and being supported by the Advocate's General (AG *Kokott*) opinion, it asserted jurisdiction upon three principal reasons. First, using the language and reasoning developed in *Leur-Bloem*, it was of the view that, in regulating internal competition matters, the relevant provisions of the Italian law provided the same solutions as those adopted in Community law. Furthermore, the *Consiglio di Stato* expressly referred to Article 1(4) of the Italian Law as a ground of its reference for a preliminary ruling, and it was not for the Court to determine the accuracy of the legislative context - the reference is

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<sup>12</sup> *Supra*, paras. 3-12.

<sup>13</sup> *Supra*, paras. 14-17.

therefore not obviously irrelevant.<sup>14</sup> And third, the Court noted that the Italian authorities (courts) had based their decisions on Community law and case-law, which proved that they had in fact followed Community rules in the main proceedings.<sup>15</sup>

The *ETI* decision is clearly of the *Leur-Bloem* case-line, where the Court gives greater deference than it did in *Dzodzi* or *Kleinwort Benson* to the national court's assessment of the relevancy and necessity of reference. At the same time, the Court seemed to uphold implicitly the requirement first articulated in *Kleinwort Benson*, namely, that the referring court should apply absolutely and unconditionally the interpretation provided in the preliminary ruling. However, the Italian law did not expressly provide so, and the Commission also emphasized the fact that Community rules to be interpreted by the Court constituted only one factor in the construction of the relevant provisions of national competition law, and therefore, they could be easily bypassed by the national authorities. The Court disagreed and concluded to the existence of national courts' obligation to apply absolutely and unconditionally the Court's interpretation given in the preliminary ruling from the fact that they had *de facto* referred to Community rules previously in the main proceedings.

In the *ETI* ruling, which followed *Leur-Bloem* in this respect, the broad "same solution" approach firmly prevailed and the Court did not demand plain reference (see *Dzodzi*), nor even direct and unconditional reference (see *Kleinwort Benson*) to Community rules. In fact, *ETI* does not give grounds for believing that the Italian legislation at issue would have met the *Kleinwort Benson* standard if the Court had applied it in the case. Although this direct and unconditional reference standard seems to be dead, because the Court has not applied it as a decisive factor since the *Kleinwort Benson* case, it may be important to show some of its difficulties, whereby sharper distinctions can later be made among different case patterns concerning purely internal situations.

## 2. What is a reference to Community rules?

The most important difficulty with the standard of direct and unconditional reference is its vague content. At first sight it is not entirely clear what the Court meant by that the reference made by national law to the Community law should be of direct and unconditional nature. The Court contrasted this double requirement with three deficiencies in the *Kleinwort Benson* situation. (1) First, there, the UK Act in question took the

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<sup>14</sup> As to the "obvious irrelevancy" standard for assessing generally the threshold of admissibility in Article 234 EC cases, see e.g. Case 126/80 *Salonia v Poidomani and Giglio* [1981] ECR 1563, par. 6., Case C-49/89 *Corsica Ferries France v Direction générale des douanes françaises* [1989] ECR 4453, par. 27., Case C-230/96 *Cabour SA and Nord Distribution Automobile SA v Arnor "SOCO" SARL* [1998] ECR I-2055, par. 21., Case C-343/90 *Manuel José Lourenço Dias v Director da Alfândega do Porto*. [1992] ECR I-4673, par. 18., Case C-129/94 *Ruiz Bernaldez* [1996] ECR I-1829, par. 7., Case C-125/96 *Hartmut Simon v Hauptzollamt Frankfurt am Main* [1998] ECR I-0145, par. 15

<sup>15</sup> Case C-280/06 *Autorità Garante della Concorrenza e del Mercato v Ente Tabacchi Italiani – ETI SpA and others* [2007] ECR I-10893, see especially paras. 23., 27. and 28.

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Community rule as a model only, and did not wholly reproduce the terms thereof, because certain provisions of the 1982 Act departed from the wording of the corresponding Convention provision; (2) furthermore, an express provision was made in the 1982 Act for the UK authorities to adopt modifications "designed to produce divergence" between any provision of national law and a corresponding provision of the Convention.<sup>16</sup> (3) In some subsequent cases, the Court identified a third deficiency, in light of the "direct and unconditional *renvoi*" standard, which had not been emphasized in *Benson* itself, that is, the UK legislation had distinguished between the provisions applicable to Community situations and those applicable to domestic situations.<sup>17</sup>

The second of these deficiencies, that the national authorities were authorized to make changes in the rules at issue, clearly related to the absence of unconditional nature of the reference. However, it is not clear to which of the two conditions the first or third deficiency can be related. As far as I know, the Court has not yet made such distinction in its case-law.

There is a problem with the concept of "direct reference" as well. A reference by the national law to Community rules becomes "direct" if the national legal provision explicitly refers to such a rule. However, if it does not, we not only cannot call it "direct reference", but it is doubtful whether we could call it reference at all. The problem lies in that we cannot identify what the concept of "indirect reference" may cover within the context of *Kleinwort Benson*. If the national legislation does not explicitly (directly) refer to Community measures, but only reproduces the language thereof, as was the case in *Benson*, there will be no reference at all, just a parallel regulation by which the domestic law provides the same legal solution to both Community and internal situations. In its opinion submitted in *Benson* AG *Tesauro* drew a clear distinction between a reference (*renvoi*) and a parallel regulation.<sup>18</sup> That is why the Court was compelled to abandon in *Leur-Bloem* even the *Dzodzi*'s plain reference requirement, for which the same solution approach was substituted, because in *Leur-Bloem* the Dutch law did not make explicit reference to Community rules, but only transposed more or less verbatim the language thereof.<sup>19</sup>

Maybe we call "indirect reference" what the Belgian law made in the *Dzodzi* case. There, the national law extended the scope of the Community law to internal situations by establishing that residence in Belgium of the foreign spouse of a Belgian national (an internal situation not governed by Community rules) was to be treated like that of a national of a Member State other than Belgium (a matter governed by Community law). As Ms. *Dzodzi* was the spouse of a Belgian national, the dispute therefore entailed a wholly internal situation, to which the Belgian law made Community law applicable. In Article 40

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<sup>16</sup> Case C-346/93 *Kleinwort Benson Ltd. v City of Glasgow District Council* [1995] ECR I-0615, paras. 16-18.

<sup>17</sup> See e.g. Case C-217/05 *Confederación Española de Empresarios de Estaciones de Servicio v Compañía Española de Petróleos SA* [2006] ECR I-11987, par. 21.

<sup>18</sup> Case C-346/93 *Kleinwort Benson Ltd. v City of Glasgow District Council* [1995] ECR I-0615, per AG *Tesauro*, par. 17.

<sup>19</sup> Case C-28/95 A. *Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2*. [1997] ECR I-4161, par. 34.

of the 1980 Belgian Law the reference to the Community law was made in the following form: the spouse of a Belgian national shall be so treated as the spouse of "an alien from within the European Community".<sup>20</sup> The national legislation did not determine directly Community law or a specific Community measure that should be applicable to internal situations envisaged by the Law itself, but specified a class of persons (Belgian citizens' spouses) to which the same treatment was to be accorded as to another class of persons (spouses of other Member States' citizens) falling within the reach of Community legislation.

In my view, that is what we can call an indirect reference, but it is certainly not the Court's opinion. Although in *Dzodzi* the Court did not make any distinction between direct and indirect reference, but it made such distinction in *Benson* in the form of requiring direct reference to Community rules.<sup>21</sup> Presumably, it would not have done so, if the Belgian rule in *Dzodzi* had been viewed as making only an indirect reference to Community measures, because this would have made the two cases incompatible with each other.

In *ETI* the relevant Italian rules embodied two forms of connecting link between the facts of internal dispute and Community measures. This link is the factor on which the conclusion to the existence of the same legal solution can somehow be based.

As to the first of these two forms of connecting link, Article 1(4) of the Italian Law made a direct, but general and conditional reference (as a type of link between the internal situation and Community law) to the general principles of Community law.<sup>22</sup> I consider this reference conditional, because the general principles of Community law might play role in the interpretation of the applicable national legal rules, and did not apply straight to the facts of the case. The reference was general, because it was not *ab ovo* limited to a determined part of Community law. This situation was slightly different from that arisen in *Dzodzi*, where the national law made an indirect, but specific and unconditional reference to Community rules (see below).

### **3. Stopping short of reference: transposition of the wording of Community law**

With respect to the second form of connecting link in *ETI*, Articles 2 and 3 of the relevant Italian Law of No 287/90, reproduced *mutatis mutandis* the language of Articles 81 EC and 82 EC,<sup>23</sup> whereby the Italian legislation made these rules by its own virtue applicable to internal competition matters otherwise falling outside the reach of Community competition measures. The questions which the *Consiglio di Stato* referred to the Court for a

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<sup>20</sup> Joined Cases C-297/88 and C-197/89 *M. Dzodzi v Belgium* [1990] ECR I-3763, par. 4.

<sup>21</sup> Case C-346/93 *Kleinwort Benson Ltd. v City of Glasgow District Council* [1995] ECR I-0615, par. 16.

<sup>22</sup> Case C-280/06 *Autorità Garante della Concorrenza e del Mercato v Ente Tabacchi Italiani – ETI SpA and others* [2007] ECR I-10893, par. 3.

<sup>23</sup> *Supra*, par. 24.

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preliminary ruling concerned at least in part Articles 81 EC and 82 EC, the wording of which was taken over by national law and the Court's answer did in fact focus upon these provisions of the EC Treaty. It follows, however, from the foregoing considerations, that such transposition of the language of Community rules into domestic legal provisions cannot be seen as a reference at all in spite of its establishing a kind of connection between internal situations and Community law. In light of the result of *ETI* case, it is clear that the Court was entirely satisfied by the nature of this connection falling far short of a reference, not requiring explicit reference to Community law to establish its own jurisdiction to give a preliminary ruling as it had done previously in *Dzodzi* or *Kleinwort Benson*.

*ETI* demonstrates the extent of the change that has happened in the Court's jurisprudence in this context. The first case before the Court where a national legislation governing internal situation did not made reference to Community law for which the referring national court sought interpretation in Luxembourg, but only took over the wording thereof, was *Kleinwort Benson*. In this case, an Act of the United Kingdom did not incorporate Community rules by explicitly referring to it or to such situations which are covered by those rules (as was seen in *Dzodzi*), but the domestic rules applicable to internal situations were simply modelled upon Community provisions.

In fact, the reference was made for the interpretation of two phrases in Article 5 of the 1968 Brussels Convention on jurisdiction and the enforcement of judgments in civil and commercial matters, (and the preliminary ruling procedure began under Protocol of 1971 to the Brussels Convention, and not under Article 234 of the EC Treaty). The aforementioned Civil Jurisdiction and Judgments Act 1982 made use of the model provided by the 1968 Brussels Convention to resolve conflicts of territorial jurisdiction among the courts of the United Kingdom. For this purpose, Section 16 of the Act provided that rules laid down in Schedule 4 to the Act should have effect for determining which court within the UK had jurisdiction even in certain internal proceedings. Schedule 4 contained provisions which were transposed with slight modifications from the Convention: for example, the language of Article 5(1) and (3) of the Schedule 4 was more or less the same as that of Article 5(1) and (3) of the Convention, which were later the subject of the reference to the European Court of Justice.<sup>24</sup>

In *Benson*, the referring UK court applying the Civil Jurisdiction and Judgments Act of 1982 (and the Schedule 4 to it) had to decide on the question whether, in a proceeding for restitution of a certain sum of money between Kleinwort Benson, which was a bank established in England, and the City of Glasgow District Council established in Glasgow, English or Scottish courts had jurisdiction to hear the case. In purporting to apply the rules in Schedule 4 to the Act, the UK court needed some clarifications from the Court on two phrases of the Convention, transposed into the Act, namely "matters relating to a contract" appearing in Article 5(1) of the Convention, and "matters relating to tort, delict or quasi-

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<sup>24</sup> Case C-346/93 *Kleinwort Benson Ltd. v City of Glasgow District Council* [1995] ECR I-0615, per AG Tesauro par. 5.

delict" appearing in Article 5(3).<sup>25</sup> As it is widely known, the Court rejected jurisdiction to reply to these questions. The Court's reasoning was grounded basically on the fact that national legal rules did not make a direct and unconditional reference to the Convention, and so, allowing departure therefrom; and being so, the rules of the Convention "cannot be regarded as having been rendered applicable as such, in cases out with the scope of the Convention".

However, some years later a similar case was brought by reference to the Court, which marked a significant turn in the Court's jurisprudence relating to jurisdiction to give preliminary rulings in cases involving internal factual situations and constituted the most important precedent to *ETI*. In a reference from the Netherlands, the Court had a chance to apply and clarify the new standard of direct and unconditional reference in a factual situation similar to that in *Kleinwort Benson* where this standard had been first set up. This was the *Leur-Bloem* case, where the referring national court asked the European Court of Justice to construe the phrase "exchange of shares" for income tax purposes within the meaning of Article 2(d) of Council Directive 90/434/EEC on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States.<sup>26</sup>

In the main proceedings, the national court had to find answer to the question whether the merger of share companies at issue in the action could be seen as a merger by exchange of shares within the meaning of the provisions of the Netherlands income tax law, and whether Ms. Leur-Bloem was entitled to receive a tax exemption on the gains which she had made by transferring her shares. This merger operation involved share companies established in the Netherlands, and so, it was not covered by the scope of the said Directive. The national law applicable to the case did not explicitly refer to the Directive, but contained two, almost identical provisions - modelled upon the relevant clauses appearing in the Directive - one for internal merger operations, and another for international mergers within the Community.<sup>27</sup>

In light of this background, the prediction of the outcome of the case did not seem to be a hard task under the holding in *Benson*: the Netherlands law did not refer - if referred at all - to Community law in a direct and unconditional manner, and the Court, therefore, may not assume jurisdiction to give answer to the questions asked by the national court under Article 234 EC. However, the Court remained silent on the direct and unconditional *renvoi* standard, and applied a new test. The Court observed that under parallel provisions of domestic law the same treatment should be given to internal mergers and intra-Community mergers for income tax law purposes, and then concluded that this legislative solution

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<sup>25</sup> *Supra*, par. 13. For a short summary of the reasoning, see Lenaerts p. 226., Arnall, pp. 108-109., Lefèvre, p. 504. *Collins* analyses the case from the angle of UK domestic law, Collins, pp. 543-544.

<sup>26</sup> Case C-28/95 A. *Leur-Bloem v Inspecteur der Belastingdienst/Ondernemingen Amsterdam 2*. [1997] ECR I-4161, par. 15. See also e.g. Betlem, pp. 165-178., Bishop, pp. 495-501.

<sup>27</sup> *Supra*, par. 5.



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satisfied the conditions for the Court's asserting jurisdiction to give a preliminary ruling in the case.<sup>28</sup>

This novel and broader "same solution" test made it possible for the Court to extend its jurisdiction under Article 234 EC much further than *Benson* or *Dzodzi* would have compelled, or even allowed.<sup>29</sup> The Court accepted jurisdiction in a case where the Community rule to be interpreted in the preliminary ruling did not apply to the case at issue, but might (not necessarily) contribute to the referring court's construction of a national legal rule, covering the purely internal factual situation of the dispute, which contained almost word by word the language of this Community rule.

Thus, the cases showing the same pattern (i.e. *Benson*, *Leur-Bloem* and *ETI*, where the languages of various Community rules inapplicable to these cases were transposed into the applicable national provisions) produced opposite outcomes. Although *Kleinwort Benson* was distinguished in the *Leur-Bloem* ruling on the basis that the referring court was not bound by the preliminary ruling to be given by the Court and the national law allowed amendments "designed to produce divergence" between any provision of the Act and a corresponding provision of the Convention, this distinction does not seem to hold water, because in *Leur-Bloem* (and later in *ETI*) the referring courts could have easily avoided the application of the Court's interpretations, and the national authorities also had the opportunity, albeit implicitly, to make amendments "designed to produce divergence" between Community and national provisions at issue.

In *ETI* the Court reaffirmed the approach taken in *Leur-Bloem*, and made it clear that *Benson's* direct and unconditional reference test was abandoned in cases where the domestic law did not refer explicitly to Community law, but only took over the language thereof.

#### 4. Six case patterns

In light of these previous considerations, some definite case patterns involving purely internal situations can be discerned from the Court's jurisprudence. The distinguishing characteristics lie in the form of connecting link between the facts of the internal dispute and Community measures, i.e. in the method, whereby the national legislation somehow makes the Community rules by its own force applicable to internal matters.

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<sup>28</sup> *Supra*, par. 32. AG Ruiz-Jarabo Colomer analysed the relation between *Kleinwort Benson* and *Leur-Bloem* (and *Giloy*) in this respect in his opinion delivered in the case of *Kofisa*, Case C-1/99 *Kofisa Italia Srl v Ministero delle Finanze, Servizio della Riscossione dei Tributi - Concessione Provincia di Genova - San Paolo Riscossioni Genova SpA* [2001] ECR I-0207, per AG Ruiz-Jarabo Colomer, paras. 45-50.

<sup>29</sup> *Kaleda's* opinion, that the Court reaffirmed the reasoning of *Dzodzi* in *Leur-Bloem*, seems unpersuasive, see *Kaleda*, p. 4.

(A) Specific, indirect and unconditional reference

The first scenario is such as that arisen in the *Dzodzi* case. Here, as can be seen above, the national legislation specified a class of persons (being in legal situations governed by national legal rules) to which the same treatment was to be accorded as to another class of persons, a reference group (in legal situations falling within the scope of Community law), thereby bringing the former class within the boundaries of Community legislation. That can be determined as a specific, indirect and unconditional reference to Community law. This reference is indirect, because domestic rules do not point directly to the applicable Community law or specific Community measures that shall be applicable to internal situations envisaged by the national law itself. At the same time, linking the internal situations at issue to only a specified and narrow range of Community rules, it is a specific reference.

Among cases, apart from *Dzodzi*, which answer this description, *Schoonbrodt* or *Kofisa* can - for example - be found.<sup>30</sup> In *Schoonbrodt*, a Belgian decree covering exemptions from excise duties on imports (an internal matter) provided that the same exemptions should be given the products imported from other countries and listed in the decree as those given from import duties. As the exemptions from import duties were determined by Community regulations, the question of whether or not the fuel in the tanks of vehicles crossing the border might be exempted from excise duties was to be answered under those regulations as interpreted by the Court in its preliminary ruling.<sup>31</sup> In the *Kofisa* case, under Article 70 of the Italian law on value-added tax, the provisions of customs law should apply to disputes and penalties relating to value-added tax on imports (an internal situation), and so, to the dispute in issue. However, customs matters fell within the scope of the Community Customs Code, and therefore the national court made reference to the Court for an interpretation of a provision of the Code to decide a procedural question in an internal dispute relating to levying of value-added tax.<sup>32</sup>

(B) Specific, direct and unconditional reference

In (B) the situation is slightly different from that arisen in the case of (A). In this type of reference the national law specifies the Community measure or measures which the national authorities shall apply to purely domestic situations falling outside the scope of

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<sup>30</sup> Case C-1/99 *Kofisa Italia Srl v Ministero delle Finanze, Servizio della Riscossione dei Tributi - Concessione Provincia di Genova - San Paolo Riscossioni Genova SpA* [2001] ECR I-0207.; C-247/97 *Marcel Schoonbroodt, Marc Schoonbroodt, Transports A. M. Schoonbroodt SPRL v Belgium* [1998] ECR I-8095. Specific, indirect and unconditional reference was also demonstrated in the *BAT* case, Case C-222/01 *British American Tobacco Manufacturing BV v Hauptzollamt Krefeld* [2004] ECR I-4683, paras. 40-41.

<sup>31</sup> *Supra*, *Schoonbrodt*, par. 7-11.

<sup>32</sup> Case C-1/99 *Kofisa Italia Srl v Ministero delle Finanze, Servizio della Riscossione dei Tributi - Concessione Provincia di Genova - San Paolo Riscossioni Genova SpA* [2001] ECR I-0207, paras. 13-14.

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Community law. In this sense, here, the reference is direct, which is the most clear and unambiguous form of all of the references to Community law.

The Court faced such a clear form of reference in the *Feron* case coming from the Netherlands to Luxembourg. The main proceedings raised the question of whether Feron was entitled to a tax exemption on the car which he had bought from his previous employer in Austria. A provision in the decree implementing the Dutch law of 1992 on duty on cars and motorcycles provided, that such a tax exemption was granted for cars originating from another Member State or from a non-Member State (an internal situation), where the vehicle, at the time of its entry into free circulation in the internal market, was entitled to exemption from customs duty under Regulation No 918/83. As the national rules made the conditions of tax exemption dependent on a Community measure relating to Community customs duties, the *Hoge Raad* (Supreme Court) had to ask the Court to interpret this Community measure.<sup>33</sup>

In the first post-*Dzodzi* case, also revealing the pattern (B), *Gmurzynska-Bscher*, the Court followed its previous ruling put down three weeks earlier.<sup>34</sup> Yet the circumstances arisen in *Dzodzi* involved scheme (A), i.e. specific, indirect and unconditional reference to Community law, while in *Gmurzynska-Bscher* the reference by national law was a direct one. Here, for purposes of granting exemptions or reductions to the turnover tax on import (internal tax matter), German law defined various classes of products by referring to the Nomenclature of the Common Customs Tariff. As the German Revenue Office classified the product imported by the *Galerie Gmurzynska* under a heading of the Common Customs Tariff which was subject to full rate of turnover tax on imports, the claimant brought an action against this decision for changing the classification. However, the difference between cases (A) and (B) did not affect the Court's conclusions as to its jurisdiction to answer the referred questions.<sup>35</sup>

(C) General, direct and conditional reference

For pattern (C), the *ETI* case provides an example. As we have seen in this case Article 1(4) of the Italian Law at issue made such a reference to general Community principles as (C) implies. But the scenario in (C) is different from that in (A) or (B), because here the applicable Community rules do not apply to the facts arisen in the case, but the national courts may use them for the interpretation of national legislation. That is why this form of reference is conditional: the national authorities have wide margin of discretion as to how and to what extent they apply Community rules for such purposes.<sup>36</sup>

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<sup>33</sup> C-170/03 *Staatssecretaris van Financiën v J.H.M. Feron*, [2005] ECR I-2299, paras. 3-4., and per AG Maduro, paras. 6-9.

<sup>34</sup> Case C-231/89 *Krystyna Gmurzynska-Bscher v Oberfinanzdirektion Köln* [1990] ECR I-4003.

<sup>35</sup> *Supra*, paras. 2-7. Such, specific, direct and unconditional reference was involved in the *CEPSA* case, Case C-217/05 *Confederación Española de Empresarios de Estaciones de Servicio v Compañía Española de Petróleos SA* [2006] ECR I-11987, par. 22.

<sup>36</sup> Case C-280/06 *Autorità Garante della Concorrenza e del Mercato v Ente Tabacchi Italiani – ETI SpA and others* [2007] ECR I-10893, par. 3.

Along these three (binary) variables eight forms of references can be conceived under logics. Of them three forms, that is (A), (B) and (C), can be actually identified in the Court's jurisprudence. In fact, no other forms of references are likely to occur in practice. For example, apart from the case of (A), the remaining and logically conceivable three forms of indirect references are not easy to imagine in practice, because it would be quite difficult for a national law to refer in a general or a conditional manner to Community law by way of identifying a target or reference class of situations governed by Community measures for the purposes of regulating similar, but internal situations (that is, by the way of indirect reference).

(D) Transposition of the language of Community rules into domestic law without reference

The situation in (D) has caused principal problems to the Court, because it lacks reference to Community law - in contrast to schemes (A), (B) and (C) -, providing only domestic legal texts which are identical or similar to the corresponding Community rules. (D) is illustrated by the *Kleinwort Benson*, *Leur-Bloem* and *ETI* cases. The preceding point concerned with this problem, so it suffices here to note that in *Leur-Bloem* the Court implicitly reconsidered the tests having applied in previous cases and found a new, less compelling standard, the "same solution" approach, which made it possible for the Court to accept jurisdiction to give a preliminary ruling.

(E) Extension of the scope of national rules implementing Community measures to internal situations

In *Benson*, *Leur-Bloem* and *ETI* belonging to pattern (D), there were parallel regulations in national laws: Community and internal situations were governed by different domestic rules, even though they were similar to each other in their wording.<sup>37</sup> However, there are scenarios where one and the same domestic rule is applicable to internal as well as Community situations. This often occurs when the reach of national legal rules implementing Community measures (mainly directives) is not limited to the legal situations envisaged by the implemented Community measures, but extended to such fact patterns which lie outside the scope of Community law.

For this scheme, the *Urbing-Adams* case is a good example.<sup>38</sup> The central legal question in the main proceedings was that whether or not the activity of managing agent in co-ownership building qualified as "liberal profession" under Luxembourg value-added tax law. According to this law, under some conditions, not the standard, but a reduced rate of VAT was applicable to activities pursued in the exercise of a liberal profession. However,

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<sup>37</sup> In *ETI* the Italian Law of No 287/90 applied to cartels, abuses of a dominant position and concentrations of undertakings which did not come within the scope of Community competition rules; see *ibid*.

<sup>38</sup> Case C-267/99 *Christiane Urbing-Adam v Administration de l'enregistrement et des domaines* [2001] ECR I-7467.

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the national tax authority disputed that the activities pursued as managing agent could be brought within the term of liberal profession, which was not defined by the Luxembourg legislation itself relating to VAT. The national court therefore made reference to the Court for the interpretation of the Sixth VAT Directive, which provided a definition for what is to be understood by liberal profession, although it did so for the purposes of VAT exemptions, and not for the purposes of determining who was entitled to a reduced VAT rate. (The Directive laid down separate rules for the application of reduced VAT rate.) So here, the Luxembourg law, in implementing Community VAT legislation, extended the reach of the Community definition of liberal profession to the purely internal matter of setting up various classes of activities with a view to applying reduced VAT rates.<sup>39</sup> The Court, following *Leur-Bloem* even in this context and applying the same solution approach, gave answer to the questions.<sup>40</sup>

(F) Establishing “same solution” by way of interpretation

*Leur-Bloem*'s twin-case, *Giloy* was decided on the same day as was the former one, but the commentators have not paid so much attention to it as to *Leur-Bloem*.<sup>41</sup> Yet *Giloy* posed a specific problem, which made it a quite interesting case in the line of *Dzodzi*-like disputes. The same solution approach, first established in the *Leur-Bloem* ruling, raises the question of from which circumstances one can conclude to the fact that the national legislation in regulating internal situations, in fact, adopts the same solutions as those adopted in Community law. The existence of the same solution in national law may be clearly discerned if it refers to Community law - see (A), (B) and (C) -, or transposes the language of a Community measure into national rules - see (D) -, or provides for a single and same treatment in comparable, internal and Community situations by expressly extending the scope of national rules implementing Community measures to internal situations - see (E). *Giloy* demonstrated that, absent circumstances standardized and described in patterns (A)-(E), the conclusion to the existence of the same solution, and so, to the Court's jurisdiction to give a preliminary ruling, may be grounded on the interpretation provided by the referring national court.

*Giloy* was concerned with the following principal legal question: to what extent German tax law had made the Article 244 of the Community Customs Code (a procedural provision) applicable to the procedure relating to the levying of value-added taxes on imports (purely internal situation), and whether the Court had jurisdiction to interpret the Code for the purposes of clarifying some legal concepts and conditions in such an internal tax procedure. The outcome of the case was the same as that of *Leur-Bloem*: the Court gave ruling on the merits in the case, though the Advocate General, the Commission, the German Government and the applicant as well as the defendant took the view that the Court had no jurisdiction in the case.

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<sup>39</sup> *Supra*, paras. 3-19.

<sup>40</sup> The *Poseidon* case also displayed the (E) scenario, see Case C-3/04 *Poseidon Chartering BV v Marianne Zeeschip VOF, Albert Mooij, Sjoerdje Sijswerda, Gerrit Schram* [2006] ECR I-2505.

<sup>41</sup> Case C-130/95 *Bernd Giloy v Hauptzollamt Frankfurt am Main-Ost* [1997] ECR I-4291.

It was not evident at all, that the German law provided for same solution, compared Community customs procedure with the wholly internal VAT-on-import procedure, in such a procedural question as the case raised (that is, the suspension of implementation of a tax decision). The Court took an unexpected, deferential position in the matter: as the case-file indicated that the provisions of domestic law in question applied without distinction to situations governed by domestic law and to situations governed by Community law under two provisions of the German Finanzgerichtsordnung (Code of Practice of Fiscal Courts) *as had been interpreted in the German case-law and by academic writings*, the existence of the same solution could be determined.<sup>42</sup>

So *Giloy* illustrates, the Court is inclined to apply the same solution standard even if, absent more objective criteria of textual evidence provided by scenarios (A)-(E), it has to rely entirely on the interpretation of the referring court, which is clearly beyond the Court's substantive control. In this respect, *Giloy* was reaffirmed in the *Andersen og Jensen* case.<sup>43</sup> Here, the Court concluded to the Danish legislature's intention to treat such internal situation as that in the case in the same way as those governed by the Community directive at issue, not from the language of the applicable national law (Fusionskattelov - law on the tax treatment of mergers), but from the drafting history thereof, as was indicated and interpreted by the referring court in the file.<sup>44</sup>

The *Giloy* and *Andersen og Jensen* rulings clearly mark the tendency of the Court's gradually losing control over the substantive issues of relevancy in cases where the only possible ground of the applicability of Community law lies in vague domestic rules or general principles of national law which need further substantial clarification.

This tendency has become even more apparent in some of the so-called reverse discrimination cases.<sup>45</sup> In order to prevent discrimination to the disadvantage of their own citizens or domestic products, the Member States often adopt explicit domestic legal rules for granting them the same treatment as to those falling under the scope of more favourable Community measures (see *Dzodzi*, which was in this sense a reverse discrimination case)<sup>46</sup> or the Member States' authorities and courts resort to various general principles and auxiliary legal rules by the help of which they relate and apply the more favourable Community measures, outside their scope, to purely internal situations (thereby creating *Dzodzi*-like circumstances). But these principles and auxiliary rules sometimes constitute a very uncertain link, substantively uncontrollable by the European Court of Justice lacking

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<sup>42</sup> *Supra*, paras. 9. and 27.

<sup>43</sup> Case C-43/00 *Andersen og Jensen ApS v Skatteministeriet* [2002] ECR I-0379.

<sup>44</sup> *Supra*, see especially paras. 12., 14. and 17-18.

<sup>45</sup> In *Ritter's* definition, reverse discrimination arises when a Member State's nationals or domestic products are disadvantaged in internal situations under the applicable domestic law in comparison to those of the Member State or other Member States involved in intra-Community legal situations or at least having some tie with EC law, and therefore treated on more favorable terms within the scope of the Community law. Ritter, p. 691. See also Craig, p. 762-763.

<sup>46</sup> See e.g. Kaleda, pp. 3-4. or Ritter, pp. 690-710.

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jurisdiction to interpret national law, between wholly internal affairs and Community rules. All this leads to scenario (F), where the connection between an internal situation and Community rules can be ascertained only by submerging in the interpretation of domestic law.

The *Guimont* ruling,<sup>47</sup> put down by the Court in one of the benchmark cases regarding reverse discrimination, revealed serious uncertainty as to what the national law said on the existence of the requirement of eliminating reverse discrimination in the particular case. Therefore, the Court was drifted into a situation where it could not be sure that the Community rules it was interpreting in its preliminary ruling would be applied by the referring court in the main proceedings. In such circumstances, not being able to ascertain the existence of the same solution or treatment requirement under national legislation, the Court could not maintain the same solution approach of *Leur-Bloem*, but applied the even broader "useful answer" doctrine as justification for its assuming jurisdiction to give a preliminary ruling,<sup>48</sup> thereby eliminating the remnants of substantive control over admissibility conditions in reverse discrimination cases revealing scenario (F).<sup>49</sup>

### 5. Concluding remarks

In the last two decades the European Court of Justice always faced serious admissibility questions in such cases where the national courts made references for the interpretation of Community rules that were made applicable by the national legislations to purely internal situations not envisaged by the Community law itself. Since the landmark decision of *Dzodzi*, the Court has applied at least four different standards for assessing the admissibility of the reference in such cases. The *ETI* case, which has been recently one of the most complex preliminary ruling procedure with regard to admissibility problems arisen in *Dzodzi*-like situations since the *BIAO* ruling,<sup>50</sup> reveals some of the methods by which the domestic rules link Community rules to internal situations.

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<sup>47</sup> Case C-448/98 *Ministère Public v Jean-Pierre Guimont* [2000] ECR I-10663, paras. 22-23.

<sup>48</sup> For some further cases of this case-line, see e.g. Case C-300/01 *Doris Salzmann* [2003] ECR I-4899, par. 33.; Case C-6/01, *Associação Nacional de Operadores de Máquinas Recreativas (Anomar) and others and Estado português* [2003] ECR I-8621, par. 41.; Joined Cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Hans Reisch and others v Bürgermeister der Landeshauptstadt Salzburg and Grundverkehrsbeauftragter des Landes Salzburg; Anton Lassacher and others v Grundverkehrsbeauftragter des Landes Salzburg and Grundverkehrslandeskommission des Landes Salzburg* [2002] ECR I-2157, par. 26.

<sup>49</sup> In contrast, the Court has tried to exercise, in general, a greater substantive control over the admissibility conditions *vis-à-vis* the assessments of referring courts, from the *Foglia* rulings onward: Case 104/79 *Pasquale Foglia v Mariella Novello (I)* [1980] ECR 0745., Case 244/80 *Pasquale Foglia v Mariella Novello (II)* [1981] ECR 3045. For further analysis, see e.g. Chalmers – Tomkins, pp. 287-291. and 297., Tridimas, pp. 21-36., Anderson - Demetriou, pp. 104-124.; Craig - De Búrca, pp. 484-493., Arnulf, pp. 114-119.

<sup>50</sup> Case C-306/99 *Banque Internationale pour l'Afrique Occidentale SA (BIAO) v Finanzamt für Großunternehmen in Hamburg* [2003] ECR I-0001. For this interesting case see e.g. Lenaerts, p. 228. or Arnulf, pp. 110-111.

Starting from *ETI*, an analysis was offered to make distinction between references (to Community law) and other forms of connecting factors between Community law and internal affairs. Six case patterns were identified in the Court's *Dzodzi* case-law in terms of these connecting factors. Distinguishing these patterns constitutes appropriate framework for the analysis of future cases and for assessing the Court's approaches to admissibility problems which such cases may bring out.

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## **THESES ON THE INFLUENCE OF THE EUROPEAN UNION ON THE MEMBER STATES' ADMINISTRATION**

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The European Union - called into existence by the Treaty of Maastricht in 1992 - has undertaken a giant task without any previous precedents in the world history, when it set the dual target of implementing the financial, monetary and political union. These designated objectives are to be pursued by a unique and constructed institutional system based on three pillars which are in co-operation with the Member States. The First Pillar of the European Union is the institutional system of the European Communities (and their common institutional system from 1965). The Second Pillar is the "Common Foreign and Security Policy" and the Third Pillar is the "Home Affairs and Justice Co-operation". This structure is still operating nowadays (autumn of 2008), though the Treaty of Amsterdam (1997) had a significant impact on the Third Pillar, as seven fields of cooperation (out of the nine) have been removed to the First Pillar. At the same time the Third Pillar's name has been changed as 'Police and Justice Co-operation in Criminal Matters'. Concerning these three pillars there are differences not only between the different fields of cooperation (called policies), but in their functioning model as well. While the First Pillar operates on principle of "Community Model", the Second and the Third Pillars operate on principle of "Intergovernmental Model". To make it simple it means:

- each participant of the common institutional system interferes with the questions of the First Pillar fields (policies). The decisions are prepared by the European Commission, and they are made by the European Council in co-operation with the European Parliament and the other "players". These decisions are brought with qualified majority comprising at least 255 votes out of 345 which are divided between the 27 Member States.
- only the European Commission has the right to interfere with questions relating to Second and Third Pillar fields (policies) and during the decision making it can solely do it with consensus.

All these are mentioned in advance to demonstrate how complicated the European Union institutional system and its operation is. We consider this complexity true, that we can do without any hesitation, we should believe the extreme complexity of the relationship between the Member States and common institutional system at supranational level. As it is complicated we need to simplify we want to say when we restrict the relation-system to the public administration. Thus we squeeze the characters of relation-system considered significant into theses as follows:

### **First Thesis**

In the lack of European Union institutions in the Member States the Community institutions and the governments of the Member States together provide for the implementation and enforcement of EU Law as one.

In details:

Surveying the history of the European Communities and the European Union and analysing the structures and functioning of the common institutes we can say that the European Union in an organic sense is a superstructure of the institutes at supranational level created by individual states standing in close and legally regulated connection with the Member States and their national institutions.

The relation between the common institutions working solely at 'central' level (Parliament, Council, Commission, Court, Audit Office and further ones) and the institutions of Member States at regional and local level (national parliaments, governments, courts and self-governments) is complementary to each other, or citing the words of Lajos Lőrincz, their relationship is characterized by the 'principle of administrative sharing of functions'.<sup>1</sup>

In this structural functioning model the common institutes and the governmental organs of Member States form a whole: an all-European state organ and an all-European legislature, administration and judiciary as the part of it.

To create a definition: the EU administration in an organic sense is the entirety of those EU (central) and Member State (regional, local) institutes that prepare the Community decisions (legal measures) and provide for its implementation and prevail.

As far as the concept of the EU administration is concerned in organic sense we should have a clear-cut view that it involves not only the different units of EU administration, the self-administration and community administration but also the public-administration of the Community and the Member States.<sup>2</sup>

### **Second Thesis**

Apart from some slight exceptions in the lack of binding legal regulations the EU has expectations only towards the Member State administrations as being reliable, understandable and democratic.

In details:

None of the primary sources of EU Law contain such a provision that would regulate explicitly the structure, functioning and personnel (public service of Member State public administration). Within the secondary sources we can exceptionally find some of these provisions that are related to the utilization of funds. It is important to mention that in these exceptional cases the relationship between the EU institutions and the administrative organs of Member States is not hierarchical but rather cooperative. As Alberto J. Gill Ibanez referred to it, this relationship can be described as a cooperation within institutional networks.<sup>3</sup> With the words of other author the EU administration in functional sense is the combination of division of state powers, cooperation and vertical division.<sup>4</sup>

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<sup>1</sup> Lőrincz Lajos: European Integration – Hungarian Public Administration (Magyar Közigazgatás, June 1998, p. 403)

<sup>2</sup> Prof. Dr. Eberhard Schmidt – Assmann: The Cooperative and Subordinated Model of European Administration (Európai Jog 2003/3 p.9)

<sup>3</sup> Alberto J. Gill Ibanez: The Execution and Supervision of Community Law (Osiris, Budapest, 2000. p.281)

<sup>4</sup> Prof. Dr. Eberhard Schmidt – Assmann (i.m., p.10)

For this reason the European Union and its institutional system does not (only exceptionally) exercise direct control over the public administration of Member States. Nevertheless it is certain that there is a continuous, extensive and more and more vigorous tension on the Member States on one hand through the 'acquis communautaire' implicitly and on the other through the EU Law more precisely Article 10 of the Treaty of Rome that explicitly obliges the Member States on the way that is also often referred to as result obligation by the civil law. This result obligation is composed of the assertion of three requirements: reliable, understandable and democratic member state administration.<sup>5</sup> What are these concepts referred to? The Member States can organise their own public administration without outer influence viz. there is no reason for talking about administrative acquis. In general it is indifferent for the EU what kind of structural solution and functional method the national administrations do apply and civil service they own. There is one thing that counts: public administration shall entirely and properly fulfil the obligations deriving from the EU in order to achieve the social, economic and political objectives set up by the Community. The emphasis is on the reach and realization of the common goals, eventually on the efficient adaptation and prevails of *acquis communautaire*. In favour of this the EU primarily requires a reliable structure and operation of the national administration (viz. EU measures shall be implemented into national legal systems in time and authorities shall effectively apply them in fact, moreover the smooth control of their obedience and the adjustment of legal disputes with appropriate means shall be ensured).<sup>6</sup> Reliance involves the different units of effectiveness: accuracy, haste, dynamic adoptability and contribution to the economic integration as main EU objective.<sup>7</sup>

On the other hand EU requires an understandable Member State administration. Unambiguous coterie of administrative organs keeps relation with the EU institutions. The different levels of decision making and the competences shall be precisely laid down and defined furthermore the scope of the different institutions shall form an integrant network of competences without any 'void' or overlap.<sup>8</sup>

Finally the democratic functioning of the national administration system stands as the third EU requirement. The demand for the democracy refers to the rule of law, protection of human rights and fundamental freedoms, political plurality, popular democracy, neutrality of the civil service and those possessing executive power, stability of legal measures and calculable administration.<sup>9</sup> As a conclusion we can say that there is not any compulsory model in existence for a unified European administration prescribed by the EU, but concerning Member States' administration we must not forget about the unified values and requirements that do prevail.<sup>10</sup>

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<sup>5</sup> See in details Jacques Forunier: *The Reliable Administration* (Magyar Közigazgatás October 1997)

<sup>6</sup> Jacques Forunier (i.m., p. 631)

<sup>7</sup> Lőrincz Lajos (i.m., p.404)

<sup>8</sup> Soós Edit: *The Decision Making Mechanism of Self-government in the EU* In: *EU-integration Self-governments* See (edited by Csefkó Ferenc) *Önkormányzati Szövetségek Tanácsa*, Budapest, 1998, p.61)

<sup>9</sup> Lőrincz Lajos (i.m.)

<sup>10</sup> Torma András: *Supplements to EU Administration* (Magyar Közigazgatás, 2/2002, pp.82-83)

### Third Thesis

Each Member State has an unique public-administration that is specific to the country, however the unified implementation obligations of Community law and the other requirements of EU cited above, have resulted in a special kind of convergence of Member State administration viz. a special way of approach to each other.

In details

For the above mentioned reasons on the one hand we can declare that each EU Member State has its own individual public administration therefore there is not any compulsorily prescribed and unified 'Brussels-like' model. On the other hand these individual administration are still greatly similar since all of them take part in the legislation process of the EU law and in its implementation and enforcement, moreover all of them are reliable, understandable and democratically functioning. Considering the treble division of Member State administration (central, regional and local) the concept of being greatly similar means the following:

**A.) In the field of central administration:**

Each Member State has evolved its own structural solution dealing with community (European) matters, but none of them has established a so-called Ministry of EU Affairs. The different solutions on the field of dealing with EU matters attained by the Member States can be grouped into two categories: the ones with centralized and the ones with the decentralized model. The essence of the decentralized model is that each supreme authority (ministries) has its special department dealing solely with EU affairs. In this case the main task that forms the cardinal problem at the same time is coordination (G.D.R., Spain). With regard to the centralized model a central organ is set up therein representatives are delegated by the supreme authorities. This organ stands under the direct control of the Prime Minister's Office (like in France) or even of the government (UK).<sup>11</sup>

**B.) In the field of regional administration:**

A determining common feature on the one hand is regionalization and strengthening of self-governments in intermediate level while on the other hand in strong coherence with it stands the significant decrease in the number of mid-level units and the great growth of its population.<sup>12</sup> The reason for the strengthening of regionalization - as an economic, social and political process - are marked as the following by the scientific literature: the appearance and headway of ethnic movements, the impact of new social controlling functions (e.g. requirements of decentralization), representation of regional interest and the regional policy of the European Community are considered as the main reasons of strengthening of regionalization.<sup>13</sup> Regionalization can be also regarded as an attack against

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<sup>11</sup> Török Éva: The Connection between the Development of Administration and Legal Harmonization within the Europe Communities (Magyar Közigazgatás, January 1994, p.38)

<sup>12</sup> The number of the mid-level territorial units reduced from 531 to 320 between 1956 and 1995 while their population increased from 468 000 to 1 159 000 in general. Source: Horváth Gyula: European Regional Politics (Dialóg Campus, Budapest – Pécs p.305)

<sup>13</sup> Horváth Gyula (i.m. pp.319-326)

the national states coming from underneath since it forces the central power to locate its competences ‘downwards’ to regional level that are positioned under national state level. That is notable in particular as in the second half of the 20<sup>th</sup> century in other significant economic and political process the European integration took place with the same result, but opposite approach. The European integration similarly to the regionalization leads to the weakening of central power as it results in the transfer of duties and competences of national states towards (‘upwards’) the Community institutions. Therefore integration can be regarded as an attack against the national states coming from above.

We can state - beside the outer obligations (e.g. globalization) – the national states have stood between the dual wrings of regionalization and integration since the second part of the 20<sup>th</sup> century. Regionalization demands for the decentralization of the tasks and competencies and resources of central state organs namely they should be set to the regions. On the contrary, the integration demands for settling these tasks and competencies to the institutions of European Communities and European Union. The result of this contradictory process is the gradual elimination of national state from the map of Europe. With other words this process can be described as the born of a new Europe, a European supranational state which is not fragmented by internal frontiers.

C.) In the field of **local and self-governmental administrative organs** we can outline the following common features:

- ◆ self-governmental administration is multi-levelled in general and the certain levels are not subordinated to each other but rather horizontally divided,
- ◆ self-governments exercise general competence hence they take measures on a wide range of local matters,
- ◆ it is the feature of service that predominates during the operation of administration and the vast majority of their activities is embodied in the coordination of different institutions operating in the local area,
- ◆ self governments are headed by a political body directly chosen by the local people whose work is assisted by a professional executive apparatus,
- ◆ a clear-cut demarcation line can be drawn between the staff and organs of self-governments with political nature and the ones with administrative nature,
- ◆ self-governments break out of their national frames and start building up extensive international relations.

#### **Fourth Thesis**

With the Treaty of Amsterdam (1997) and the Copenhagen Criteria which was destined for the insurance of the accession of Eastern-European post-socialist countries – through containing the requirements of the accession – the EU has made a decisive step towards the establishment of a homogenised European Administrative Space similarly to the carrying out of free trade.<sup>14</sup>

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<sup>14</sup> Czuczai Jenő: Public Administration and European Integration (Magyar Közigazgatási Jog Különös Rész (edited: Ficzer Lajos) (Osiris, Budapest, 1999 p.447)

In details:

In theoretical sense the European Administrative Space is the value synthesis of the Member State administrative systems and practice based thereon.<sup>15</sup> The main features are outlined hereinafter:

- ◆ political stability viz. prevail of the principle of rule of law: the uphold of such a legal system that ensures the division of different state powers, the functioning of a democratic institution system and the prevail of basic human rights and freedoms,
- ◆ sustainable and environmental-friendly economic development wherein solidarity stands as a determinant factor,
- ◆ declining authorities of national representative bodies (parliaments) and strengthening role of administration,
- ◆ predominance of the principles of ‘good governance’ – openness, participation, effectiveness and coherence- shaped by the Commission at Community, Member State and local level,<sup>16</sup>
- ◆ maintenance and operation of the public sector that perform its duties in a lawful and effective way to the satisfaction of the public,
- ◆ armed forces and organs keeping the public order functioning within legal bounds under political direction but in a politically neutral way,
- ◆ uphold of an independent judicial system obeying the rule of fair proceedings,
- ◆ prevail of the principle of decentralization, subsidiary and solidarity and as a consequence the strengthening of sub-national and supranational organs on the burden of state organs at national level on the one hand and reduction and gradual compensation of differences in the development of regions on the other hand,
- ◆ reliable, understandable and democratic administration,
- ◆ the existence of such legal institutions and operational rules that ensures the obtain of common objectives,
- ◆ mutual approach of legal administrative style realized in some of the Member States (e. g.: France) and the pragmatic administrative style (UK),
- ◆ stable, predictable, competent, skilled, professional and impartial civil service.<sup>17</sup>

The document on ‘good governance’ rises above these specifications concerning its importance hence it is reasonable to have a look at it in details.

As we can read it in the White Paper the transformation of the EU administrative system stands as the main purpose of its publishing in order to promote the approach of EU institutes towards the EU citizens through the coherence of EU policies.

The European Commission underlined the fact that the transformation of its work solely is far not enough for the attainment of ‘good governance’ outlined in the document. The effort of the further EU institutes namely the Member States and candidate countries as well as

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<sup>15</sup> Czuczai Jenő (i.m. p.446)

<sup>16</sup> See: White Paper on European Governance (2001)

<sup>17</sup> See in details Heinrich Siedentopf – Christoph Hauschild: European Integration and Self-administration of Member States (Közigazgatási-tudományi Antológia Second Edition (edited Lőrincz Lajos) (Unió, Budapest, 1994) See further: Dr. Józsa Zoltán: Coherence in the European Administrative Space (Magyar Közigazgatás, December 2003) Verebélyi Imre: Effect of the European Union on National Administration and Governance II (Magyar Közigazgatás August 2001)

their self governments are also highly needed. So the White Paper functions as a compass as well not only for the Commission but also for the other participants of EU legislation and execution.

The White Paper stated the position of EU as an initial point referring to both positive and negative elements. Among the positive elements it was outlined that the European Communities provided peace, stability and an almost undiminished economic growth and democratic functioning in the past 50 years. As to the negative critics it referred to the fact that the EU had become an estranged system of institutes in the eyes of several people of which functioning is not clear on the one hand while on the other the EU does not adopt effectively to new circumstances like unemployment, crime and global political changes.

After analysing the current situation the Committee proposes the solution as well that is the realization of the five principles of 'good governance'- openness, participation, effectiveness and coherence. The Commission points out again the necessity of predominance of these principles within the operation of other Community institutions, Member States, candidate countries and within their local governments. The principle of openness requires the institutions to create a more open-minded and fenceless way of operation from the present one. The causes of their acting and their decisions taken shall be accessible to everyone in an appropriate form and clear way. The principle of participation creates the ground for decisions and strengthen the confidence of citizens placed in the institutes as it grants the citizens and other institutes the right of having a say in the decision making process. That is the reason why we should deprive the certain Community institutes of their exclusive right of decision making as a prerogative. The principle of accountability refers to the fact that each institute is obliged to interpret the reason of its action towards the public and to take responsibility of its agency and misconduct. The principle of effectiveness involves three requirements against the institutions. The different policies shall be realised in time through clear aims with special attention to experiences from the past and to possible future effects. The decisions taken and their consequences shall always be commensurate with the objectives (proportionality). Decisions shall be taken at appropriate level thus the principle of subsidiary can prevail. The principle of coherence is responsible for the effectuation and ascertain of concordance between the various fields of cooperation of institutes. As the document words we need to realize that the changes taking place in the World are more and more complicated thus the answers to them need to be properly complex (coherent) as well.

At the end of the White Paper the Commission outlines the urgent necessity of the transformation of EU institutional system. It has to be clear, understandable, accessible and open. In favour of these objectives the following actions should be taken:

- a clear-cut separation of legislative and executive duties similarly to national states. In the decision making process the Council and European Parliament shall participate as equal parties and the Commission shall gain absolute executive responsibility,
- the spheres of competences between the European Union and Member States shall be clearly divided. Everyone's duty shall be visible in front of the public.

### Fifth Thesis

A new tendency has emerged in recent years having a forceful tension in Member States' administration. Mainly we refer to certain primarily sources of EU Law that are in connection with regional policy.

In details:

We would draw attention to two decrees. The first one is the 1059/2003/EC decree (26<sup>th</sup> May 2003) of European Parliament and the Council on the establishment of common classification of territorial units and the second one is the 1083/2006/EC decree of the European Council on the lay down of general rules of Development Fund, the European Social Fund and the Cohesion Fund and on the repealing regulation of 1260/1991/EC decree.

A.) The Unified Territorial Statistical Classification System – from 2003 the Nomenclature of Territorial Units for Statistics - is an essential instrument for the implementation of EU regional policy. The main purpose of its establishment - in 1988 - by the Statistical Authority of European Communities (Eurostat) was to enable the comparison of statistical data of different geographical territories. On the ground of this system it is easier to define the economically underdeveloped regions and also makes the allocation of financial aid more equitable. Actually the NUTS system served (and serves even today) for demarcating the regions entitled for utilization of Community supports. This task is carried out through collecting, compiling and spreading of comparative statistics.

Five levels are separated within the NUTS system, three are regional and two are local. Pursuant to the 1260/1999/EC decree of the Commission on the sources of Structural Basis that aimed the achievement of regional policy were typically available for NUTS 2 areas (regions).

The NUTS system and its functioning were not legally regulated until 2003 as there were not any special sources of law that would have contained measures on it. This inadequacy was ceased by the 1059/2003/EC decree (26<sup>th</sup> March 2003) of European Parliament and the Council on the establishment of Nomenclature of Territorial Units for Statistics (NUTS). Article 2 of the provision divides the countries of Member States into territorial units within the frames of NUTS sorting and also destine a unique name and code to each unit. The introduction of NUTS system represents a breakthrough concerning the relation of the Community and Member States. Through this decree the Council regulated those questions that had belonged to internal affairs – to the sovereignty - of Member States. In our opinion this legal provision has interfered into the public administration of Member States in a highly forceful manner as it compulsorily determines the disposition and subdivision of Member State administration. Though decisions are taken by ministers of Member States in the European Council and decision preparation process takes also place mainly in the Member States it still does not change the situation.

NUTS classification is a hierarchical nomenclature that divides all Member States into NUTS 1 territorial units that are further divided into NUTS 2 ones and finally they are subdivided into NUTS 3 territorial units. According to Article 3 and Appendix 1 of the decree each Member States territory is classified into NUTS 1, NUTS 2 and NUTS 3 levels depending on the number of permanent inhabitants of the certain territory. NUTS 1 consists



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of territories with at least three but at most seven millions inhabitants, the population of NUTS 2 regions vary between eight hundred thousand and three million. While NUTS 3 composed of at least one hundred-fifty thousand and eight hundred thousand dwellers. These units are supplied by a concrete name and code besides the classification. The number of the entire population of the Member State lays under the threshold of the given NUTS unit the state forms only one unit on that certain level. In their competence Member States are entitled to create further divided hierarchical, territorial units subdividing NUTS 3 levels. The already existing administrative units serve as the basic criterion of classification. Administrative unit is well defined geographical territory with administrative authority that owns political or administrative decision making competence within the legal and institutional frames of that certain Member States. The previously existing administrative units used for NUTS classification are defined by the Appendix 1 with reference to its original naming. Appendix 2 of the decree contains these naming used by the Member States at each level. It may happen that a Member State is in lack of an appropriate sized administrative unit that could be set within the above mentioned criterions. In that case the appropriate number of the original and neighbouring administrative district is united in order to receive the absence of NUTS level. This unification process shall take place with special attention to geographical, socio-economic, historic, cultural and environmental features. The name of this tightened territory is 'non-administrative unit'. It is worth mentioning that the size of this unit shall also fit the population restrictions of NUTS system.

With the issue of 1059/2003/EC Decree the possibility of Member States for creating the unique territorial division in compliance with their preferences and interest in order to access community funds simply ceased to exist. Since 2003 the modification of this provision viz. the contribution of all Member States is needed for the creation of new NUTS 2 territories (regions) which is the target zone of Community development funds. In this consent the 1059/2003/EC Decree not only determines the territorial structures, but also keeps them constant.

**B.)** The 1083/2006/EC Decree of the Council fully defines the type of institution system that the Member States are obliged to set up and operate in order to guarantee the proper way of utilization of development funds. We need to mention this question is regulated by many other articles of the decree beside the ones in Chapter 6 exclusive of the principles of utilization. Partnership, execution at local level, divided direction, conformity and coordination just to mention are the most important ones. The institutions set up by this decree are destined to ensure the prevail of the above mentioned principles in a determinant, but obviously not exclusive way. The regulation makes clear that Member States are responsible for the accomplishment of Operative Programs which provide a frame for the appropriation of development funds. This responsibility includes the setting up and operation of Directing and Controlling Programs. The European Commission merely oversees the functioning of Member States institutes and applies sanctions in the case of misconduct.

**B.) 1.) The management and controlling system**

The binding elements of the institutional system – in particular supervision authority, justificatory authority and controlling authority – are termed in Article 59 of the Decree while the further articles put down the duties of certain institutes.

The Controlling Authority is a national, regional or local authority and constitutional or private organs respectively appointed by the Member State. Their task is the supervision and enforcement of the given operative program in accordance to the principle of effective and successful management of finances. The Controlling Authority reports annually on the execution of the operative program to the European Commission till 30 June from 2008.

The Justificatory Authority is a national, regional or local authority appointed by the Member State. Its main task is to check and verify the statements and the remittance petitions concerning the attainment of certain projects from the Operative Program before the Commission would receive it.

The Supervision Authority is a national, regional or local authority appointed by the Member States being independent from the controlling and justificatory authorities in a functional sense. Its duty is to ensure the sufficient way of operation of controlling and supervision system of certain Operative Programs. The Decree provides wide freedom for the Member States in accordance with the institutional system.

As it enables that an authority shall be appointed for several Operative Programs.

Certain or all of the authorities can be set up within the frames of one administrative organ.

The authorities may decide on the regulations of their connection with the European Commission on their own.

Member States are allowed to appoint one or more sub-organs for helping the work of the Controlling and Justificatory Authorities.

It is important to outline that Member States are obliged to present their report on the directing and super visioning system evolved by them to the Commission before the petition for the first interval out payment, but not later than one year from the acceptance of the Operative Program. An expertise has to be enclosed to this report issued by an independent authority which evaluates the established institution system and proclaims whether it fits the criterions set in the Decree. If the Commission makes reserve, Member States are to do the necessary corrections.

**B.) 2.) The Monitoring System**

Regarding the phrases of EU regional policy controlling and monitoring are not synonymous words. We can make difference between these concepts on the ground of five viewpoints: objective, their nature relating to time, the way of their functioning, staff and the method of feedback. Regarding these viewpoints the main objective of monitoring is the examination of realization with special respect to the target. The nature of its time is continuous and the way of functioning is operative. The person doing this activity is outer and the method of feedback is assistance and correction. In comparison with this the main aim of controlling is examination of adequacy to rules, the nature of time is continuous, the way of functioning is operative, the person doing this activity is outer or internal and the method of feedback is the use of sanctions.

Article 63 of the provision declares that Member States area obliged to set up Monitoring Committees for each Operative Program in compliance with the Controlling

Authority. At the same time, it is possible for a monitoring committee to be attached to several Operative Programs. The main duty of this committee is the continuous follow-up and assistance of the fulfilment of a certain Operative Program. The high standards of fulfilment are ensured by the Controlling Authority and the Monitoring Committee together.

The combination of the committee is determined by Member States concert with the Controlling Authority, but it is always the representative of either the Member State or the Controlling Authority who presides over the Committee. One delegate of the European Commission shall take part in the job as an expert on his or her own initiative or upon the request of the Monitoring Committee.

It is worth to mention that the establishment of Controlling Authority (es), Justificatory Authority(es), Supervision Authority(es) and Monitoring Committee(s) is compulsory for each EU Member State who wishes to share from the Community development funds. As a result of this the EU regional policy contributes to the approach of the Member States public administrative system in a great extent with consideration to the fact that NUTS system does the same in the aspect of territorial division. After the formation of free market these factors strive to facilitate the evaluation of integrated European Administrative Area.

### Sixth Thesis

The unified geographical territory without internal frontiers and the existence of an also unified European citizenship, the partly achieved free market, economic-monetary union that the Member States have already called into existence necessarily demands for the unification of execution of Community tasks.

In details:

Concerning our point of view the present situation according to which the single elements of administrative cycle and the institutions applying them in EU matters are disrupted cannot be maintained for long.<sup>18</sup> Namely programming, orientating, planning, decision making, coordinating and controlling carried out at EU level through Community institutions while the performance of decision at Member State level through Member State (national) institutions 'a la demand de jure' in a unified way de facto in 27 ways.<sup>19</sup> So what we state is that economic-monetary and political integration has to be followed by a kind of administrative integration, viz. a more dynamic unification of the administrative systems of Member State from the present one even it (might) represent more painful lost for the Member States fearing for their sovereignty than economic integration.

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<sup>18</sup> On the Accomplishment of the Separate Elements of the Administrative Cycle See Essay of Torma András: Attempt on the Describe of the Scientific Model of Administration of EU Institutions Operation (Magyar Közigazgatás July-August 2002)

<sup>19</sup> On the Administrative Cycle and its Separate Elements See in Detail Kalas Tibor: The Administration In: Magyar Közigazgatási Jog Általános Rész I. (edited Kalas Tibor) (Virtuóz, Budapest, 2004 pp.918)



## GROWING IMPORTANCE OF FAMILY LAW IN COMMUNITY LEGISLATION\*

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### Foreword

The growing mobility of citizens within the European Union has led to an increasing number of international couples, i.e. spouses of different nationalities, spouses who live in different Member States or who live in a Member State in which one or both of them are not nationals. In view of the high number of the divorces<sup>1</sup> within the European Union, a great number of citizens face the problems concerning applicable legislation, jurisdictional matters and child custody each year. Please note that Community rules on this matters apply only to the so-called *cross-border cases*. In the “new” EU the number of divorces has

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<sup>1</sup> Divorce is possible in all countries except Malta. The oldest regulations were made in Iceland, where divorce has been possible since the 16th century. In France divorce was introduced in 1791 and in Luxembourg in 1794. In Austria, Belgium, Denmark, Finland, Germany, Hungary, Netherlands, Norway, Slovak Republic, Sweden, Switzerland and England and Wales, divorce was made possible in the 19th century. In Ireland (1995), Italy (1970), Liechtenstein (1974), Portugal (1975), Spain (1981) and Scotland (1976), divorce has only been possible since relatively recently. In almost all countries divorces are registered at the court. Iceland, Cyprus and Ireland are the only exceptions. A number of countries also register the divorce on the marriage certificate, or on the birth certificate. In Sweden the information about divorces is sent to the Tax Authority, which forwards it to the Swedish population register. In all countries decisions about divorces are taken by the court. However, for a number of countries additional remarks can be made:

- in Portugal a decision can be taken by the civil registrar if both spouses agree to getting a divorce. In most countries, structural disruption of the marriage and no prospect of reconciliation are necessary conditions for a divorce;

- in Austria, Belgium, Bulgaria, Denmark, Iceland, Latvia, Liechtenstein, Lithuania, Luxembourg, Spain and United Kingdom, adultery is a reason to grant a divorce;

- only in four countries (Czech Republic, Ireland, Slovak Republic and Spain) is a lower limit of marriage duration set;

- in 15 countries (Austria, Czech Republic, France, Germany, Iceland, Ireland, Italy, Liechtenstein, Lithuania, Norway, Poland, Slovak Republic, Spain, Switzerland and United Kingdom), there are regulations regarding the minimum period that the spouses must have lived apart in order to have a divorce granted. This minimum period varies widely among countries.

Seven countries (Bulgaria, Czech Republic, Ireland, Norway, Slovak Republic, Slovenia and Spain) require proper provisions for dependent children before a divorce is granted.

[www.eurostat.ec.europa.eu](http://www.eurostat.ec.europa.eu)

almost quadrupled since 1960.<sup>2</sup> In 2002 there were 863 000 divorces across the Member States of EU.<sup>3</sup>

### 1. Short history of regulating family law in the Community Legislation

The entry into force of the Amsterdam Treaty was followed by the harmonization of the civil substantial and procedural law and some harmonized areas included the area of *family law*. The family law harmonization focuses mainly on the *matrimonial matters* and the *parental responsibility*. In order to create harmonized rules in this area, the Member States signed the *Convention on Jurisdiction and the Recognition and Enforcement of Judgments in Matrimonial Matters*<sup>4</sup> (hereinafter referred to as: the “Convention”) after the Amsterdam Treaty was signed, but before it entered into force. The subject and the structure of the Convention was very similar to the Brussels Convention of 1968, thus, legal works started to call it Brussels II. However, this international agreement could not enter into force, since due to the growing Community dimension of matrimonial matters, *Council Regulation No 1347/2000/EC* on Jurisdiction and the Recognition and Enforcement of Judgments in Matrimonial Matters and in Matters of Parental Responsibility for Children of Both Spouses<sup>5</sup> entered into force.

The reason for the fact that an *international agreement* containing the rules on jurisdiction and the recognition and enforcement of judgment was followed by a Community legislation on the same rules, is, that the *scope* of the Brussels Convention *did not include cases concerning the personal status*. Although in the beginning of the 90’s, negotiations started on the extension of the scope of the Brussels Convention of 1968 to matrimonial matters (including especially divorces), and, as a result of such negotiations, a Working Committee was established in 1993, the draft prepared by the Working Committee set out the objective to draft – on the basis of the Brussels Convention of 1968 - a *separate* convention on matrimonial matters. French and Spanish legal experts initiated that a future convention must regulate parental responsibility issues as well, and such initiatives were accepted.

On 3 July 2000, France initiated the amendment of Council Regulation 1347/2000/EC. The purpose of the initiative was to extend the scope of the Regulation to all *decisions* concerning parental responsibility and the guarantee of the equal rights of children. The purpose of the “*French Initiative on the Rights of Access to Children*”<sup>6</sup> was to extend the unified rules on jurisdiction and the mutual recognition and enforcement to cases of parental responsibility where the legal dispute on the parental responsibility is *independent* from the matrimonial action. The initiative set out that unified rules on jurisdiction are not enough; there is a need for rules on other issues being a result of the deterioration of the

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<sup>2</sup> More details: Helen Stalford: Regulating Cross-National Divorce, Child Contact and Residence in the European Union, [http://www.ciimu.org/webs/wellchi/reports/workshop\\_1/w1\\_stalford.pdf](http://www.ciimu.org/webs/wellchi/reports/workshop_1/w1_stalford.pdf) (date of query: 03.10.2008)

<sup>3</sup> Source: [www.eurostat.ec.europa.eu](http://www.eurostat.ec.europa.eu)

<sup>4</sup> Convention on Jurisdiction and Recognition and Enforcement of Judgments in Matrimonial Matters: Official Journal of the European Union, 16 July 1998.; C221.

<sup>5</sup> Official Journal 2000/06/30 p. 19-29.

<sup>6</sup> Initiative of the French Republic with a view to adopting a Council Regulation on the mutual enforcement of judgments on rights of access to children.

marriage, such as parental responsibility, custody of children and right to access children, since there are no unified rules on such issues and enforcement of judgments in another Member State are not guaranteed.

As a result of the French initiative, the Council repealed Regulation No 1347/2000/EC and enacted *Regulation No 2201/2003/EC* (hereinafter referred to as the “Regulation”), which contains rules on the jurisdiction and the recognition and enforcement of judgments in matrimonial matters and matters of parental responsibility<sup>7</sup>. The Regulation entered into force on 1 March 2005. However, this Regulation did not satisfy all the needs and it turned out to be incomplete in several respects.

The European Council has invoked the question of *applicable law to divorce* on two occasions. The European Council in Vienna requested in 1998 that the possibility of drawing up a legal instrument on the law applicable to divorce be considered within five years of the entry into force of the Treaty of Amsterdam. More recently, the European Council called upon the Commission in November 2004 to present a Green Paper on the conflict-of-law rules in matters relating to divorce in 2005. So in the spring of 2005, a *Green Paper on applicable law and jurisdiction matters in divorce matters*<sup>8</sup> was enacted, which sets out and supports with studies the lack of the due process of law and accountability and criticizes some of the rules of the Regulation. With regard to the critiques, the Council suggested the amendment of the jurisdictional rules of Regulation 2201/2003 and the introduction of new rules on applicable laws in matrimonial cases<sup>9</sup>.

The overall objective of the Proposal for a Council Regulation amending Regulation (EC) No 2201/2003 is to provide a clear and comprehensive legal framework in matrimonial matters in the European Union and ensure adequate solutions to the citizens in terms of legal certainty, predictability, flexibility and access to court. The current situation may give rise to a number of problems in matrimonial proceedings of an international nature. The fact that national laws are very different both with regard to the substantive law and the conflict-of-law rules leads to legal uncertainty. The great differences between and complexity of the national conflict-of-law rules make it very difficult for international couples to predict which law will apply to their matrimonial proceeding. The large majority of Member States do not provide any possibility for the spouses to choose applicable law in matrimonial proceedings.

The Proposal would amend the Regulation (EC) No 2201/2003 at the following objectives:

1. Strengthening legal certainty and predictability
2. Increasing flexibility by introducing limited party autonomy
3. Ensuring access to court in matrimonial proceedings
4. Preventing “rush to court” by one spouse<sup>10</sup>

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<sup>7</sup> Council Regulation No 2201/2003/EC concerning jurisdiction and the recognition and enforcement of judgments in matrimonial matters and the matters of parental responsibility, repealing Regulation (EC) No 1347/2000

<sup>8</sup> Green Paper on applicable law and jurisdiction matters in divorce matters on 14 March 2005; COM (2005) 82., 2005.03.14. [www.europa.eu](http://www.europa.eu)

<sup>9</sup> Proposal for a COUNCIL REGULATION amending Regulation (EC) No 2201/2003 as regards jurisdiction and introducing rules concerning applicable law in matrimonial matters (presented by the Commission) {SEC(2006) 949} {SEC(2006) 950} [www.europa.eu](http://www.europa.eu)

<sup>10</sup> More details: Proposal for a COUNCIL REGULATION amending Regulation (EC) No 2201/2003 as regards jurisdiction and introducing rules concerning applicable law in matrimonial matters

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## 2. Scope and new terms of the Regulation (EC) No 2201/2003.

The scope of the Regulation is restricted only to procedures concerning the legal separation of spouses, divorce and marriage annulments. The Regulation *does not govern* on the grounds for divorce, culpability, property consequences of marriage, child support or other ancillary measures, although these issues are closely related to issues set out in the Regulation. Rules on the child maintenance are set out in Council Regulation (EC) 44/2001.

The scope of the Regulation does not include *procedures of a religious nature*, which gain importance due to the migration (e.g. Islam or Hindi marriages)<sup>11</sup>. The Regulation does not set out the *maximum age of the child* (over parental responsibility) belonging to the scope of the Regulation, but leaves space for the national legislation to determine the maximum age of a child that can be under parental responsibility. In general, persons under the age of 18 come under the scope of the Regulation. Persons under the age of 18, who became adults by getting married, constitute an exception from this general rule<sup>12</sup>.

One of the Regulation's greatest merits is that, with regard to the different matrimonial rules of the Member States<sup>13</sup>, it defines – opposite to Regulation (EC) 1347/2000 and the Convention<sup>14</sup> – all terms and expressions it uses for matrimonial issues. On the basis of the above, the Regulation clearly sets out the definition of the “*right of custody*” (Point 9 of Article 2.), which includes rights and duties relating to the care of the person of a child, and in particular the right to determine the child's place of residence. The “*right of access*” (Point 10 of Article 2) means in particular the right to take a child to a place other than his or her habitual residence for a limited period of time (e.g. for the purpose of access to the child).

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(presented by the Commission) {SEC(2006) 949} {SEC(2006) 950} [www.europa.eu](http://www.europa.eu)

<sup>11</sup> Explanatory Report on the Convention, drawn up on the basis of Article K.3 of the Treaty on European Union, on Jurisdiction and the Recognition and Enforcement of Judgments in Matrimonial Matters (approved by the Council on 28 May 1998) prepared by Dr. ALEGRÍA BORRÁS Professor of Private International Law University of Barcelona (98/C 221/04) The Borrás Report; Point (20) B.

<sup>12</sup> Practice Guide for the application of the new Brussels II Regulation. Up-dated version. 2005.06.01. p. 8. Source: [www.europa.eu](http://www.europa.eu)

<sup>13</sup> See Article 2 of Council Regulation (EC) 2201/2003.

<sup>14</sup> The Working Committee drafting the Convention of 1998 could not agree on the definition of parental responsibility. As a result of this, interpretation of the parental responsibility was the duty of the court of the Member State which conducted the proceedings. In the Explanatory note, professor Borrás refers to international conventions, with special regard to the Hague Convention of 1996, where this term is used. Professor Borrás declares – in an optimistic way – that “to a certain extent it has unifying power”. Reference to the Hague Convention raised certain issues, since it could not be foreseen when Member States sign the Convention. The Working Committee was afraid that the lack of definition can raise problems when applying the Convention in practice, especially when recognizing judgment rendered in another Member State. Members of the Working Committee noted that there are significant differences among applicable legislations of Member States concerning several issues, such as “parental control”. In Sweden and Finland there are no similar terms at all. In: Maarit Jantera-Jareborg: Marriage Dissolutions in an Integrated Europe. In: Yearbook on Private International Law, Vol. I. 1999, Kluwer Law International, Swiss Institute of Comparative Law, p. 14.



The Regulation sets out the *rules on the jurisdiction concerning marriages* in Part II. Rules on the jurisdiction in *parental responsibility* cases are set out in a separate chapter.

### 3. Rules on jurisdiction in matrimonial cases, problems of enforcement

Jurisdictional rules are based on concept that there must be a connection between the affected party and the state of jurisdiction. Opposite from Council Regulation (EC)44/2001. (Brussels I.), Brussels II. Regulation does not set out the dual system of *general* and *optional* or *exclusive* jurisdiction. Under Section "General jurisdiction", it lists all grounds of jurisdiction that are classified according to the same rules.

On the basis of this, the jurisdiction lies with the courts of the Member State in whose territory the *spouses are habitually resident*, or the spouses were *last habitually resident, insofar as one of them still resides there*, or the *respondent is habitually resident*. In case of a joint application, the jurisdiction lies with the courts of the Member States in whose territory either of the spouses is *habitually resident*<sup>15</sup>.

We have to note that in the Regulation, the jurisdiction is based on the *habitual residency*, while in Council Regulation (EC) No 44/2001 concerning civil and commercial cases, the jurisdiction is expressly based on *residency*. Pursuant to Point 1 of Article 59 of Brussels I. Regulation "in order to determine whether a party is domiciled in the Member State whose courts are seized of a matter, the court shall apply its internal law".

Connected with the meaning of habitual residence a meditating question arised in the English judicature: habitual residence – one country or two?

Under the domestic definition of habitual residence it is possible to be habitually resident in more than one country at any one time. Therefore if a person divides their time between two different countries and can be said to live in both with a settled purpose, it will be held as a matter of domestic law that they are habitually resident in both. ECJ case law, the Borrás report and the wording of Brussels II (Revised) itself mean that "at any given time a person can have only one habitual residence for the purposes of the Regulation" (para 41). The wording focuses upon "the place or State, in which someone has the centre of his interests" (para 40). He concluded that "there can only be one such place, only one such centre" (para 40) and it would be "linguistically and conceptually inconsistent" (para 40) for there to be two simultaneous places of habitual residence.<sup>16</sup>

Legislators of Brussels I. Regulation *avoided* to set out habitual residency as ground for jurisdiction, because they wanted to prevent the multiplication of jurisdictions. The tried to specify jurisdictions so that there can be only one jurisdiction. Legislators of the Convention of 1998 were hesitating to refer back – similarly to the Brussels Convention (later to the above method of Brussels I) - to national rules regarding the establishment of the place of habitual residency, but finally they did not apply this method.

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<sup>15</sup> The applicant is habitually resident if he or she resided there for at least a year immediately before the application was made, or the applicant is habitually resident if he or she resided there at least for six months immediately before the application was made and is either the national of the Member State in question or in the case of the United Kingdom or Ireland, has his or her 'domicile' there. (Article 3.)

<sup>16</sup> Nicholas Allen: Where does our client live? Habitual Residence and Residence under Brussels II (Revised) after Marinós, <http://www.familylawweek.co.uk/site.aspx?i=ed1176> Lehívás dátuma: 2008-10-03

Jurisdictional rules concerning matrimonial cases are *non-hierarchical* and *optional*, thus in cross-border cases, they provide the opportunity for spouses to choose between several alternative jurisdictions. In practice, the plaintiff chooses the jurisdiction, in which the outcome of the dispute is the most favourable for him also considering the costs and duration of the legal dispute. Some legal experts are of the view that jurisdictional rules described above can stimulate *forum race*. Each of the spouses may feel it pressing that the matrimonial case is started by him or her, because with regard to both the merits of the case and other ancillary issues, they are aware that it is important which court of the Member State they file their petition to<sup>17</sup>.

When the Convention of 1998 was made public, some legal experts were of the view that it is not good to increase the number of forums and thus provide a choice for spouses among the different jurisdictions. However, legislators of Regulation 1347/2000/EC and the Regulation did not find such anxieties well-grounded and rules of the Convention were incorporated in Regulation 1347/2000 and the Regulation as well. The legislators declared that opposite to the purpose of the Amsterdam Treaty, connecting the elements for jurisdictions and establishing an order for choice of jurisdiction would have made “access to justice” difficult.

#### 4. Defects of the legislation in force

Following the entry into force of the Regulation, several anxieties were declared concerning the rationality of the rules on alternative jurisdiction. Further, the Regulation does not regulate the applicable law at all. When a lawsuit on dissolution of a marriage starts before a court of a Member State, the applicable law will be determined on the basis of the collision rules of such Member State. However, there are significant differences among the different collision rules of the Member States, therefore, it is difficult to determine the applicable law. Determining the applicable law is extremely difficult in cases when spouses do not have a common habitual residence or their nationality is different. In practice, this resulted in a “rush to court”, where spouses are stipulated to start the action for the dissolution of the marriage before each other at a forum which renders the most favourable decision for them. On the basis of the *Green paper*<sup>18</sup> published in 2005, the *Proposal for a Council Regulation COM (2006) 399*, would insert a new section to the Regulation providing the opportunity for spouses to choose among courts closely related to their marriage in their joint declaration (Article 3a)<sup>19</sup>.

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<sup>17</sup> Jantera-Jareborg op. cit. p. 35.

<sup>18</sup> Green Paper on applicable law and jurisdiction matters in divorce matters ; COM (2005) 82., 2005.03.14. [www.europa.eu](http://www.europa.eu)

<sup>19</sup> Providing spouses the opportunity to choose applicable laws:

- (1) Spouses may agree in joint declaration to designate the following laws for their divorce or legal separation, provided they have close relationship to the state the laws of which they have chosen:
  2. any of the jurisdictional grounds set out in Section 3 exist
  3. the last habitual residence of the spouses was there at least for the last three years
  4. any of the spouses is a member of that state or has “domicile” in the United Kingdom or Ireland.
- (2) The joint declaration on the jurisdiction shall be in writing and shall be signed by both of the spouses latest when seizing the court.

In addition to the above, the draft sets out the *applicable law* for the dissolution of marriages and the separation of spouses. The basis for the suggested rules is the choice of the spouses. In order to avoid that spouses choose jurisdictions to which they have no relations, the opportunity to choose would only include jurisdictions to which the marriage has close relations. In case spouses do not choose jurisdiction, the jurisdiction must be determined on the basis of certain factors that ensure that a jurisdiction which the marriage is related to is chosen<sup>20</sup> (e.g. jurisdiction of the state where the spouses are habitually resident or a state which spouses are citizens of).

### 5. Jurisdiction in cases concerning parental responsibility

Pursuant to Article 8 of the Regulation, the courts of a Member State have jurisdiction in matters of parental responsibility over *a child who is habitually resident* in a Member State at the time the court is seised (*general jurisdiction*). This means that if the habitual residency of the child changes, the courts of the Member State of the new habitual residence will have jurisdiction. Pursuant to the Regulation, this rule is in favour of the child.

However, in order to protect the rights of the child and the parent who has parental responsibility over the child, the Regulation sets out *rules on exclusive jurisdiction*, such as *retaining jurisdiction of the courts of the Member State of the child's former habitual residence* (Article 9.). Thus, if a child moves lawfully from one Member State to another and acquires a new habitual residence there, the courts of the Member State of the child's former habitual residence shall retain jurisdiction during a three-month period following the move for the modifying judgment on access rights issued in the Member State before the child moved, where the holder of access rights pursuant to the judgment on access rights continues to have his or her habitual residence in the Member State of the child's former habitual residence. The above rule on exclusive jurisdiction is explained to be useful, since "the modification of its earlier judgment to take into account the child's relocation is made by the court that is closest to the child, which allows for some continuity without nonetheless touching on the definition of the term "habitual residence""<sup>21</sup>.

Rights of custody and efficiency of the return of the child are guaranteed in Article 10 of the Regulation setting out detailed rules on the jurisdiction in cases of *child abduction*. Pursuant to Article 10, in case of *wrongful removal or retention of the child*, the courts of the Member States, where the child was habitually resident immediately before the wrongful removal or retention, retain their jurisdiction until the child has acquired a habitual residence in another Member State.

In addition to the above rules, the Regulation contains the guaranteed rules on the procedure of the request for return in case of a wrongful removal or retention of the child. If a person, institution or other body having rights of custody applies to the competent

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<sup>20</sup> See Preamble of Proposal for a Council Regulation amending Regulation (EC) No 2201/2003 as regards jurisdiction and introducing rules concerning applicable law in matrimonial matters {SEC(2006) 949} {SEC(2006) 950} /\* COM/2006/0399.

<sup>21</sup> Proposal for Council Regulation concerning jurisdiction and the recognition and enforcement of judgements in matrimonial matters of parental responsibility repealing Regulation (EC) No. 1347/2000. Com/2002/0222. Art. 11. In: Official Journal 2002/08/27 p. 155-178. Source: [www.europa.eu](http://www.europa.eu) Eur-Lex

authorities in a Member State to deliver a judgment in order to obtain the return of a child that has been wrongfully removed or retained in a Member State other than the Member State where the child was habitually resident immediately before the wrongful removal or retention, the below rules are applicable. The child must be given the opportunity to be heard during the proceedings unless this appears inappropriate having regard to his or her age or degree or maturity. The court must act expeditiously in proceedings on the application, using the most expeditious procedures available in national law. Except where exceptional circumstances make it impossible, the court must issue its judgment within six weeks after the application is lodged.

The Regulation sets out the rules on the *prorogation of jurisdiction*. Pursuant to such rules, if courts of a Member States have jurisdiction over matrimonial cases, their jurisdiction will be automatically prorogated for any matter relating to parental responsibility connected to the application (Article 12).

Under the title “*transfer to a court better placed to hear the case*”<sup>22</sup>, the Regulation provides the opportunity for courts having jurisdiction to the substance of the matter to transfer, in exceptional cases, to a court better to placed to hear the case, if they consider that a court of another Member State, with which a child has a *particular connection*, would be better placed to hear the case (Article 15). Such “particular connection” required for the transfer can be e.g. either the formal habitual residence of the child, place of the child’s nationality, the habitual residence of a holder of parental responsibility or the place where the property of the child is located. It should be emphasized that transfer is possible only in case of special circumstances.

## **6. Special procedural rules for parallel proceedings and ordering provisional measures**

Similarly to Regulation 44/2001/EC, time of the commencement of the proceedings, the time when the proceedings *is deemed to have started*, is of great importance. At the time of the commencement of the proceedings, it must be examined whether the child is a habitual resident in that particular Member State and also, time of the commencement of the proceeding is of great importance concerning the issue of pending at law. Opposite to the Convention of 1998 and Regulation 1347/2000/EC, the Regulation clearly establishes the time from when the procedures must be deemed to have started. Article 16 of the Regulation uses the expression: *seizing of a court*.

### **1. A court shall be deemed to be seized:**

(a) at the time when the document instituting the proceedings or an equivalent document is lodged with the court, provided that the applicant has not subsequently failed to take the steps he was required to take to have service effected on the respondent; or

(b) if the document has to be served before being lodged with the court, at the time when it is received by the authority responsible for service, provided that the applicant

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<sup>22</sup> The Regulation uses the expression: “*transferred to a court better placed to hear the case*” (Article 15)

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has not subsequently failed to take the steps he was required to take to have the document lodged with the court (Article 16).

It is very important to clarify the time of the commencement of the proceedings, when proceedings relating to divorce, legal separation or marriage annulment between the same parties are brought before courts of different Member States. Also, it is important to clarify the question of *lis pendens*, i.e. the court, which will be entitled to carry out the procedure. Similarly to Brussels I, the Regulation sets out the rules on *lis pendens*. Pursuant to Article 19:

1. Where proceedings related to divorce, legal separation or marriage annulment between the same parties are brought before courts of different Member States, the court second seized shall of its own motion stay its proceedings until such time as the jurisdiction of the court first seized is established.
2. Where proceedings related to parental responsibility relating to the same child and involving the same cause of action are brought before courts of different Member States, the court second seized shall of its own motion stay its proceedings until such time as the jurisdiction of the court first seized is established.
3. Where the jurisdiction of the court first seized is established, the court second seized shall decline jurisdiction in favour of that court.

In that case, the party who brought the relevant action before the court second seized may bring that action before the court first seized.

When examining the establishment of *lis pendens*, it must be difficult to determine the *identity of the parties* and the *identity of the object of the lawsuit*, however, I am of the view that the Regulation is easier to interpret than Regulation 44/2001/EC.

The Regulation takes over from Regulation Brussels I. the rules on exclusive jurisdiction in case of *provisional and protective measures*. Pursuant to these rules, in urgent cases, the provisions of this Regulation shall not prevent the courts of a Member State from taking such provisional, including protective measures in respect of persons or assets in that State as may be available under the law of that Member State, even if, under this Regulation, the court of another Member State has jurisdiction as to the substance of the matter (Article 20).

## **7. Recognition and enforcement of judgments pursuant to the Regulation**

Pursuant to *Article 21* of Chapter III of the Regulation, a judgment given in a Member State shall be recognized in the other Member States without any special procedure being required. This is, similarly to Regulation Brussels I. an *automatic recognition*, which can be denied only exceptionally, for a reason we all know very well from our international private law studies.

The Regulation sets out the grounds of non-recognition for judgments relating to matrimonial matters (Article 22) and the grounds of non-recognition for judgments relating to parental responsibility (Article 23). Both of the above Articles still contain a so-called *order public*, pursuant to which the recognition shall be denied if such recognition would be *manifestly contrary* to the public policy of the Member State in which recognition is sought. In Sweden for example, it is recognized that judgments rendered in another

Member State that apply the principle of culpability, are contrary to the public interest and thus, can not be recognized<sup>23</sup>.

Other reasons for non-recognition include if a procedure was carried out by violating fundamental principles of the Member State in which the recognition is sought, for example if – except for the case of urgency – a child is not given an opportunity to be heard or the judgment sought to be recognized is irreconcilable with an earlier judgment (*res iudicata*).

The Regulation sets out rules for differences in *applicable law* as well. Pursuant to these rules, the recognition of a judgment may not be refused because the law of the Member State in which such recognition is sought would not allow divorce, legal separation or marriage annulment on the same facts.

It is obvious that it would be against the principle of mutual trust, if the court of the Member State where the judgment is sought to be reviewed would be entitled to review the judgment as to its substance. Therefore, the Regulation prohibits the review as to the substance (Article 26). Some legal experts are of the view that such prohibition may be reasonable e.g. in case of judgments given in commercial cases, however it is very rigorous in e.g. matrimonial cases or change of the child's custody. It is extremely difficult to adjust such "rigorous and sudden" rules to the child's interests<sup>24</sup>.

Procedural rules on the enforcement are based on the Brussels Convention of 1968. Obviously, the Regulation sets out the enforcement rules only with regard to judgments on parental responsibility, while courts of the Member States are *only obliged to recognize* judgments on annulment of marriage and divorce. Pursuant to Point 2 of Article 21, *no special procedure shall be required for updating the civil-status records of a Member State on the basis of a judgment relating to divorce, legal separation or marriage annulment given in another Member State.*

A judgment on the exercise of parental responsibility given in a Member State shall be enforced in another Member State when, on the application of any interested party, it has been declared enforceable there (Article 28). In countries with continental system, judgments shall be declared enforceable with a so-called enforcement-clause, while in Great-Britain, judgments shall be declared enforceable by registration of a judgment for enforcement (Point 2 of Article 28). Detailed rules on the endorsement procedure are set out by the national legislations of the Member States. An application for a declaration of enforceability shall be submitted to the court appearing in the list notified by each Member State to the Commission pursuant to Article 68.

The procedure for making the application shall be governed by the law of the Member State of enforcement. The court applied to shall give its decision without delay. Neither the person against whom enforcement is sought, nor the child shall, at this stage of the proceedings, be entitled to make any submissions on the application. Under no circumstances may a judgment be reviewed as to its substance (Article 31). The decision on the application for a declaration of enforceability may be appealed against by either party. The appeal shall be dealt with in accordance with the rules governing proceedings in contradictory matters. The time for appealing depends on whether the applicant is habitual resident in the Member State where the declaration on enforceability was given. If the

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<sup>23</sup> Jantera-Jareborg op.cit. p.36.

<sup>24</sup> Jantera-Jareborg op. cit. p. 26

applicant is habitually resident in the Member State where the declaration on enforceability was given, the appeal against the declaration on enforceability must be lodged within one month and if not, it must be lodged within 2 months from the service thereof (Article 33). Regulation 44/2001/EC provides almost the same rules on enforceability.

Section 4 of Chapter III of the Regulation provides special rules on the enforceability of judgments concerning the *right of access* and judgments which require the *return of the child*. The rights of access granted in an enforceable judgment given in a Member State shall be recognized and enforceable in another Member State *without the need for a declaration of enforceability* and without any possibility of opposing its recognition if the judgment has been certified in the Member State of origin. The judge of origin shall issue the *certificate* using the standard form in Annex III only if:

- all parties concerned were given an opportunity to be heard;
- the child was given an opportunity to be heard, unless hearing was considered inappropriate having regard to his or her age or degree of maturity;
- where the judgment was given in default, the person defaulting was served with the document which instituted the proceedings or with an equivalent document in sufficient time and in such way as to enable that person to arrange for his or her defence.

The certificate shall be completed in the language of the judgment. Where the rights of access involve a cross-border situation at the time of the delivery of the judgment, the certificate shall be issued *ex officio* when the judgment becomes enforceable, even if only provisionally. If the situation subsequently acquires a cross-border character, the certificate shall be issued at the request of the parties (Article 41).

If the enforceable judgment orders the *return of the child*, the judgment will be enforced in another Member State in the same way as described above. In such case, there is no need for a declaration of enforceability and the recognition of the judgment can not be denied either. In the event that the court or any other authority takes measures to ensure the protection of the child after its return to the state of habitual residence, the certificate shall contain the details of such measures (Article 42.).

In connection with the territorial scope of the Regulation, we must note that two Member States of the European Union, Finland and Sweden attached a separate declaration to the Regulation (Annex VI) pursuant to which instead in their mutual relationships, they will *fully or partially* apply the Convention of 6 February 1931 and its Closing Protocol concluded between Denmark, Finland, Iceland, Norway and Sweden *instead of the rules of this Regulation*. Pursuant to Article 59(2)(a) of the Council Regulation concerning jurisdiction and the recognition and enforcement of judgments in matrimonial matters and matters of parental responsibility, repealing Regulation (EC) No 1347/2000, Sweden declared that the Convention of 6 February 1931 between Denmark, Finland, Iceland, Norway and Sweden comprising international private law provisions on marriage, adoption and guardianship, together with the Final Protocol thereto, will apply in full in relations between Sweden and Finland, in place of the rules of the Regulation (Annex VI). Finland made a similar declaration. The above means that rules of the regulation *are not applicable* for cross-border disputes between Finland and Sweden.

### Conclusions

Based on the above, we can establish that the Community Legislation made great achievements at the most important areas of family law (dissolution of marriage, child custody), but the current situation may give rise to a number of problems in matrimonial proceedings of an international nature. However, we must think forward and make further efforts on legislation of ancillary issues of matrimonial cases (such as e.g. claim for maintenance, matrimonial property law). I am of the view that we should move on faster than set out in the Hague Program because as Professor Borrás said in 1998 “ The issue of family law therefore has to be faced as part of the phenomenon of European integration.”<sup>25</sup>

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<sup>25</sup> Explanatory Report on the Convention, drawn up on the basis of Article K.3 of the Treaty on European Union, on Jurisdiction and the Recognition and Enforcement of Judgments in Matrimonial Matters (approved by the Council on 28 May 1998) prepared by Dr. ALEGRÍA BORRÁS Professor of Private International Law University of Barcelona (98/C 221/04) The Borrás Report; Point (20) B. OJ C 221, 16/07/1998. p. 0027-0064.



## ON THE PROTECTION OF BIODIVERSITY IN EUROPEAN LAW

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### 1. Introduction

Over recent decades, humanity has benefited enormously from economic development<sup>1</sup>, which has enriched our lives. However, much of this development has been associated with a decline in both the variety and extent of natural systems — of biodiversity.<sup>2</sup> This loss of biodiversity, at the levels of ecosystems, species and genes, is of concern not just because of the important intrinsic value of nature, but also because it results in a decline in ‘ecosystem services’ which natural systems provide. These services include production of food, fuel, fibre and medicines, regulation of water, air and climate, maintenance of soil fertility, cycling of nutrients. In this context concern for biodiversity is integral to sustainable development and underpins competitiveness, growth and employment, and improved livelihoods.

The European Union’s 25 Member States cover an area of over 4 million km<sup>2</sup> stretching from the Arctic Circle in the north to the warm Mediterranean waters in the south. From the wave-lashed Atlantic coast to the snow-capped Alpine peaks, the EU includes a vast range of natural habitats and a great diversity of flora and fauna. Our natural heritage includes several thousand types of habitat, 150 species of mammal, 520 species of bird, 180 species of reptile and amphibian, 150 species of fish, 10 000 plant species and at least 100 000 species of invertebrate. Yet, in comparison with other regions in the world, these numbers are relatively small. Europe is the most urbanized and, together with Asia, the most densely populated continent in the world. These factors have exacted a toll.

Despite the improved conservation policies introduced in the Member States, the EU’s precious ‘biodiversity’ – essential for supporting life on the planet – continues to be under serious threat. Poor planning, wasteful land-use and intensive farming methods have resulted over the years in the destruction of many natural habitats such as wetlands, which many wild species depend upon for their survival.

In Europe, 42% of native mammals 15% of birds, 45% of butterflies, 30% of amphibians, 45% of reptiles and 52% of freshwater fish are threatened. In north and Western Europe, some 60% of wetlands have been lost. Two-thirds of trees in the EU are under stress, while forest fires in the south continue to pose a problem.

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<sup>1</sup> See, e.g. Human Development Index trends, in UNDP Human Development Report 2005

<sup>2</sup> CBD Secretariat (2006) Global Biodiversity Outlook 2.

The EU has been involved in efforts to protect the continent's natural heritage for the past 30 years. The Sixth Environmental Action Plan (EAP), 'Environment 2010: Our Future, Our Choice', which sets out the EU's environmental policy agenda until 2010, highlights nature and biodiversity as a top priority, stating that responses must be found to the pressures from human activities on nature in Member States and the biodiversity it supports. The 6th Framework Programme<sup>3</sup>, complemented by Member States' research funding, has helped strengthen a European approach to biodiversity, land use and climate change research and improve scientific support to policy for the EU and its partner regions, in particular those of the developing world. However, much more is needed to fill critical knowledge gaps. A helpful assessment of research needs has been produced by the European Platform for Biodiversity Research Strategy. The 7th Framework Programme (FP7) provides opportunity to address these needs through cooperation, new infrastructures and capacity building. The MA has played a key role in bringing to political and public attention the current state and trends of biodiversity and ecosystem services globally. Important as this has been, there is currently no mechanism to ensure that this is regularly reviewed and updated.

It is also an important aim of the EU raising public awareness and engagement. The Community institutions, Member States and civil society have pursued a wide range of initiatives in this regard, including adoption of Directives on the Århus Convention, and the multi-stakeholder Countdown 2010 initiative.

In 2001, when EU heads of state and government launched the EU Sustainable Development Strategy in Gothenburg, they declared that the decline in biodiversity must be halted by 2010. A '2010 target' also exists at the international level: during the 2002 World Summit on Sustainable Development in Johannesburg, world leaders committed themselves to significantly reducing global biodiversity loss by 2010. The aim of EU policy is to reach these targets and to include nature protection into other policy areas, such as farming, fishing and industry. Two EU Directives deal with the conservation of European wildlife, focusing on the protection of sites as well as species. The 1979 Birds Directive identified 181 endangered species and sub-species for which the Member States are required to designate Special Protection Areas (SPAs). Over 3 000 SPAs have been designated to date, covering 7% of EU territory. As a result of this action, some severely threatened species are now beginning to recover. But there is still a lot of work to do before the European Union have the necessary SPA network in place to provide full protection for Europe's most vulnerable birds.

The 1992 Habitats Directive aims to protect wildlife species and their habitats. Each Member State is required to identify sites of European importance and to put in place a special management plan to protect them, combining long-term preservation with economic and social activities, as part of a sustainable development strategy. These sites, together with those of the Birds Directive, make up the Natura 2000 network – the cornerstone of EU nature protection policy. The Natura 2000 network already comprises more than 18 000

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<sup>3</sup> Decision No 1513/2002/EC, OJ L 232, 29.8.2002, p.1

sites, covering over 17% of EU territory. It is co-financed through the Commission's LIFE programme (set up in 1992 to develop EU environmental policy) and other Community finance instruments.

## 2. Habitat Directive

The continuing deterioration of natural habitats and the threats posed to certain species are one of the main concerns of the Union's environment policy. The Directive<sup>4</sup>, known as the "Habitats Directive", is intended to help maintain biodiversity in the Member States by defining a common framework for the conservation of wild plants and animals and habitats of Community interest.

The Directive establishes a European ecological network known as "Natura 2000". The network comprises "special areas of conservation" designated by Member States in accordance with the provisions of the Directive, and special protection areas classified pursuant to Directive 79/409/EEC on the conservation of wild birds. Annexes I (Natural habitat types of Community interest) and II (Animal and plant species of Community interest) to the Directive list the habitats and species whose conservation requires the designation of special areas of conservation. Some of them are defined as "priority" habitats or species (in danger of disappearing). Annex IV lists animal and plant species in need of particularly strict protection. Special areas of conservation are designated in three stages. Each Member State must draw up a list of sites hosting natural habitats and wild fauna and flora. On the basis of the national lists and by agreement with the Member States, the Commission will then adopt a list of sites of Community importance. The Member State concerned must designate it as a special area of conservation no later than six years after the selection of a site of Community importance.

Where the Commission considers that a site which hosts a priority natural habitat type or a priority species has been omitted from a national list, the Directive provides for a bilateral consultation procedure to be initiated between that Member State and the Commission. If the result of the consultation is unsatisfactory, the Commission must forward a proposal to the Council relating to the selection of the site as a site of Community importance. Member States must take all necessary measures to guarantee the conservation of habitats in special areas of conservation, and to avoid their deterioration. The Directive provides for co-financing of conservation measures by the Community. Member States must also:

- encourage the management of features of the landscape which are essential for the migration, dispersal and genetic exchange of wild species<sup>7</sup>
- establish systems of strict protection for those animal and plant species which are particularly threatened and study the desirability of reintroducing those species in their territory

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<sup>4</sup> Council Directive 92/43/EEC of 21 May 1992 on the conservation of natural habitats and of wild fauna and flora.

- prohibit the use of non-selective methods of taking, capturing or killing certain animal and plant species.

The Member States and the Commission must encourage research and scientific work that can contribute to the objectives of the Directive. Every six years, Member States must report on the measures they have taken pursuant to the Directive. The Commission must draw up a summary report on the basis thereof.

Bio geographical regions. Pursuant to the "Habitats Directive", the Commission must, in agreement with the Member States concerned, draw up a list of sites of Community importance for each of the six following bio geographic regions:

- Alpine
- Atlantic
- boreal
- continental
- Macaronesian and
- Mediterranean.

### **3. European Biodiversity Strategy**

On 4th February 1998, the European Commission adopted a Communication<sup>5</sup> on a European Biodiversity Strategy. This strategy aims to anticipate, prevent and attack the causes of significant reduction or loss of biodiversity at the source. This will help both to reverse present trends in biodiversity reduction or losses and to place species and ecosystems, including agro-ecosystems, at a satisfactory conservation status, both within and beyond the territory of the European Union.

During the last decades reduction and losses on biodiversity at a global scale has accelerated dramatically. Existing measures have proved to be insufficient to reverse present trends. The best way forward is for actors in the relevant policy areas to assume the responsibility for the impacts of their policies on biodiversity. With this strategy, the EU reinforces its leading role world-wide in the efforts to find solutions for biodiversity within the framework of the United Nations' Convention on Biological Diversity (CBD).

### **4. Clearing House Mechanism**

It is the European Community's contribution to the global Clearing House Mechanism being developed under the United Nations Convention on Biological Diversity. The EC CHM aims at facilitating scientific and technical co-operation and at providing access to information relevant to the implementation of the Convention on Biological Diversity by the European Community. It should also contribute to education programmes and to raising public awareness of biodiversity. The European Community is committed to facilitate public access to information relevant for biodiversity. The EC CHM is a one-stop-shop for such information. For example, it provides access to information on policies, legislation,

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<sup>5</sup> Communication of the European Commission to the Council and to the Parliament on a European Community Biodiversity Strategy (COM (98)42)

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funding opportunities, data bases, sources of expertise, etc held by European Community institutions. The European Commission requested the European Environment Agency (EEA) to develop and maintain the EC Clearing House Mechanism.

### 5. Natura 2000

With completion of the Natura 2000 network, the management of designated sites will become the priority measure for protecting biodiversity in the EU. Sufficient funding will be required to ensure that Natura 2000 fulfils the objectives that have been set and is adapted to specific local requirements. The Commission considers that the network can bring considerable benefits, both economic (the development of ecosystem services, provision of food and wood products, activities related to the site such as tourism, etc.) and social (more diverse employment opportunities, increased social stability, improved living conditions, safeguarding heritage, etc.). It also considers, however, that significant financial resources will be needed, be it concerning conservation of the designated sites (one-off investments or actions over extended periods such as site monitoring) or the impact on economic activities (lower land prices, agriculture, fishing, transport, construction, mining and forestry, etc.). According to the data provided by the Member States, the Commission expects the cost of managing Natura 2000 to increase to around 6.1 billion a year for EU-25. The Commission seems to favour a framework for Community co-financing for Natura 2000 due to the cross-border impact of protecting biodiversity. After examining several funding options, the Commission considers that the best approach is to make use of different existing funds (and therefore integrate the funding of Natura 2000 into other relevant Community policies).

The Commission plans therefore to propose, as part of forthcoming financial perspectives, allowing Member States to benefit from co-financing for certain activities from a range of existing instruments.

A Commission report<sup>6</sup> covers the period from 1994 to the end of 2000. It points to major delays in the implementation of the Habitats Directive. Regarding conservation of habitats, the Commission indicates that most countries have been slow in selecting proposed sites. At the end of the period covered by the report, gaps remained in all the national lists of proposed sites. The Commission notes, however, that significant progress was made with the establishment of the Natura 2000 network between the end of the report period and the actual drafting of the report.

With regard to site protection, the report identifies three groups of countries and regions:

- those that have introduced full legal protection for all their sites (including the United Kingdom, Ireland and Galicia)
- those that have taken some administrative steps to protect all their proposed sites,
- those only protecting proposed sites through existing protected areas and failing to select new sites.

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<sup>6</sup> Report from the Commission of 5 January 2004 on the implementation of the Directive 92/43/EEC on the conservation of natural habitats and of wild fauna and flora (COM(2003) 845 final - not published in the Official Journal).

Regarding site management, the report distinguishes between:

- those incorporating proposed sites into their system of protected areas or where a system for establishing management plans is up and running (France)
- those waiting for proposed sites to become sites of Community interest and making limited progress with the implementation of management plans.

The Commission notes that the obligation to establish management mechanisms, including management plans where necessary, will apply only after sites are designated as Special Areas of Conservation. For the moment, therefore, the management of these sites is based on the existing national legal and administrative frameworks and not on the obligations deriving from the Directive. The information sent by the Member States on species protection remains vague. A species protection working group set up in 2002 should support the implementation of the Directive in this area. The report notes differences in the human and financial resources that Member States and regions are committing to implementing the Directive.

## **6. LIFE-Nature**

The specific objective of LIFE-Nature is to contribute to the implementation of Community nature protection legislation: the "Birds Directive"<sup>7</sup> and the "Habitats Directive"<sup>8</sup>, and in particular the establishment of the "Natura 2000" network for the in situ management and conservation of Europe's most remarkable fauna and flora species and habitats.

Nature conservation projects which contribute to maintaining or restoring natural habitats and species populations to a favourable conservation status within the meaning of the Habitats Directive are eligible for LIFE-Nature. Projects must concern Special Protection Areas or Sites of Community Importance and the species listed in these Directives.

The European Union has allocated approximately 300 million euros for LIFE-Nature for the period 2000-2004. The rate of Community co financing may be up to 50% of the costs. LIFE-Nature finances nature conservation projects. This can cover a very wide range of projects, reflecting the diversity of natural environments in Europe. Examples include:

- Germany: restoration of wetlands.
- Ireland: enhancement of Ireland's natural heritage, in particular through eco-tourism.
- Italy: protection of certain species (wolves, bears, bats, etc) or certain habitats (wetlands, springs).
- Luxembourg: restoration of biodiversity destroyed by farming.
- Hungary: habitat conservation of the wolf and the lynx in the north-east part of the country.
- Romania: national action plan to protect dolphins in the Black Sea.

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<sup>7</sup> (79/409/EEC)

<sup>8</sup> (92/43/EEC)

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## 7. International cooperation

At the international level, the EU has signed up to a number of important conventions aimed at nature protection, including the Ramsar Convention on the Conservation of Wetlands in 1971, the Bonn Convention on Migratory Species in 1979, the Convention on the Protection of the Alps in 1991 and, most importantly, the 1992 Rio Convention which established the principle of sustainable development. Convention on International Trade in Endangered Species of Wild Fauna and Flora CITES has been implemented in the European Union since 1984 through a number of Regulations. In 1997, after 15 years, the old legislation was replaced by two new Regulations, which since that date are the core of the Community's wildlife trade legislation.

## 8. The EU Action Plan to 2010 and Beyond

The 2003–04 policy review culminated in an important stakeholder conference held under the Irish Presidency in Malahide in May 2004 which achieved broad consensus on priority objectives towards meeting the 2010 commitments, expressed in the 'Message from Malahide.'<sup>9</sup> Building on this, the Commission has identified four key policy areas for action and, related to these, ten priority objectives. Additionally, the Commission has identified four key supporting measures. These objectives and supporting measures are strongly supported by the results of a recent public consultation.

Delivery of the objectives and supporting measures will require specific actions which are set out, with related targets, in an 'EU Action Plan to 2010 and Beyond', annexed to the Commission's Communication. The Action Plan also specifies actions and targets for monitoring, evaluation and reporting. The Action Plan represents an important new approach for EU biodiversity policy, in that it addresses both Community and Member States, specifies the roles of each in relation to each action, and provides a comprehensive plan of priority actions towards specified, time bound targets. Success will depend on dialogue and partnership between the Commission and Member States and common implementation.

The Action Plan responds to the recent CBD call to priorities actions to 2010, and is intended as a complement to the EC Biodiversity Strategy and Action Plans. Member States are encouraged to adjust their own strategies and action plans taking it into account. The Commission proposes that, implementation of the Action Plan should be overseen by the existing Biodiversity Expert Group (BEG). The BEG should also work to ensure coordination and complementarity between Community and Member States level actions.

The four key policy areas of the Action Plan are the following.

The first policy area: Biodiversity in the EU. The most important objective in this area is to safeguard the EU's most important habitats and species. Action for the EU's most important habitats and species is vital to halting biodiversity loss by 2010 and fostering recovery.

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<sup>9</sup> In: Conference Report, DG Environment on Europe

Securing these habitats requires greater commitment from Member States to propose, designate, protect and effectively manage Natura 2000 sites. It also requires that they strengthen coherence, connectivity and resilience of the network, including through support to national, regional and local protected areas. The use of species action plans for the recovery of the EU's most threatened species should be extended. Comparable measures for habitats and species are required in those EU outermost regions not covered by the nature directives<sup>10</sup>

The second policy area: The EU and global biodiversity. In this area the EU's objectives:

- To substantially strengthen effectiveness of international governance for biodiversity and ecosystem services.
- To substantially strengthen support for biodiversity and ecosystem services in EU external assistance.
- To substantially reduce the impact of international trade on global biodiversity and ecosystem services.

New impetus in Community and Member State action is required if the commitment to significantly reduce the rate of biodiversity loss globally by 2010 is to be met. A more coherent EU approach is required, which ensures synergy between actions for governance, trade (including bilateral agreements) and development cooperation. Regarding governance, the EU should focus on more effective implementation of the CBD and related agreements. Regarding external assistance, the EU should enhance 'earmarked' funds for biodiversity and strengthen mainstreaming of biodiversity into sector and geographical programmes.

Regarding trade, measures to address tropical deforestation, including trade in commodities which drive deforestation, are particularly urgent. Rapid implementation of the programme of Forest Law Enforcement Governance and Trade can make an important contribution in this regard.

The third policy area: Biodiversity and climate change. In this area the EU wants to support biodiversity adaptation to climate change. Impacts on biodiversity in the EU are already measurable. Climate change has the potential, over a period of a few decades, to undermine our efforts for the conservation and sustainable use of biodiversity. Substantial cuts in global greenhouse gas emissions are required to mitigate the longer-term threat to biodiversity. The European Union must honour the Kyoto commitments and more ambitious global emissions targets post-2012 are needed in order to limit the increase in global annual mean temperature to no more than 2 C above pre-industrial levels. Protection of biodiversity can help limit atmospheric greenhouse gas concentrations because forests, peat lands and other habitats store carbon. Policies will also be needed to help biodiversity adapt to changing temperature and water regimes. This requires in particular securing coherence of the Natura 2000 network. Care must also be taken to prevent, minimize and offset any potential damages to biodiversity arising from climate change adaptation and mitigation measures.

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<sup>10</sup> Measures taken voluntarily and at national initiative for French Guiana, Reunion, Guadeloupe, Martinique.



The fourth policy area's objective is to substantially strengthen the knowledge base for conservation and sustainable use of biodiversity, in the EU and globally. Understanding biodiversity presents one of the greatest scientific challenges facing mankind. There is a critical need to strengthen our understanding of biodiversity and ecosystem services, if the EU is to refine their policy response in future. This requires strengthening (under FP7 and national research programmes) the European Research Area, its international dimension, research infrastructures, the science-policy interface and data interoperability for biodiversity. This should exploit emerging information and communication technologies. Subject to funding being found from existing financial resources, the Commission will establish an EU mechanism for independent, authoritative research-based advice to inform implementation and further policy development. Internationally, the EU should identify and support ways and means to strengthen independent scientific advice to global policy making, inter alia by actively contributing to CBD consideration of the 2007 evaluation of the MA, and the consultations on the need for improved International Mechanisms on Scientific Expertise on Biodiversity.

Future opportunities and challenges in the EU's nature and biodiversity efforts includes significantly increase the land area of the EU, covering many unspoiled landscapes, forests, parks and wetlands and so increasing the Community's biodiversity. Making sure these wildlife riches are conserved will be a major challenge for policy-makers in the years ahead.



## THE IMPLEMENTATION OF THE AARHUS CONVENTION IN COMMUNITY LAW

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### The Aarhus Convention at ten

On 25 June 2008, it was exactly 10 years ago, that the Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters<sup>1</sup> (hereinafter the Convention) had been adopted by representatives of 35 States and the European Community at an UN ECE-sponsored pan-European Ministerial Conference<sup>2</sup> in the Danish city of Aarhus.<sup>3</sup> The Convention entered into force on 30 October 2001 and the progress of ratification is still relatively rapid.

The Convention is a big step forward for both environment and democracy. It is unique in many ways:

- a new kind of environmental agreement that focuses not only on the environment protection *per se* but on the procedural rights of civil society;
- the first international treaty with the purpose of granting rights directly to the public with regard to the protection of the environment;
- it represents the first binding international instrument that attempts to address, comprehensively and exclusively, the issues of citizens' environmental rights;<sup>4</sup>
- it establishes that sustainable development can be achieved only through the involvement of all stakeholders, and links government accountability and environmental protection;
- it focuses on interactions between the public and public authorities in a democratic context;
- this was the first international agreement in Europe that derived substantially from the circumstances of transition;
- it is forging a new process for public participation during negotiation and implementation of international agreements.

Adoption of the Convention in 1998 marked a milestone in the development of environmental rights of the public. The whole preparatory period for the Convention was an unique possibility to work together with non-governmental organizations (NGOs),

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<sup>1</sup> <http://www.unece.org/env/pp/>

<sup>2</sup> The „Environment for Europe” process is an ECE-wide cooperation on environmental issues, established following the collapse of communism in Eastern Europe at the end of the 1980s and punctuated by a series of Ministerial Conferences (Dobris, Czechoslovakia, 1991; Lucerne, Switzerland, 1993; Sofia, Bulgaria, 1995; Aarhus, Denmark, 1998; Kiev, Ukraine, 2003; Belgrade, Serbia, 2007).

<sup>3</sup> The text of the Convention is available at <<http://www.unece.org/env/pp/>>.

<sup>4</sup> Jerzy Jendroska and Stephen Stec: The Aarhus Convention: Towards a New Era in Environmental Democracy, *Environmental Liability*, Vol. 9 Issue 3, June 2001, p. 148.

governments and international institutions on equal basis and had demonstrated a great openness for NGO involvement. Indeed, the initial idea of developing an UN ECE convention on the theme was introduced by environmental NGOs at the very first session of the task force that developed the Sofia Guidelines.<sup>5</sup> The guidelines were adopted at the Third Ministerial “Environment for Europe” Conference in Sofia in October 1995. The experiences of the Aarhus Convention process may provide guidance for other global, regional and national initiatives around the world.

The Convention lays down the basic rules to promote citizens’ involvement in environmental matters and enforcement of environmental law. It guarantees environmental rights by implementing Principle 10 of the Rio Declaration.<sup>6</sup>

The Convention does not create a substantive right to a clean and/or healthy environment. Rather, it creates procedural rights to assert the ‘right to live in an environment adequate to his or her health and well-being’.<sup>7</sup> To have meaning, of course, a substantive right must be accompanied by the ability to seek enforcement of that right.<sup>8</sup>

The Convention consists of three main ideas or ‘pillars’, each of which grants different rights:

- the first pillar provides for access to environmental information;
- the second pillar provides for the participation in decision-making processes;
- the third pillar provides for access to justice.

Access to information is the most detailed pillar of the Convention. Public participation is concerned with three different stages: ‘decisions on specific activities’<sup>9</sup>, ‘plans, programmes and policies relating to the environment’<sup>10</sup>, and ‘the preparation of executive regulations and/or generally applicable legally binding normative instruments’<sup>11</sup>. The access to justice pillar of the Convention is closely tied to the other two pillars.

### **The Aarhus Convention and the European Community**

Community legislation in the field of environment aims to contribute preserving, protecting and improving the quality of the environment and protecting human health. Environmental problems frequently need to be approached beyond the pure national level, because the pollution spreads over the frontiers. Only Community action can guarantee the uniform

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<sup>5</sup> Task Force on Environmental Rights and Obligations, Geneva, February 1994.

<sup>6</sup> “Environmental issues are best handled with the participation of all concerned citizens, at the relevant level. At the national level, each individual shall have appropriate access to information concerning the environment that is held by public authorities, including information on hazardous materials and activities in their communities, and the opportunity to participate in decision-making process. States shall facilitate and encourage public awareness and participation by making information widely available. Effective access to judicial and administrative proceedings, including redress and remedy, shall be provided.” (Principle 10 of the Rio Declaration on Environment and Development)

<sup>7</sup> Aarhus Convention, Preamble. para. 7.

<sup>8</sup> Teall Crossen and Veronique Niessen: NGO Standing in the European Court of Justice – Does the Aarhus Regulation Open the Door?, RECIEL, Vol. 16 Issue 3, 2007, p. 332.

<sup>9</sup> *Ibid*, Art. 6.

<sup>10</sup> *Ibid*, Art. 7.

<sup>11</sup> *Ibid*, Art. 8.

application of environmental law. As more and more environmental issues take place at Community level, it is necessary to ensure that the basic principles, e.g. public participation,<sup>12</sup> are also applied at the Community level.

Within the EC, environment action programmes constitutes the framework for the Community's environmental policy. These action programmes determine the environmental strategy of the EC, and indicate the directions of development. In spite of the fact that public participation is one of the basic principles in the environmental policy of the EC since the first environmental action programme<sup>13</sup> (Principle 9, 1973<sup>14</sup>), and the importance of public participation in enforcing environmental law was stressed on several occasions,<sup>15</sup> the environmental provisions of the EC Treaty do not mention individuals or non-governmental organisations. These shortcomings are due to, among other things, the lack of financial private interest in strengthening environmental law, in contrast to other areas of Community law, such as internal market and competition.

It is the European Commission's omission that it, generally speaking, does not try to mobilise private individuals who wish to ensure a better protection of the environment, by making people participate in environmental law-making and implementing. The European Union citizenship, introduced by Arts 17 *et seq.* EC, is lacking a concrete follow-up in the environmental sector, where individual persons remain receivers of Community environmental law and policy, rather than being given the status of instigators and participants.<sup>16</sup>

In 1985, the Community adopted Council Directive 85/337 on the assessment of the effects of certain public and private projects on the environment.<sup>17</sup> The Directive provided for the public to be informed of the application for development consent for a project which was covered by the Directive and required that the 'public concerned' had the right to express an opinion on the project, before a decision on the application was taken. This Directive served as a model both at international and national level.

The broadest expansion of the right to information was achieved on June 7, 1990, when the European Community adopted a Directive on freedom of access to information on the

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<sup>12</sup> Recent developments in international public participation 'law' reflect the growing importance of the role of public participation in economic development around the world. The clear trend is toward increased public participation in laws and practice. See George (Rock) Pring and Susan Y. Noé: *The Emerging International Law of Public Participation Affecting Global Mining, Energy, and Resources Management*, In: Donald Zilmann, Alastair Lucas and George (Rock) Pring (eds.): *Human Rights in Natural Resource Development: Public Participation in the Sustainable Development of Mining and Energy Resources*, Oxford University Press, 2002., p. 76.

<sup>13</sup> OJ C 112, 20.13.1973, p. 1.

<sup>14</sup> Principle 9: "The protection of the environment is a matter for all in the Community, who should therefore be made aware of its importance. The success of an environment policy presupposes that all categories of the population and all the social forces of the Community help to protect and improve the environment. This means that at all levels continuous and detailed educational activity should take place in order that the entire Community may become aware of the problem and assume its responsibilities in full towards the generations to come."

<sup>15</sup> See Decision 1600/2002 of the European Parliament and of the Council of 22 July 2002, laying down the Sixth Community Environment Action Programme, OJ L 242, 10.9.2002., p. 1.

<sup>16</sup> Ludwig Krämer: *EC Environmental Law (Fifth Edition)*, Sweet&Maxwell, London, 2003. p. 49.

<sup>17</sup> OJ L 175, 5.7.1985, p. 40.

environment.<sup>18</sup> The aim of the Council Directive was to ensure freedom of access to, and dissemination of, information on the environment held by public authorities and to set out the basic terms and conditions on which such information should be made available. Public authorities were required to make available information relating to the environment to any natural or legal person at his request and without his having to prove an interest, unless otherwise provided by the Directive. The Directive obliged periodic publication of descriptive reports, but it did not impose an obligation to create publicly accessible databases.

The European Community, in accordance with the Treaty, and in particular Article 175(1) thereof, is competent for entering into international agreements, and for implementing the obligations resulting there from, which contribute to the pursuit of the objectives listed in Article 174(1) of the Treaty. On 25 June 1998 the Community, together with the fifteen Member States, signed the Aarhus Convention. As the Commission notes, the Convention is the first international instrument which applies to the Community institutions and calls it a “major political and legal development”.<sup>19</sup> The signing of the Convention obliges the European Community to align its legislation to the requirements of the Convention with a view to its conclusion by the European Community.

#### **The first steps and the ‘Aarhus package’**

By signing the Aarhus Convention, the European Community acknowledged the importance of its objectives, and demonstrated its commitment at international level to increased transparency and openness as well as to ensuring adequate consultation of the public in the process of shaping EC environmental policy.

Since 1998 the Community has taken important steps to update existing legal provisions in order to meet the requirements of the Convention by means of legislation directed to the Member States, but also for its own institutions.<sup>20</sup> Article 19(5) of the Convention requires organisations, such as the European Community, to declare the extent of their competence with respect to the matters governed by the Convention.

On the basis of Article 255 of the Treaty of Amsterdam, Regulation 1049/2001/EC<sup>21</sup> gives the fullest possible effect to the right of public access to documents held by the Commission, the European Parliament and the Council; and these institutions have already made considerable progress in putting documents they have in their possession (and which are not covered by one of the exceptions foreseen in the Regulation) in electronic databases and through registers that are publicly accessible through telecommunications networks.

Directive 2003/4/EC on public access to environmental information<sup>22</sup> repeals Council Directive 90/313/EEC with effect from 14 February 2005, to provide interested parties with a single, clear and coherent legislative text. On the one hand, the new directive aims at

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<sup>18</sup> OJ L 158, 23.6.1990, p. 56.

<sup>19</sup> European Commission press statement, 23 June 1998.

<sup>20</sup> For an overview of EC activities taking place to allow ratification of the Convention by the EC, see <<http://ec.europa.eu/environment/aarhus>>.

<sup>21</sup> OJ L 145, 31.05.2001, p. 43.

<sup>22</sup> OJ L 41, 14.2.2003, p. 26.

correcting the shortcomings identified in the practical application of Directive 90/313/EEC. On the other hand, it paves the way towards the conclusion by the Community of the Aarhus Convention by implementing the obligations arising from the so-called first pillar of the Convention (access to information) into Community law. Member States shall take the necessary measures to ensure that national, and, where appropriate, regional or local reports on the state of the environment are published at regular intervals not exceeding four years.

Exploiting the possibilities offered by the 'information society', Member States ensure that public authorities organise the environmental information, with a view to its active and systematic dissemination to the public, in particular by means of computer telecommunication and/or electronic technology, where available. Environmental information has to become progressively available in electronic databases which are easily accessible to the public through telecommunication networks.

On 24 October 2003 the Commission adopted a "package" of three legislative proposals to align Community legislation with the requirements of the Aarhus Convention. The 'legislative package' consists of three different proposals:

Proposal for a Regulation of the European Parliament and of the Council on the application of the provisions of the Aarhus Convention on Access to information, Public Participation in Decision-making and Access to Justice in Environmental Matters to EC institutions and bodies,<sup>23</sup>

Proposal for a Directive of the European Parliament and of the Council on access to justice in environmental matters,<sup>24</sup>

Proposal for a Council Decision on the conclusion, on behalf of the European Community, of the Convention on access to information, public participation in decision making and access to justice regarding environmental matters.<sup>25</sup>

The Community has adopted secondary legislation with a view to implement the Convention with respect to Community institutions and bodies (in the form of a Regulation), and with respect to Member States' authorities (in the form of Directives). By Council Decision of 17 February 2005 the EC approved the Convention.<sup>26</sup>

The Commission made proposals for another Directive on public participation in the drawing up of plans and programmes relating to the environment and amending Directives 85/337/EEC and 96/61/EC.<sup>27</sup> This Directive updates provisions on public participation in the permitting procedures at national level under legislation on environmental impact assessment and integrated pollution prevention and control, and it introduces rules on access to justice. Furthermore, it contains rules on public participation in the preparation of a number of environmental plans and programmes under Directives on waste, air pollution and protection of waters against nitrate pollution. Member States were obliged to adopt their laws and other provisions to comply with this Directive by 25 June 2005 at the latest.

Directive 2001/42/EC on the assessment of the effects of certain plans and programmes on the environment,<sup>28</sup> and 2000/60/EC Directive establishing a framework for Community

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<sup>23</sup> COM(2003) 622

<sup>24</sup> COM(2003) 624

<sup>25</sup> COM(2003) 625

<sup>26</sup> See Council Decision 2005/370/EC (OJ 2005 L 124, p. 1.) and <<http://www.unece.org/env/pp/ratification.htm>>.

<sup>27</sup> Directive 2003/35/EC, OJ L 156, 25.6.2003, p. 17.

<sup>28</sup> OJ L 197, 21.7.2001, p. 30.

action in the field of water policy<sup>29</sup> were already adopted in line with the Aarhus Convention, but some, mainly older, environment-related Directives needed amendment to improve or include public participation provisions.

### **The implementation of the third pillar**

The Aarhus Convention allows for specific requirements that NGOs have to meet in order to obtain the right of access to be retained or introduced by providing that the “public concerned” is to be understood as including “non-governmental organisations promoting environmental protection and meeting any requirements under national law” (Article 2 (5)).<sup>30</sup> However, the Convention also requires that the procedures created provide adequate and effective remedies, and be fair, equitable and timely (Article 9(4)).

Under Article 9(3) of the Convention NGOs have the right not only to challenge acts and omissions by public authorities which contravene environmental law, but also acts or omissions of private persons that do so. This provision appears to be the most complicated element within the EU and other Parties of the Convention. Difficulties arise regarding the interpretation of the provision, and the diversity of systems where this provision is supposed to apply. According to the Implementation Guide to the Convention, Article 9(3) has been introduced to give citizens standing to go to court or another review body to enforce environmental law.<sup>31</sup> Such access is to be provided to members of the public “where they meet the criteria, if any, laid down in ... national law.” In other words, the issue of standing is primarily determined at national level, as is the question of whether the procedures are judicial or administrative.<sup>32</sup> EU Member States belong to different traditions with some of them granting a broad access to justice (including *actio popularis* that gives the possibility to everybody to act in favour of the environment), others having a more limited approach. The majority of Member States continue to require an ‘interest’ of the applicant for seeking judicial redress.

The Draft Directive on access to justice in environmental matters contains provisions granting rights for individuals and other private entities, in particular environmental NGOs, to have access to specific types of administrative and judicial review procedures. In addition, it also requires Member States to grant members of the public rights of access to administrative and judicial review procedures in order to challenge acts or omissions by private persons in breach of environmental legislation.

The Draft Directive is complemented by other recent EC measures providing access to justice rights that are more specific in terms of sectoral coverage and/or context. These include Directive 2003/4/EC, 2003/35/EC and 2004/35/EC. The latest one on environmental liability with regard to the prevention and remedy of environmental damage

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<sup>29</sup> OJ L 327, 22.12.2000, p. 1.

<sup>30</sup> The distinct role for NGOs is perhaps the most significant innovation of the Convention. See Maria Lee & Carolyn Abbot: *The Usual Suspects? Public Participation Under the Aarhus Convention*, *The Modern Law Review*, Vol. 66. (2003), p. 86.

<sup>31</sup> UN ECE, *The Aarhus Convention. An Implementation Guide*, United Nations, New York and Geneva, 2000, p. 130.

<sup>32</sup> Jeremy Wates: *The Aarhus Convention: A New Instrument Promoting Environmental Democracy*, *In: Marie-Claire Cordonier Segger & Judge C. C. Weeramantry (eds.): Reconciling Economic, Social and Environmental Law*, Martinus Nijhoff Publishers, 2005, pp. 401-402.



confers specific rights on private persons to access particular administrative legal review procedures. These procedures are intended to enable such persons to liaise with and hold to account those competent authorities designated by Member States to ensure that occurrences of environmental damage or imminent threats of such damage caused by operators of certain activities are remedied or prevented by them respectively.<sup>33</sup>

The proposal for a Directive on access to justice is pending before the Community legislature, although the adoption would support the uniform enforcement of environmental law in the Member States. Widespread fears of public interest actions are not well-founded in that such actions will not lead to a collapse of the judicial system and carry little risk of abuse. On the other hand, the proposal has some aspects, which could be seen as the lowest common denominator with regard to public interest actions.<sup>34</sup>

In order to obtain a comprehensive overview of different measures adopted or in place in the Member States to implement Article 9(3) of the Convention and related provisions, the Commission contracted a consultant to prepare a study.<sup>35</sup> On 2 June 2008 the Commission organised a conference to discuss the findings of the study, in order to take stock of a determine the present state of play with respect to access to justice at Member States' level, as well as possible next steps, initiatives and the most appropriate course of action in this respect.

### **The Aarhus Regulation: a major step forward in access to justice?**

The Aarhus Convention makes Community institutions subject to obligations concerning its three pillars. On 6 September 2006 the European Parliament and the Council adopted Regulation 1367/2006 on the applications of the provisions of the Aarhus Convention to Community institutions and bodies (hereinafter the Regulation).<sup>36</sup>

The Regulation covers not only the institutions, but also bodies, offices or agencies established by, or on the basis of the EC Treaty. They now need to adapt their internal procedures and practice to the provisions of the Regulation. The Regulation addresses all the three pillars of the Convention where those are of relevance to Community institutions and bodies and lays down related requirements.

As the provisions of the Aarhus Regulation have to be in consistency with the EC Treaty, the Regulation addresses only acts and omissions by public authorities.<sup>37</sup> Administrative act is defined in Article 2(1)(g) of the Regulation as any measure of individual scope under environmental law, taken by a Community institution or body, and having legally binding

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<sup>33</sup> Martin Hedemann-Robinson: *Enforcement of European Union Environmental Law, Legal Issues and Challenges*, Routledge-Cavendish, 2007, p. 305.

<sup>34</sup> Miriam Dross: *Access to Justice in EU Member States*, *Journal for European Environmental & Planning Law (JEEPL)*, Vol. 2 Number 1, January 2005, p. 30.

<sup>35</sup> The study covers all Member States except Romania and Bulgaria, which had not joined the EU yet when the study was initiated. The findings can be found: [http://ec.europa.eu/environment/aarhus/study\\_access.htm](http://ec.europa.eu/environment/aarhus/study_access.htm).

<sup>36</sup> OJ 2006 L 264, p. 13; it shall apply from 28 June 2007.

<sup>37</sup> The Aarhus Convention defines public authorities in a broad and functional way. For the purpose of the Regulation, 'Community institution or body' means any public institution, body, office or agency, established by, or on the basis of the EC Treaty, except when acting in a judicial or a legislative capacity.

and external effects. The definition of administrative omission encompasses any failure of a Community institution or body to adopt an administrative act as defined in Article 2(1)(g). The Regulation introduces a preliminary procedure in Article 10, which allows any NGO meeting the criteria set out in Article 11 to make a request for internal review to the Community institution or body that have adopted an administrative act under environmental law. Internal review is a necessary step for the NGO to be entitled to access to justice. The criteria for entitlement at Community level are the following:

it is an independent non-profit-making legal person in accordance with a Member State's national law and practice;

it has the primary stated objective of promoting environmental protection in the context of environmental law;

it has existed for more than two years and is actively pursuing its objective;

the subject matter in respect of which the request for internal review is made is covered by its objective and activities.<sup>38</sup>

The new Regulation does not represent a major improvement with regard to public interest rights in environmental matters. Environmental protection organisations which meet those objective criteria have no standing for the purposes of the fourth paragraph of Article 230 EC, because the principles governing the hierarchy of norms<sup>39</sup> preclude secondary legislation from conferring standing on individuals who do not meet the requirements of that Article. NGOs may institute proceedings before the ECJ only in accordance with the relevant provisions of the EC Treaty.<sup>40</sup> This provision still requires that the applicant must be "directly and individually concerned" by the decision.

The Commission has recently adopted two Decisions to implement the Regulation further:

Commission Decision 2008/50 of 13 December 2007 laying down detailed rules for the application of the Regulation as regards requests for the internal review of administrative acts;<sup>41</sup>

Commission Decision 2008/4001/EC, Euratom of 20 April 2008 amending its Rule of Procedure as regards detailed rules for the application of the Regulation.<sup>42</sup>

### **The role of the Convention in further development of EC law**

A number of legislative texts were adopted or are under preparation in EC environmental law, but further measures are necessary in order to adapt completely the provisions of the Convention. Of these instruments, only the proposal for a Directive on access to justice has not been adopted yet. Without this Directive, neither the European Community, nor the Member States can be considered to be fully in compliance with the Convention's requirements.

The Aarhus Regulation could not successfully combine requirements of Article 9(3) of the Convention with Article 230(4) EC, in particular, how to assure that environmental

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<sup>38</sup> The Commission is entrusted to adopt the necessary provisions to ensure transparent and consistent application of these criteria.

<sup>39</sup> See, *inter alia*, Case C-240/90 *Germany v Commission* [1992] ECR I-5383, para. 42.

<sup>40</sup> Article 12(1) of the Regulation.

<sup>41</sup> OJ L 13., 16.1.2008., p. 24.

<sup>42</sup> OJ L 140, 30.5.2008, p. 22.

organisations can file lawsuits in the public interest, while not being ‘directly and individually concerned’.<sup>43</sup> If the ECJ continues to interpret the law in a restrictive manner, revision of the EC Treaty is probably necessary to comply with the Convention.<sup>44</sup> Such an alteration would certainly be appropriate in order to strengthen environmental protection and enforcement of environmental law Community-wide.

The Community has also ratified the UN ECE Protocol on Pollutant Release and Transfer Registers by means of Council Decision 2006/61/EC.<sup>45</sup> The Protocol has been implemented through the enactment of Regulation (EC) No 166/2006 of the European Parliament and the Council of 18 January 2006 concerning the establishment of the European Pollutant Release and Transfer Register (E-PRTR) and amending Council Directives 91/689/EC and 96/61/EC.<sup>46</sup>

Finally, all EU Member States are now Parties to the Convention, except Ireland. Ireland signed the Convention in 1998, but the legislation was passed with dramatically reduced public participation in the planning process to speed up the development of huge infrastructural projects. The freedom to take a judicial review of a decision by the Planning Appeals Board (*An Bord Pleanála*) was dramatically reduced when standing was only given to those with a ‘substantial interest’, as opposed to the previous need to have ‘sufficient interest’.<sup>47</sup>

The implementation of the Aarhus Convention in Community law shows that a strong focus on procedural environmental rights is in place in Europe. In the 1970s, there were discussions under the auspices of the Council of Europe to complete the European Convention on Human Rights by a Protocol on the right to a clean environment. These efforts failed, as no agreement could be reached on the drafting of such a right, though there was a consensus that such a right existed. Subsequently, efforts at national and international level concentrated on procedural rights of the public.<sup>48</sup>

A substantive human right to the environment is currently lacking on the international and the Community level, but the strong developments in Community law have the potential to add to instruments in other regions, and have the potential to add further weight to the development of a substantive right.

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<sup>43</sup> Jerzy Jendroska: Public Information and Participation in EC Environmental Law, *In: Reflections on 30 Years of EU Environmental Law – A High Level of Protection?* (Edited by Prof. Richard Macrory), The Avosetta Series (7), Europa Law Publishing, 2006, p. 83.

<sup>44</sup> Femke de Lange: European Court of Justice, *Unión de Pequeños Agricultores v. Council* (Case Note), RECIEL 12 (1) 2003, p. 118.

<sup>45</sup> OJ L 32, 4.2.2006, p. 54.

<sup>46</sup> OJ L 33, 4.2.2006., p. 1.

<sup>47</sup> Michael Ewing: A Long Romance – Ireland and the Aarhus Convention, *In: PARTICIPATE* (Public Participation and Right to Know Campaign Newsletter), No.21 Winter 2007-2008, p. 2.

<sup>48</sup> Summary Report on the inventory of EU Member States’ measures on access to justice in environmental matters, Milieu Ltd., September 2007, p. 21.



## **CURRENT ISSUES IN THE UNIFICATION OF EUROPEAN CONTRACT LAW**

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### **1. Basic Questions**

During the last years, European private law – and contract law within – has become the focus of extraordinarily controversial discussions. Whereas most of the Member States of the European integration and national private lawyers, respectively want to preserve the identity, independence and characters of their legal systems, there are remarkable initiatives to unify European contract law - either by means of so called restatements of soft law character or even with a mandatory European Codification. For a long time the European Institutions – mostly the Commission and the Council – only made a piecemeal harmonization of the contract laws of the European Union. The situation, however, changed after the meeting of the European council in Tampere in 1999, namely, the Commission started to act.<sup>1</sup>

In the recent years an enormous activity has been carried out in the field of European contract law. Since 2001 not only the official organs of the European Union but also private initiatives have shown particular interest in the topic, namely how and by what means can the fragmented European legal regulations be harmonized, why shall it be actually done and how can the desired outcome be reached.

The current and dominant point of view of the European organs is behind an optional, harmonizing instrument of soft law character which can be accepted by all the Member States (that means the politics) and the representatives of the economic sectors, respectively. This is a frequently disputed concept since significant part of the science is not convinced of the usefulness of a mere optional instrument.<sup>2</sup>

The debates will last long, consequently, no compromise might be reached in the near future. These problems are so decisive that it is essential to examine all the possible effects on both the jurisprudence and the economics.

Is there a need for the legal harmonization in the field of European contract Law? On what extent shall it be realized? Is there a legal basis for it? What shall be the new instrument like? Optional or mandatory? These questions shall be answered in the following.

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<sup>1</sup> Ole Lando: The Structure and Legal Values of the Common Frame of Reference in: European Review of Contract Law (ERCL) 2007. p. 245.

<sup>2</sup> See i.e. Lando, von Bar, Kötz, Basedow, Drobing etc.

## 2. Unification or Harmonization?

The most problematic issue of the whole debate is the character of the new regulation. How far, actually, shall the process reach? Is it merely enough to harmonize the legal regulations of the different Member States or a deeper impact, a further cooperation leading to an overall unification is needed?

Both ideas have a great number of supporters among the legal scholars. Lando wrote a brilliant article on that topic where he had stated that there was no need for just an optional harmonization since the necessity of the unification was much too urgent.<sup>3</sup>

Why the unification is needed so much? In its Communication to the Council and the European Parliament on European Contract Law of September 2001<sup>4</sup> the Commission raised the basic questions on the topic. It has caused an overall discussion that has not come to an end yet. The four possible solutions were the following:

- *To leave the solution of any identified problems to the market.*
- *To promote the development of non-binding common contract law principles, useful for contracting parties in drafting their contracts, national courts and arbitrators in their decisions and national legislators when drawing up legislative initiatives.*
- *To review and improve existing EC legislation in the area of contract law to make it more coherent or to adapt it to cover situations not foreseen at the time of adoption.*
- *To adopt a new instrument at EC level. Different elements could be combined: the nature of the act to be adopted (regulation, directive or recommendation), the relationship with national law (which could be replaced or co-exist), the question of mandatory rules within the set of applicable provisions and whether the contracting parties would choose to apply the EC instrument or whether the European rules apply automatically as a safety net of fallback provisions if the contracting parties have not agreed a specific solution.*<sup>5</sup>

These possibilities are of both legal and economic importance. The method of the harmonization, which can extend from a simple approximation of laws to the total unification, is, as a matter of course, of legal nature. It is the task of the scholars to draft the provisions and to elaborate the final version. It is, however, the task and responsibility of the politicians to make a decision whether they support the proposal or not. On what facts does the political will depend? On, of course, the political benefit to be expected after the decision. These are for example the economic effects of such a harmonization of great significance. Economic arguments play a central role in the discussion about the European Contract Law and even in the Communication itself. In particular: the Commission assumes – and it has obviously right – that legal diversity increases the transaction costs of cross-border contracting and discourages consumers and small and medium size enterprises from engaging transactions of that kind.<sup>6</sup>

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<sup>3</sup> Lando: Optional or Mandatory Europeanisation of Contract Law - European Review of Private Law 4 pp. 59–69

<sup>4</sup> Brussels, 11.07.2001 COM(2001) 398 final OJ 13.19.2001 C 255 p. (further: Communication)

<sup>5</sup> Communication p. 2

<sup>6</sup> Gerhard Wagner: The Economics of Harmonization: The Case of Contract Law in: ERA-Forum – 2 – 2002 p. 78

This is one of the main reasons in favor of the harmonization. The latter – and this is almost as important as the previous one – is to secure the proper functioning of the single Market. That is what Lando and the Commission on European Contract Law were working for. The Lando-Commission proposed a Community-wide, uniform 'infrastructure' for the contractual relationships of parties doing business. It provides for a set of rules detached from national legal systems and thus facilitating cross-border trade within Europe. Apparently, projects such as the Lando-Commission provide a solution to very practical needs.<sup>7</sup> The different legal regulations are the most significant barriers regarding the competitiveness of the European Union. There are, of course, many others for example the linguistic differences and the countries outside the Euro-Zone. The real problem, nevertheless, seems to be the lack of the unified law. That is why it turns out to be essential to carry out the harmonization process. The question is: in which way and form?

The effects of a possible legal instrument are even for the institutions of the European Union predominantly unforeseeable. Some of them are convinced of the soft law character of the unified or approximated law. There are different reasons to support this opinion of an optional solution. The Council as an intergovernmental organ representing the governments of the Member States may not afford to support a mandatory instrument since it could endanger the sovereignty of the represented states. The wider the law-making competences of the EU, the more unified the law is, the less sovereignty for the single states remains to define the legal environment and exercising their legal power. From the Council's point of view it is, consequently, acceptable do not like being deprived of the prerogatives connected with the individual legislative power. Political considerations can also be found regarding the Commission's aspect. As a supranational institution, it may not really represent the interest of Member States. It can, however, adopt its policy by paying attention to different opinions. Since the Commission emphasized several times that a mandatory legal instrument would not have the essential political support, the Council's point of view has been taken in its process in order to avoid the dissension. As far as the mandatory character of the possible legal instrument concerned, beside a number of determined authors,<sup>8</sup> who have published hundreds of articles on the topic, the European Parliament was the only official organ within the EU that supported the idea of the real unification of laws definitely and doubtless.<sup>9</sup> The members of the EP represent hardly determinable party interests they seem, consequently or nevertheless, to be the real fosterer of the case by defining reasons from everyday life.<sup>10</sup> Although in its latest resolutions<sup>11</sup> the

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<sup>7</sup> Kristina Riedl: The Work of the Lando-Commission from an Alternative Viewpoint in: European Review of Private Law 2002. p. 71

<sup>8</sup> see Lando and others above No. 3.

<sup>9</sup> In one of its latest resolution it clearly defined its point: B. *whereas, even though the Commission denies that this is its objective, it is clear that many of the researchers and stakeholders working on the project believe that the ultimate long-term outcome will be a European code of obligations or even a full-blown European Civil Code, and that in any event the project is by far the most important initiative under way in the civil law field,...* in: P6\_TA(2006)0109 European Parliament resolution on European contract law and the revision of the acquis: the way forward

<sup>10</sup> These are for example: Reduction of transaction costs, confidence in trans border transactions, the benefit for consumers etc.

Parliament did not mention the mandatory Europeanization, it can be assumed that it would support it when necessary. It is, furthermore, clear that integration and unification must go hand in hand. What we actually have today is a cautious attempt of approximation of laws. However, it is not just practical interest which makes unification necessary; it is also challenging academically to achieve a uniform private law which is capable of removing the alleged contradistinctions between Civil Law, Common Law and partly Scandinavian (Nordic) law.<sup>12</sup> That is why it seems to be unavoidable to find the lowest common nominator in order to get rid of the obstacles that makes impossible to create a market friendly legal environment and to secure the proper functioning of the Single Market. These goals can only be achieved when all the actors of the discussion realize their roles and responsibility in connection with the possible future of the European Integration take the anticipatory changes in the world economy seriously and co-operate with each other putting aside the single and individual interests. This is, as the story of the last decade exactly shows, not an easy attempt at all. The members of the current European Union will not have an equal say in the debate about unification or even approximation of contract law. Economic and political interdependencies between the respective members will come into play. That is to say, the members the economies of which are relatively less dependent upon the economies of other members than vice versa or with significant political influence, respectively are poised to have a larger say in the debate. It is obvious that the more significant Member States as Germany, Great-Britain, France or Italy have the leading role in the process not only on political stage but also as far as the legal discussion is concerned. It is no wonder that the scholars whose contribution is most stressful relating to the legal harmonization origin form these countries. These efforts bore fruits. After five years of hard research and cooperation, the academic Draft of Common Frame of reference has arrived.

### 3. The Draft Common Frame of Reference

At the end of 2007 a brand new material was submitted to the Commission with the title: The Draft Common Frame of Reference.<sup>13</sup> It was made by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) as well

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<sup>11</sup> European Parliament resolution of 12 December 2007 on European Contract law P6\_TA(2007)0615 and European Parliament resolution of 3 September 2008 on the Common Frame of Reference for European Contract Law P6\_TA-PROV(2008)0397

<sup>12</sup> Jan Smits: A European Private Law as a Mixed Legal System - Towards a Ius Commune through the Free Movement of Legal Rules in: Maastricht Journal of European and Comparative Law 5 (1998), p. 332.

<sup>13</sup> Principles, Definitions and Model Rules of European Private Law Draft Common Frame of Reference (DCFR) Interim Outline Edition Prepared by the Study Group on a European Civil Code and the European Research Group on Existing EC Private Law (Acquis Group) Based in part on a revised version of the Principles of European Contract Law Edited by Christian von Bar, Eric Clive and Hans Schulte-Nölke co-operation Hugh Beale, Johnny Herre, Jérôme Huet, Peter Schlechtriem†, Matthias Storme, Stephen Swann, Paul Varul, Anna Veneziano and Fryderyk Zoll See: <http://www.storme.be/DCFRInterim.pdf> (05.11.2008) in print: von Bar-Clive-Schulte-Nölke (eds): Principles, Definitions and Model rules of European Private Law Draft Common Frame of Reference (DCFR) Interim Outline Edition Sellier München, 2008



as a set of additional drafts prepared by other participants of the Network, namely the Principles of European Insurance Contract Law by the Project Group Restatement of European Insurance Contract Law (Insurance Group) and works on Terminology, Guiding Principles and a Revision of PECL by the Association Henri Capitant des Amis de la Culture Juridique Française and the Société de Législation Comparée.

The DCFR is explicitly presented as an academic/scholarly project which is not to be equated with the certain political CFR called for by the European Commission in its 2003 Action Plan on a More Coherent European Contract Law.<sup>14</sup> The DCFR may provide a model for that, but it is not said that the CFR will have the same coverage and contents as the DCFR. On the contrary! It can be well assumed that the present DCFR will hardly anything to do with the final (politically supported) version of the CFR.

The scope of the DCFR presented by academics and legal scholars is much broader than only general contract law including consumer contract law.<sup>15</sup> General contract law and consumer law are included in Book II (contracts), Book III (obligations and corresponding rights), and some parts of Book IV on specific contracts (e.g. sales, loans, and probably services, insurance contracts, leasing etc.) There are six more books in the academic DCFR: Benevolent intervention in another's affairs (Book VI), Unjustified enrichment (BOOK VII), Acquisition and loss of ownership in movables (Book VIII), Proprietary security rights in movable assets (Book IX) and Trusts (Book X).<sup>16</sup>

The further status of the DCFR is still unknown. What is, so far, sure is the fact, that the Commission is preparing a White Paper on a Common Frame of Reference on the basis of selected parts of the DCFR. This massive material of compilation is expected to reach over 10.000 pages. It seems to be the Commission's decision what parts will be chosen and what will be left behind. It can be, however, surely expected that CFR in its final version will greatly influence future legislative work in contract law:

There are, nevertheless, some critical remarks regarding the new compilation. One of these represented by Jan Smits outlines three points of criticism against the draft. The first point is that the draft stands too far apart from the present (consumer) *acquis*. The second is that it suffers from unclear methodology. Finally, the DCFR seems to adopt the wrong view of when uniform law exists.<sup>17</sup> Others, for example Schulze, say that, although the DCFR may be useful for the academic discussion, it does not, however, fulfill the functions of European contract law rules. The decision to structure parts of the materials as a Law of Obligations rather than a Law of Contract makes the DCFR less acceptable both for legal-political and legal-cultural as well as for political reasons. Future work should rather aim at drafting European contract law rules by making use of the works and drafts that are presently available (the Principles of European Contract Law and the *Acquis Principles* as well as the DCFR).<sup>18</sup> This opinion clearly suggests the need of careful estimation of the

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<sup>14</sup> Brussels, 12.02.2003 COM (2003) 68 final

<sup>15</sup> See below note No- 33

<sup>16</sup> Angelika Fuchs: A Plea for a Europe-Wide Discussion of the Draft Common Frame of reference in: ERA Forum 2008, pp. 4-5

<sup>17</sup> Jan M. Smits. The Draft Common Frame of Reference (DCFR) for a European Private Law: Fit for Purpose? in: Maastricht Journal of European and Comparative Law (MJECL) 2008 pp. 145-148.

<sup>18</sup> Schulze-Wilhelmsson: From the Draft of Common Frame of Reference towards European Contract Law in: European Review of Contract Law (ERCL) 2008, pp: 154.

new material and points out that although a lot has been done for the unified European contract law so far, the following can not be exactly foreseen.

The question arises consequently from the above mentioned: what are the future expectations in the field of European contract law? Which solution is supported by the institutions will there be a unified private law ever? In order to be able to answer these questions we have to answer, first of all, one:

What has happened in 2008 and what conclusions can be drawn from these developments?

#### 4. Actual developments in 2008

It was attempted to outline the present situation above and to draft the two basic opinions for solving the problems. As Lando has pointed out, we have no choice but to declare ourselves either as Cultivators or Codifiers.<sup>19</sup> We can let the law fill the gaps and wait for the gradual development which can last for decades but at least for 50 years or, on the other hand, take determined, well-balanced steps to put through the necessary<sup>20</sup> changes. The question is to simplify the above presented discussion, whether to unify the contract law of the Member States or not. When the answer is positive shall it be done optionally or mandatorily? The current situation, however, seems to favor the optional solution. The European Council in its report of 18 April 2008<sup>21</sup> expressed its clear point of view on the questions arising on connection with the new affairs in contract law. In April 2007 the Justice and Home affairs (JHA) Council decided to mandate the Committee on Civil Law Matters<sup>22</sup> with defining a Council position on the fundamental aspects of a possible future common frame of reference.<sup>23</sup>

*On the basis of that mandate and against the background of the presentation of the Commission's Second Progress Report on the Common Frame of Reference<sup>24</sup> the Committee discussed the issue at two dedicated meetings in 2007 and another two in 2008.*

*The discussions in the Committee on Civil Law Matters have focused on four fundamental aspects:*

*-purpose,*

*-content,*

*-scope, and*

*-legal effect.*

As far as the purpose is concerned, it is important to emphasize that the Council, the Commission, the European Parliament and the several legal networks and commissions have different point of view in this respect.<sup>25</sup> The Committee favored the option of shaping

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<sup>19</sup> Lando: Optional or Mandatory Europeanisation of Contract Law - European Review of Private Law 4 p. 65.

<sup>20</sup> This adjective, of course, can be and is debated since the core question of the whole process is about the alleged necessity of the harmonization (unification, approximation).

<sup>21</sup> Draft report to the Council on the setting up of a Common Frame of Reference for European contract law 8286/08 LIMITE JUSTCIV 68 CONSOM 39

<sup>22</sup> Committee from now on

<sup>23</sup> Council Report p. 1

<sup>24</sup> Transmitted to the Council on 25 July 2007

<sup>25</sup> The Committee considered a number of options as to the purpose of the Common Frame of Reference. It rejected from the outset the option of using the Common Frame of Reference to

the Common Frame of Reference<sup>26</sup> as one tool amongst others for better lawmaking targeted at Community lawmakers. This would mean that the Common Frame of Reference could be used by lawmakers at Community level when they draw up new legislation or review existing legislation. It is that way obvious that the CFR would come into consideration only at the preparing process of the European legislation and would only serve as an additional material for improving the legal environment. This could either happen by the creating new law or by reviewing the existing legal material.<sup>27</sup> The effective value of the CFR would deserve more. Not only the roots that come from the Lando-Commission but the heart and soul of the harmonizing process would be determined for a much more sophisticated application. The former attempts mostly aimed at the totally unification of laws. In that case the creation of the European Civil Code is meant, which is the dream many of European scholars. The first step towards this unified European private law is to produce legal materials firstly with optional, soft-law character then use these rules for cross-border transactions as a possibility for the choice of law for the contracting parties and finally, let that become the foundation-stone of the European civil code. The first step is, nevertheless, not to create a mandatory legal instrument. That is what the Lando-Commission actually did – they drafted the so far most comprehensive unifying legal instrument the Principles of European Contract Law.<sup>28</sup> At this point it may turn out that it was a useless effort since the Council does not seem to support any kind of legal regulation having a slightest chance to become obligatory once in the future.

As to the content of the Common Frame of Reference the Council's Committee discussed several options.<sup>29</sup> It seemed to prefer a possibility of making the CFR as appropriate tool for securing the better lawmaking within the EU to have an average systematic collection or compilation of legal solutions of national level. The CFR should be – so the Council – the first step of a longer process that leads to the approximated legal environment in the Single Market. It is, nevertheless, highly possible that this view of the future is not clear even for the Council itself. Their point relating the legislative power of the Member States in the field of the Civil Law is, of course, completely comprehensible. Which state would be happy being limited in exercising or deprived of its authority? The only interesting factor in

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harmonize the contract law of the Member States by creating a European Civil Code. It equally rejected the option of a Common Frame of Reference consisting of a complete set of standard terms and conditions of contract law which could be chosen by companies and trade associations as the law applicable to a specific contract.

<sup>26</sup> The new material or secret weapon proposed by the Commission in the Action Plan in 2003. Created by the Study Group on a European Civil Code and the Research Group on the Existing EC Private Law (Acquis Group) see: Christian von Bar, Eric Clive and Hans Schulte-Nölke (eds): Principles, Definitions and Model rules of European Private Law Draft Common Frame of Reference (DCFR) Interim Outline Edition Sellier München, 2008

<sup>27</sup> See: Marco M. B- Loos: Review of the European Consumer Acquis Sellier, München 2008

<sup>28</sup> Ole Lando-Hugh Beale (eds.): Principles of European Contract Law Part I-II, Kluwer Law International, The Hague 1999, Ole Lando, Eric Clive, Andre Prüm, Reinhard Zimmermann (eds.): Principles of European Contract Law Part III. Kluwer Law International 2003

<sup>29</sup> The Committee discussed various options as to the content of the Common Frame of Reference. Having opted in favor of a Common Frame of Reference as a better lawmaking tool the Committee rejected the option of letting the Common Frame of Reference be a mere systematic collection and compilation of national legal principles and equally rejected the option of making it a mere consolidation and systematization of the contract law developed so far at Community level.

the debate is the fact that the Member States and their representatives are not able to realize the consequences of their denying attitude in connection with the legal harmonization process and the proper functioning of the Single Market. There are, nevertheless, authors who challenge the connection between the competitiveness of the European Single Market and the unification of the different laws of the Member States<sup>30</sup> or have the opinion that this kind of unification has no positive effect at all, or, furthermore, it can even do harm.<sup>31</sup> Partly accepting this point of view, the Council prefers as to the content of the CFR set of definitions, general principles and model rules in the area of contract law. This solution would suit the initiatives of the former attempts since all of them could be characterized by using general principles, definitions and effectively represented themselves as model rules. In this sense there is nothing new or surprising in the Council's report. They would greet such a flexible but, by all means, optional legal instrument which can be used as some kind of solution for the problems existing for more than twenty years. These principles and model rules will be created by reviewing the existing Community legislation applying the rules of the national legislations and the legal traditions. The exact content of these kinds of rules can not be foreseen yet.

The Committee on Civil Law Matters considered three options as to the scope of the Common Frame of Reference: the first one was the consumer contract law, second one was general contract law excluding consumer contract law and the third one, finally, was general contract law including consumer contract law. There are three approaches for the CFR to apply: a narrow, a broader and an extensive one. Although it was not really difficult to notice the attempts to purport to decrease the significance of general contract law and, parallel, increase the meaning of consumer contract law, it would make no sense to reduce the scope of the harmonized (unified) law. Considering these aspects, the Council decided to choose the third option, namely the general contract law including the consumer contracts, *for the simple reason that it would be difficult to treat consumer contract law in isolation and also difficult to carve out consumer contract law from general contract law.*<sup>32</sup> The Committee found that the CFR could be appropriate to cover all the phases of the contractual relations. That was also the main idea of the former initiatives, too, for example that of the Lando-Commission or the Study Group<sup>33</sup>, to provide an overall legal instrument for the parties of the cross-border transactions. In accordance with the Council's point of

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<sup>30</sup> See: Kristina Riedl: The Work of the Lando-Commission form an Alternative Viewpoint – ERPL, 2000. No. 1. pp. 71-83. i. e. “Not only does the set of rules offered by the Lando-Commission consist of mere principles, the scope of which is moreover limited to contract law - hence, it is not comparable with a coherent system of national private law. But also, the PECL in their present state have not been proven to work in practice; private parties will hesitate to adopt a set of rules to govern their contracts which has never before been adopted.” p. 83.

<sup>31</sup> See: Pierre Legrand: European Legal Systems are not converging – Int. CLQ, 1996. Vol. 45. pp. 52-81. and: Against a European Civil Code in: Maastricht Law Review, 1/1997 pp. 44-63

<sup>32</sup> Council report p. 3

<sup>33</sup> Hein Kötz – Alex Flessner: Europäisches Vertragsrecht I. - J. C. B. Mohr (Paul Siebeck) Tübingen, 1997

Giuseppe Gandolfi (ed.): Code Européen des Contrats – Avat-projet Giuffrè Verlag, Milano, 2001, or Study Group on a European Civil Code: Principles of European Law Sales Contracts (PEL S) Sellier München, 2008

view the CFR could serve as appropriate solution from the pre-contractual stage of the contract through the cooperation of the parties to the performance or non-performance. The Report, finally, deals with the possible legal effect of the CFR. As it has been discussed above, the legal effect is the most important question of the whole process. It is essential to determine what character the future legal instrument shall have. It can be mandatory, on the one hand, and optional, on the other. That means a legal instrument being introduced from above<sup>34</sup> that represents an absolutely new and unknown solution. On the contrary, one can find the organically growing, from below developing law which takes its place slowly, letting the public enough time to adapt to the new situation. The Council chose the latter. The most important thoughts are hiding in the following citation: *The Committee discussed a number of options as to the legal effect of a future Common Frame of Reference. It rejected the option of creating a binding legal instrument in the area of contract law to be implemented by the Member States and equally rejected the option of giving the Common Frame of Reference a form which would make it binding for the Community lawmakers in the sense that they would be unable to deviate from it.*<sup>35</sup> Instead of the above, only such set of guidelines could be politically supported which shall serve as a common source of inspiration or reference in the legislation but exclusively on a voluntary basis.

The summary of the report can be presented as follows:

- *Purpose of the Common Frame of Reference: a tool for better lawmaking targeted at Community lawmakers.*
- *Content of the Common Frame of Reference: a set of definitions, general principles and model rules in the area of contract law to be derived from a variety of sources.*
- *Scope of the Common Frame of Reference: general contract law including consumer contract law.*
- *Legal effect of the Common Frame of Reference: a set of non-binding guidelines to be used by the lawmakers at Community level on a voluntary basis as a common source of inspiration or reference in the lawmaking process.*<sup>36</sup>

The Report emphasizes that its intention does not cover to influence the following debate on European contract law. Nor does it in any way prejudge a discussion on the need or the possibility of a legal basis for the Common Frame of Reference. This statement seems to be, differing from the former parts of the Report, a bit indulgent for other opinions and convictions. It indicates that the process has not been decided yet, there can be modifications or variances compared to the report submitted by the Committee on Civil Law Matters. It is, however, still possible to reach the necessary level of unification in order to fix all the malfunctions that can be observed within the European Community.

Another important occurrence in the field of European Contract law is the resolution of the Parliament in September 2008.<sup>37</sup> As it was underlined earlier, the European Parliament is one of the main actors among those engaged with the matters of unification of contract law.

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<sup>34</sup> For example as a regulation

<sup>35</sup> Council Report p. 4

<sup>36</sup> Council Report p. 5

It has passed several resolutions<sup>38</sup> so far, many of those were of extraordinary importance for defining the opinion regarding the legal unification. Not only the Resolution of March 2006 but also this latest one emphasizes the significance of the unification process. As difference it is to be noted that the Parliament did not mention the possibility of a mandatory legal instrument in its latest resolution. It may be the in connection with the recognition of the present situation that seems to favor the slightest mandatory character possible.

The Parliament, nevertheless, welcomes the DCFR and its analyses from the official organs, working groups and stakeholders. The final version is expected to be ready in December 2008 then it will be submitted to the Commission. There are some interesting points in the Resolution which are worth of examination.

First of all, the Parliament points out, that the expected document will be the basis of the further efforts aiming at the unified contract law<sup>39</sup> regardless its form or character. The message of this statement is that both a non-binding legislative tool and an optional instrument are welcomed by the EP. The difference between these two phenomena is of crucial importance. As to the previous one, the non-binding legislative instrument is predominantly a measure for the official institutions and legislative organs to build it in their policy and law-making activity. An optional instrument is, oppositely, is mostly for the contracting parties taking part in legal relations of civil law character, who could benefit from this kind of unified legal instrument since it makes them possible to avoid the problems of trans-border transactions regarding the choice of law. The third option at this point would (should) be the mandatory regulation as the only possible measure, as dealt with above, to treat the inconsistency of legal environment of the different Member States.

The EP, furthermore, *suggests that, if this is the case, the CFR should be as wide-ranging as possible and that there may be no need to exclude any content or materials at this stage.*<sup>40</sup> This statement corresponds with the Council's Report when suggesting the wide-range content, namely the comprehensive general part of the contract law including the consumer contracts, as well.

Suggests that, if used as a non-binding legislative tool, the relevant parts of the CFR should be appended to any future legislative proposal or communication made by the Commission which touches on contract law, so as to ensure that this is considered by the Community legislature.<sup>41</sup>

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<sup>37</sup> European Parliament resolution of 3 September 2008 on the common frame of reference for European contract law P6\_TA-PROV(2008)0397

<sup>38</sup> Resolution of 12 December 2007 on European contract law., Texts adopted, P6\_TA(2007)0615. Resolution of 7 September 2006 on European contract law., OJ C 305 E, 14.12.2006, p. 247, Resolution of 23 March 2006 on European contract law and the revision of the acquis: the way forward, OJ C 292 E, 1.12.2006, p. 109, Resolution of 26 May 1989 OJ C 158, 26.6.1989, p. 400. , Resolution of 6 May 1994, OJ C 205, 25.7.1994, p. 518., Resolution of 15 November 2001, OJ C 140 E, 13.6.2002, p. 538. and Resolution of 2 September 2003, OJ C 76 E, 25.3.2004, p. 95.

<sup>39</sup> The Commission document will be the basis for the decision of the European Institutions and all interested stakeholders on the future purpose of the CFR, its content and legal effect, which may range from a non-binding legislative tool to the foundation for an optional instrument in European contract law. Resolution point 5.

<sup>40</sup> EP Resolution September 2008 point 8.

<sup>41</sup> EP Resolution September 2008 point 10.

## 5. Final Remarks

The availability of the DCFR has already produced an intense discussion within legal science, economics and politics. The main question is: can we move forward on the basis of the DCFR? Yes, by all means! It has faults. It will give rise to differences of opinion on issues such as the balance between certainty and flexibility. But with the help of academic commentators and stakeholders and expert officials faults can be identified and corrected.<sup>42</sup> As to the main organs of the EU, the EP seems to be convinced of the legal character of the CFR text. The Council also has a clear view about the future of the legal instrument: it shall not be at most optional a binding measure is strictly out of question. The Commission, however, has not really explicated its point, its position seems to be a bit patient, wait and see. The DCFR and the prospective CFR are, unquestionably, would be better instruments than just a non-binding legislative tool made to improve the legislation process. There are predominant chances to have it at least as an optional measure. Supposing the latter solution would take place, relevant parts of the CFR should not go to waste. They should, nevertheless, be used for completing the Commission's Communications in order to apply them regularly. The DCFR is, notwithstanding, rest of more than 25 years of collaboration between lawyers from different jurisdictions is Europe.<sup>43</sup> It shall be, therefore, estimated and cultivated for the benefit of all actors of the European economy and, consequently, for the consumers of the Single Market. It is worth moving on with this project.

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<sup>42</sup> Eric Clive: An Introduction into the Academic Common Frame of Reference in: ERA Forum 2008 pp 13-31

<sup>43</sup> Angelika Fuchs: A Plea for a Europe-Wide Discussion of the Draft Common Frame of reference in: ERA Forum 2008. p. 1





## THE RULES OF THE FACTORING AND THE ASSIGNING IN THE DOMESTIC REGULATION AND THE REGULATION OF THE EUROPEAN UNION

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The rule system related to the factoring contract is shaped partly the inner law<sup>1</sup> (underlying contractual relationship is the assigning), the contractual practice<sup>2</sup> (contract samples), the judicial custom, the international law<sup>3</sup>, as regards the international standards.<sup>4</sup> These rules affect the condition system of the contract collectively, and the characters of the economic life are helped in the literature ripened points of view in the solution of the problems together. I point at some problematic areas of the factoring contract with the overview of the rule systems.

### 1. The formal questions of the contract

One of the areas like this is the formal question of the contract. The domestic civil law does not tie up currently formal requirements to assigning and in this manner to the factoring contract neither, to which the conception of the 2006 Ptk. (Ptk. is the abbreviation for the Civil Code) insisted.<sup>5</sup> The contract may come into existence in writing and orally, indeed according to Ptk. explanation relating on the road of behaviour<sup>6</sup>

In this regard Ptk. 2007 draft brought a change developing a correct point of view, since it declares that it is possible to take action about the assigning only in writing validly.<sup>7</sup>

At the same time this rule is at the factoring contracts speak able, if the legislator does not wish to prescribe a written form generally to the assignment.

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<sup>1</sup> 1959. évi IV. törvény a Magyar Köztársaság Polgári Törvénykönyvéről (Ptk.) 328§-331.§[Civil Code of the Hungarian Republic]; GELLÉRT, György: A Polgári Törvénykönyv Magyarázata I-II [Explanation of the Civil Code], Complex Kft., Budapest, 2007. 1178-1188. p.; Polgári Törvénykönyv Kötelmi Jog, Javaslat és indoklás (2006. június 31.), kézirat (Ptk. koncepció), [Contract Law, Proposal and justification, manuscript, (Conception of Civil Code)]

<sup>2</sup> [www.cib.hu](http://www.cib.hu); [www.erste.hu](http://www.erste.hu) (2007. January 15.)

<sup>3</sup> 1997. évi LXXXV. törvény a nemzetközi követelés-vételről szóló, Ottawában, 1988. május 28-án kelt UNIDROIT Egyezmény kihirdetéséről; Európai Szerződési Jog Alapelvei (ALAPELVEK) [PRINCIPLES] (Principles of European Contract Law, Part III) In: Európai Jog, 3/2004. 2. sz. melléklet; United Nations Convention on the Assignment of Receivables in International Trade, G.A. Res. 56/81, U.N. GAOR, 56<sup>th</sup> Sess., U.N. DOC. A/RES/56/81 (2002.) [UNCITRAL Convention]

<sup>4</sup> Code of International Factoring Customs [CUSTOMS] In: SALINGER, Freddy: Factoring law and practice, Sweet & Maxwell Limited, London, 1995.

<sup>5</sup> Ptk. koncepció (2006.): 184. p. [Conception of Civil Code]

<sup>6</sup> GELLÉRT, Gy. (2007.): 1178. p.

<sup>7</sup> [www.irm.gov.hu](http://www.irm.gov.hu) (2007. December 20.): a Ptk. 2007. évi szövegtervezete (Tervezet) 5:170.§ (1) bek. [Engedményezés] 307. o. [Draft 2007 of Civil Code][Assignment]

However the factoring contracts come into existence in writing in the practice, which has the reasons to be being looked for between the credit institution rules. The credit institution law defines the factoring as transaction entailing assumption of risk and prescribes obligatory written form.<sup>8</sup>

It follows from this according to my view that it is obligatory to put the factoring contract in writing, since one of the contractors are financial institutions. Different notion dominates on the sphere of the international and of the foreign regulation.

Full freedom is provided to the contracting parties in respect of the form compulsion by the Principles of the European Contract Law (Principles).<sup>9</sup> It is declared, that it is not necessary to put the assigning in writing, as regard as the transaction is not fasten to formal requirements. The provision makes it possible to the contracting parties, that the assigning is proved with witnesses even.

We do not find formal requirements neither in the UNIDROIT Convention, nor in the International Factoring Customary Regulation, although we find references between the rules in the latter one, which point out that the customary law does not prescribe form compulsion though, but it considers the written form the concomitant of transaction based on the practice.<sup>10</sup>

The foreign legal solutions do not adopt form compulsion characteristically, but an exception appears as on the field of the Dutch, the French and the Swiss law, where the written form is obligatory.<sup>11</sup>

## 2. The object of the contractual relationship: the claim

Similarly problematic sphere is the regulation concerning the claim. The claim itself is the *indirect object* of the contractual relationship. Different points of view were developed with regard to the object of the claim; it's transferable, with respect to the rights and obligations related to the claim all in the domestic, all in the foreign literature and legal regulation. It is necessary to analyse the character of the claim as first thought that is it possible that all claims is object of the factoring.

The *character of the claim* must be analysing as first thought, that is all claims may be the object of the factoring.

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<sup>8</sup> 1996. évi CXII. törvény a hitelintézetekről és pénzügyi vállalkozásokról (Hpt.) 77.§ (2) bek. [Act about the loan offices and financial undertakings] [In the No. 2 Insert of the Act contains the: III.10.1.f. about the factoring]

<sup>9</sup> PRINCIPLES Article 11:104 Form of assignment. An assignment need not be in writing and is not subject to any other requirement as to form.

<sup>10</sup> CUSTOMS Article 5: The written agreement has priority between the export -and importfactor.

<sup>11</sup> GÁRDOS, Péter: Az engedményezésre vonatkozó szabályok újragondolása a nemzetközi gyakorlat tükrében, Polgári jogi kodifikáció 5/2003. sz. 8. o. [Thoughts about the regulation of the assignment in the mirror of the international practice.] The Dutch and the French Civil Code contains similar solutions. The Article 1341. of the French Civil Code declares the written form (notarial document or private document) to the assignment contracts above a limit of value. Just like the regulation of the OR. (Article165. ) in Switzerland.

We do not find restriction in the regulation of the European Union onto the money claims relevantly; indeed it is said with an expanding rule that the rules of Principles are applicable to the assigning of all transferable claims.<sup>12</sup>

The UNCITRAL and the UNIDROIT Convention, as regard as the Customary Rules hint that the claim being subject of the factoring may be only a money claim unambiguously. The reason of this is on the one hand, that only parties, who take part in the international trade, are the participants of the transaction, on the other hand the provisions are about account claims, outstanding debts, which basically determine, that there may be a word only from money claims.<sup>13</sup>

All money claims however may not be the object of the factoring and the assigning. The international regulation deals with the *claims with a personal character*. The international provision precludes a part of these, the application of usage to the assignment of the natural persons' claims with a personal character<sup>14</sup>, since these were created onto the traffic of claims with a commercial character with a business aim. UNCITRAL Convention or Customary Regulation applies a solution like this.

UNIDROIT Convention was established for the traffic of the claims with a commercial character, but this goes into detail about the claims being attached to person definitely. It states that such contract is not qualified as a claim purchase contract in the application of the convention, the object of which was obtained by the indebted from the aim of personal, family or domestic usage.<sup>15</sup>

We find also references to this in the regulation of the European Union, in connection with the other invalid provisions. The provisions of the Principles declares, that the assignment without the approval of the obliged is invalid towards the obliged, if it is aimed at the fulfilment of such service, either the fulfilment of which is because of nature of the service, or with regard to the existing contractual relationship between the assignor and the obliged, can be sensibly demanded from the obliged only towards the assignor. So the European Union's regulation opens the road the assignment of claims being attached to the entitled person, if the entitled assents to this.

*We may declare it certainly, that the object of the factoring claim may not constitute claims subjected to the entitled person neither in domestic, nor in international relation since the factoring means the purchasing of the claims deriving from the business, commercial contractual relationships.*

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<sup>12</sup> PRINCIPLES Article 11:101 (2) Except where otherwise stated or the context otherwise requires, this Chapter also applies to the assignment by agreement of other transferable claims..

<sup>13</sup> GÁRDOS, Péter: Az engedményezés az UNCITRAL egyezményben és a készülő új Polgári Törvénykönyvben, *Gazdaság és Jog*, 3/2004. sz. 11. p.;[Assignment at the UNCITRAL Convention and at the preparation of the new Civil Code] Introduction regulations of the UNIDROIT Convention: the states parties to this Convention, conscious of the fact that international factoring has a significant role to play in the development of international trade... Chapter I Article 1. This Convention governs factoring contracts and assignments of receivables as described in this Chapter., CUSTOMS Article 1-10.

<sup>14</sup> GÁRDOS, P. (2004.): 13. p.

<sup>15</sup> UNIDROIT Convention Article 1. point 2. a.

Important question in connection with the regulation of the claims, that the factoring and the assignment of the single claims may preclude or may limit in a contract. We find provisions concerning this on the field of the international regulation.<sup>16</sup>

UNIDROIT and UNCITRAL Convention<sup>17</sup> accept the exclusive clause as valid one, but this does not affect the supplier's and the factor firm's contractual relationship, that is the exclusion towards a third person not effective. The right of the supplier may not limit in respect of the transfer of the claim<sup>18</sup>, but the supplier's responsibility exists for the breach of contract naturally.

The European Union's regulation applies a solution differing from this.<sup>19</sup> The main rule is here, that the contractual exclusion of the assignment is also effective towards third parties that are in a contract serving as the basis of assigned claim precluded or contrasted assignment with the contract on another manner is not put into force towards the obliged.

From under this the Principles allow three exceptions:

- consent of the obliged,
- the well-meaning assignee (not known or may not have known about the exclusive provision),
- in case of the future money claims' assignment.

This legal solution is vaguer, than the legal solution of the Conventions, particularly in case of the consent of the obliged and in the event of the well-meant assignment. The former makes the assignment difficult, while the latter may give rise to legal debates.

With the third case circle the legislator wished to facilitate the factoring, that is the exclusive clause is not put into force towards the factor firm in case of future money claims.

*The problem arises however naturally that the factoring concerns not only the future, but the currently existing claims, in connection with what it does not give an exceptional rule, in this manner the exclusion prevails, this may impede the additional spread and function of the factoring largely.*

<sup>16</sup> GÁRDOS, P. (2003.): 3-4. p.

<sup>17</sup> UNIDROIT Convention Article 6. Point 1-3:

1. - The assignment of a receivable by the supplier to the factor shall be effective notwithstanding any agreement between the supplier and the debtor prohibiting such assignment.
2. - However, such assignment shall not be effective against the debtor when, at the time of conclusion of the contract of sale of goods, it has its place of business in a Contracting State which has made a declaration under Article 18 of this Convention.
3. - Nothing in paragraph 1 shall affect any obligation of good faith owed by the supplier to the debtor or any liability of the supplier to the debtor in respect of an assignment made in breach of the terms of the contract of sale of goods.

<sup>18</sup> GÁRDOS, P. (2004.): 14. p.

<sup>19</sup> PRINCIPLES: Article 11:301: Contractual prohibition of assignment

An assignment which is prohibited by or is otherwise not in conformity with the contract under which the assigned claim arises is not effective against the debtor unless:

- (a) the debtor has consented to it; or
- (b) the assignee neither knew nor ought to have known of the non-conformity; or
- (c) the assignment is made under a contract for the assignment of future rights to payment of money.

(2) Nothing in the preceding paragraph affects the assignor's liability for the non-conformity.

*In connection with the contractual exclusion of the factoring give the Conventions the mostly correct solution, putting the regulational and interpretational problems to an end.*

The legal regulation and the theory consider it important in many cases beside the inhibitory and limiting provisions, that *what kind of claims can be assigned, and may be concerned for the objects of a factoring contract.*

The allowance of the future claims is a problem like this. The central problem of the assignment of the claims originating in the future, that these claims are determinable, identifiable.<sup>20</sup>

The international regulation represents the assignment of the future claims a similar notion. The Principles indicate it too, that the existing and the future claims can be assigned then equally, if the claim, even in the time of its formation, or in the other time fixed by the parties, can be identified as an affected claim by the assignment.<sup>21</sup> We do not find here reference, what kind of criterion system means the identification.

The German legal solution represents a similar notion and handles the assignment of future claims flexibly. It declares, that the claim does not need to be in the time of assignment neither determined, nor definable, enough, but at the same time also necessary, that the claim be identifiable at the time of its formation.<sup>22</sup>

The UNIDROIT Convention provides an even bigger freedom for the contracting parties. It declares that it is not necessary to mark the existing and future claims one by one, it is enough, if verifiable, and that the claim fell under the effect of the claim purchase contract on the time of the entering into a contract. Indeed the Convention disposes in connection with the transfer of the future claims that the provision being about this is enough in the contract, which yields that, that the claims transfer to the factor firm in the moment of their formation without a separate newer transfer.<sup>23</sup>

*So the correct legal point of view is in connection with the assignment of future claims, both in the literature, and on the basis of the international regulation, that it is not necessary to apply neither on the field of the assignment, nor on the sphere of factoring contracts a limitation with a character like this, since the object of the factoring contracts are primarily the purchasing of future (in future arising or in future expiring) claims.*

<sup>20</sup> GÁRDOS, P. (2003.): 5. p.

<sup>21</sup> PRINCIPLES Article 11:102 Contractual claims generally assignable.

(1) Subject to Articles 11:301 and 11:302, a party to a contract may assign a claim under it.

(2) A future claim arising under an existing or future contract may be assigned if at the time when it comes into existence, or at such other time as the parties agree, it can be identified as the claim to which the assignment relates.

<sup>22</sup> SZEIBERT, Orsolya: A tulajdonjog-fenntartás mint hitelbiztosíték, Polgári jog kodifikáció, 4/2000. sz. 15. o.[The reservation of the ownership as a credit deposit]

<sup>23</sup> UNIDROIT Convention Article 5. points a-b.,

As between the parties to the factoring contract:

(a) a provision in the factoring contract for the assignment of existing or future receivables shall not be rendered invalid by the fact that the contract does not specify them individually, if at the time of conclusion of the contract or when they come into existence they can be identified to the contract;

(b) a provision in the factoring contract by which future receivables are assigned operates to transfer the receivables to the factor when they come into existence without the need for any new act of transfer.

Interesting question circle is the assignment of the parts of the claims.<sup>24</sup> The European Union's regulation acknowledges the part assignment of the divisible claims, but it disposes the bearing of the potential additional expenses. The Proposal indicates it, that the debtor have to accomplish for more creditors owing to the division of the claim, and plus administrative and bank expenses may be produced with the register of the debt and the fulfilment of the obligation.

So the assignment and factoring of the claim parts are not impossible separately, indeed economic necessity, but the debtor may demand the reimbursement of the incidental expenses. Would be expedient however if this principle would be formulated on a law level in the domestic regulation, even with the reception of the union regulation.

### 3. The rights and the obligations of the contracting parties

The questions in connection with the existence and modification of the basic legal relationship and with the notification of the debtor belong to *the covenants related to the basic legal relationship* that cause a problem in the practice and the legislators equally.

A problem occurred in the practice is the question of *the modification of the basic legal relationship*.

The Principles of the European Contract Law imply a regulation concerning this.<sup>25</sup> The Principles declare with a general character, that the basic legal relationship is not changed without the assignee's contribution

The provisions imply exceptions however beside the basic rule; in that case the contract modification influences the assignee. Into the circle of the exceptions can be enumerated the approval of the assignee, the separate provision of the assignment contract from the allowable of the modification, concerned the modification with a character like that, where the parties proceed in good faith, and the assignee does not have a reasonable reason onto the protest.

The *notification obligation* belongs to the circle of the contractual rights and obligations although there is a literature point of view that considers it the rules of debtor protection.<sup>26</sup>

The significance of the notification, which expresses itself in the redemption of the legal effects, is exceptionally big. The notification plays a special role furthermore in terms of the typification of the factoring, since we distinguish the two types of the factoring, the

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<sup>24</sup> PRINCIPLES 11:103.§ Partial Assignment: A claim which is divisible may be assigned in part, but the assignor

is liable to the debtor for any increased costs which the debtor thereby incurs.

<sup>25</sup> PRINCIPLES 11:204. Undertakings by Assignor point b.): the claim and any contract under which it arises will not be modified without the consent of the assignee unless the modification is provided for in the assignment agreement or is one which is made in good faith and is of a nature to which the assignee could not reasonably object.

<sup>26</sup> GÁRDOS, P. (2004.): 15. p.

hidden or factoring without notification, as regard as the open or factoring with notification.

<sup>27</sup>

The literature notions point out that the notification is not the necessary element of the factoring and the assignment, since the transaction may come into existence without a notification validly, but the debtor will perform in this case for the original authorised. Resulting from the character and the risks of the transaction spread the notification form in the practice.

Different points of view prevail in the international regulation. The European Union's rules do not prescribe a notification obligation, but the legal effects of the notification are analysed, from the point of view of the effect to the engagement of the obliged. <sup>28</sup> In this manner is not validity accessory the notification. UNCITRAL Convention is on this point of view. <sup>29</sup>

The regulation of the UNIDROIT Convention is not unambiguous on the other hand. It considers the debtors' notification the conceptual element of the claim purchase contract, but does not mention that this would be a validity accessory separately. <sup>30</sup> The measure formulates the rules of the notification between the contractors' rights and obligations anyway. <sup>31</sup>

We find definitive differences in the *formal and content accessories* of the notification yet.

The written form prevails in the international regulation as the UNCITRAL Convention <sup>32</sup>, the UNIDROIT Convention <sup>33</sup> or the union principles' rules <sup>34</sup> indicate it.

The UNIDROIT Convention interprets the concept of the written notification extensively. <sup>35</sup>

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<sup>27</sup> SALINGER, Freddy: Factoring law and practice, Sweet & Maxwell Limited, London, 1995. 24. p. MARTINKÓ, Károly: Faktoring – a vállalatfinanszírozás hamupipókéje,[Factoring] Saldo, Budapest, 2002. 28. p. The expression "quiet factoring" is wrong to my opinion, so I avoid the use of it.

<sup>28</sup> PRINCIPLES 11:303.(1):

Subject to Articles 11:301, 11:302, 11:307 and 11:308, the debtor is bound to perform in favour of the assignee if and only if the debtor has received a notice in writing from the assignor or the assignee which reasonably identifies the claim which has been assigned and requires the debtor to give performance to the assignee.

<sup>29</sup> GÁRDOS, P. (2003.): 9. p.

<sup>30</sup> UNIDROIT Convention Article 1. point. c.) A notice of the assignment of the receivables is to be given to debtors.

<sup>31</sup> UNIDROIT Convention Article 8.

<sup>32</sup> GÁRDOS, P. (2003.): 9. p.

<sup>33</sup> UNIDROIT Convention Article 1. Point 4., Article 8.

<sup>34</sup> PRINCIPLES 11:303. (1)

<sup>35</sup> UNIDROIT Convention Article 1. point 4. a-c.)

(a) a notice in writing need not be signed but must identify the person by whom or in whose name it is given;

(b) "notice in writing" includes, but is not limited to, telegrams, telex and any other telecommunication capable of being reproduced in tangible form;

(c) a notice in writing is given when it is received by the addressee.

Explains that it is not necessary to supply the written notification with a signature, but it is necessary to mark the sender's person identifiably. The Convention considers the telex, the telegram and other distance communication a written notification.

Content restrictions are made the foreigner (the French *bordereau*), concerned the international rules equally. The UNCITRAL Convention defines the definition of the assigned claim and regulations concerning the language of a notification that is aimed at, that the debtor is allowed to interpret the notification punctually.<sup>36</sup>

The UNIDROIT Convention considers an important content element of the notification the reasonable indication of the claim and the factor (assignee). But, the measure does not give guiding what it understands under this, it does not interpret the concept of rationality.<sup>37</sup>

An interesting rule furthermore, that considers the notification valid if it concerns claims like that only, that arise at the time of the sending of the notification or before it on the basis of the bound sales contract. We may draw the conclusion from this that it is possible to enter into a factoring contract onto a future claim, but it is worth sending the notification only after the formation of the basic legal relationship.

Important, that the notification may be occurred to consider only then, if the addressee got it.<sup>38</sup>

The European Union's rule system formulates the content rules related to the notification similarly, the obliged has to take over the notification, the notification has to imply furthermore a reasonable indication onto the claim relevantly and a fulfilment notice.

The European Union's regulation draws a distinction between the assignor's and the assignee's notification furthermore, mentions that case circle concerned, if the claim obliged hears of the claim's transfer on another manner.<sup>39</sup>

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<sup>36</sup> GÁRDOS, P. (2003.): 9. p.

<sup>37</sup> UNIDROIT Convention Article 8. Point 1. a-c.), point 2..

1. - The debtor is under a duty to pay the factor if, and only if, the debtor does not have knowledge of any other person's superior right to payment and notice in writing of the assignment:

(a) is given to the debtor by the supplier or by the factor with the supplier's authority;  
 (b) reasonably identifies the receivables which have been assigned and the factor to whom or for whose account the debtor is required to make payment; and  
 (c) relates to receivables arising under a contract of sale of goods made at or before the time the notice is given.

2. - Irrespective of any other ground on which payment by the debtor to the factor discharges the debtor from liability, payment shall be effective for this purpose if made in accordance with the previous paragraph.

<sup>38</sup> UNIDROIT Convention Article 5.

<sup>39</sup> PRINCIPLES 11:303. (2)-(4):

(2) However, if such notice is given by the assignee, the debtor may within a reasonable time request the assignee to provide reliable evidence of the assignment, pending which the debtor may withhold performance.  
 (3) Where the debtor has acquired knowledge of the assignment otherwise than by a notice conforming to paragraph (1), the debtor may either withhold performance from or give performance to the assignee.  
 (4) Where the debtor gives performance to the assignor, the debtor is discharged if and only if the performance is given without knowledge of the assignment.



There is an opportunity here in case of the notification coming from the assignee onto the request of the justification, but the provisions guarantee a right for retention for the debtor here.

The European Union's provisions regulate that case circle if the obliged hears of the assignment on a different manner from the notification. In this case the obliged may accomplish towards the assignee or may retain the fulfilment, but onto no case may accomplish towards the assignor.

But the European Union's regulation is incomplete in that respect, that it does not direct the concept of a "different manner", making the fulfilment vague. It does not go into detail about the case that the indebted exposes him to the twofold fulfilment, if he performs not for authorised. The regulation thinks to this only in the case of the notification, prefers only the subjective viewpoints. The obliged is not getting rid even in case of a notification if he knows about the fact that the assignee is not the eligible person for the fulfilment.<sup>40</sup> The subjective viewpoints make the fulfilment difficult likewise and the parties are made unsure.

It may mean an additional problem in connection with the notification if the obliged receives more notification.

In the practice the consequences deriving from the wrong fulfilment are limited with provisions put into the factoring contract by the factor firms and loan offices.

If the debtor performs to the supplier and does not for the factor, the supplier intervenes in that manner as the representative of the factor and the supplier is obliged to transfer the amount for the factor firm promptly.

The European regulation orders the problem on the basis of the order of satisfaction which was established to the *competing demands and the competing claimants*.<sup>41</sup>

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<sup>40</sup> PRINCIPLES 11:304.: A debtor who performs in favour of a person identified as assignee in a notice of assignment under Article 11:303 is discharged unless the debtor could not have been unaware that such person was not the person entitled to performance.

<sup>41</sup> PRINCIPLES 11:305.: Competing Demands

A debtor who has received notice of two or more competing demands for performance may discharge liability by conforming to the law of the due place of performance, or, if the performances are due in different places, the law applicable to the claim.

11:401.:Priorities

- (1) Where there are successive assignments of the same claim, the assignee whose assignment is first notified to the debtor has priority over any earlier assignee if at the time of the later assignment the assignee under that assignment neither knew nor ought to have known of the earlier assignment.
- (2) Subject to paragraph (1), the priority of successive assignments, whether of existing or future claims, is determined by the order in which they are made.
- (3) The assignee's interest in the assigned claim has priority over the interest of a creditor of the assignor who attaches that claim, whether by judicial process or otherwise, after the time the assignment has taken effect under Article 11:202.
- (4) In the event of the assignor's bankruptcy, the assignee's interest in the assigned claim has priority over the interest of the assignor's insolvency administrator and creditors, subject to any rules of the law applicable to the bankruptcy relating to:
  - (a) publicity required as a condition of such priority;
  - (b) the ranking of claims; or
  - (c) the avoidance or ineffectiveness of transactions in the bankruptcy proceedings.

The Union's regulation does not give a solution the problem of the repeated assignment, it only takes action, that the obliged may prevent his responsibility, and has as consequence the solution under the place of the fulfilment or the effect of the law to be applied to the claim.

The provisions declare concerning the subsequent, more consecutive assignment that the temporal order of the assignments are influential in case of the consecutive claims but the order prevails if the obliged is informed about this, and the solution happens on the basis of the notification.

Interesting to emphasize among the rules the two provisions that directs the interest collision between the rivalling claimants and the assignee and it would be expedient lifting this into the domestic regulation, and to modify the laws being about the bankruptcy proceedings and liquidation concerned according to this.

The claim of the assignee concerning the demand precedes the claim of the assignor's creditor in the course of the judicial proceedings according to the Union's provisions, or the claim is enforced by the assignor's receiver, liquidator and creditor.. That is it would not be possible to involve the assigned claims neither in the circle of the execution procedure, nor the liquidation procedure.

Important fields of the regulation are the responsibility questions related to claim likewise. The Union's principles do not imply the responsibility for the solvency that is the Union's regulation big deficiency to my opinion.

The Union's rules imply triple covenant, which have to come true in the time of coming into force of the entitlement:

- entitlement onto the transfer of the claim;
- the existence of a claim and the exemption from objections and other rights;
- exemption from the previous assignment, a third party's security right and other burdens.<sup>42</sup>

It can be seen well so, that the regulation emphasizes beside the exclusion of inclusion's right, also the exemption from claims and burdens, which would be necessary to lift into the Hungarian legal regulation because of the reasons mentioned above.

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<sup>42</sup> PRINCIPLES 11.204.Undertakings by Assignor

By assigning or purporting to assign a claim the assignor undertakes to the assignee that:

(a) at the time when the assignment is to take effect the following conditions will be satisfied except as otherwise disclosed to the assignee:

- (i) the assignor has the right to assign the claim;
  - (ii) the claim exists and the assignee's rights are not affected by any defences or rights (including any right of set-off) which the debtor might have against the assignor; and
  - (iii) the claim is not subject to any prior assignment or right in security in favour of any other party or to any other in cumbrance;
- (b) the claim and any contract under which it arises will not be modified without the consent of the assignee unless the modification is provided for in the assignment agreement or is one which is made in good faith and is of a nature to which the assignee could not reasonably object; and
- (c) the assignor will transfer to the assignee all transferable rights intended to secure performance which are not accessory rights.

#### 4. The rights and the obligations of the indebted

Beside the factor and the supplier is the indebted participant of the factoring contractual relationship in this manner the rules of the factoring and the assignment touch upon in detail for the *indebted rights and obligations*. The factoring contractual relationship even only the assignment, does not mean the transfer of the creditor's position, but always concerns single claims, and not onto the full contractual relationship, since the latter one belongs to the concept of the contract transfer.<sup>43</sup>

It follows from this that the assignment does not affect the position of the indebted, the assignor remains entitled to the single rights deriving from the contract, he is due for, in this manner, or in case of wrong fulfilment, the right of the claim of the correction, or price reduction.<sup>44</sup>

With regard to the obliged the contractual relationship does not become burdensome, but the debtors are not always glad about the appearance of the factor in the practice of the factoring, since the fulfilment of the obligation being linked to the payment may accelerate up.

The reason of this, that the factor is not pledging himself for the customer, is not relating onto the item of additional salary deferments, allowances, can make an appearance in more efficacious in the interest of the claim performing in a deadline because of this.

The obliged rights and obligations is approached from the side of the debtor protection all the literature<sup>45</sup>, all the single measures<sup>46</sup>, with which I do agree neither in respect of the factoring contractual relationship, nor in connection with the assignment and I distribute the related concern with this of the single literature points of view.<sup>47</sup>

It can be related in generality, that the factoring is made difficult the rights of the obliged (the right of an objection, an inclusion, reclamation) beside the other risks, that an opportunity is provided to the obliged for the claim validation towards the factor, in spite of the fact that the factor did not take part at the formation and fulfilment of the original contractual relationship, any kind of imputation does not burden.

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<sup>43</sup> PRINCIPLES 12:201

(1) A third person may undertake with the agreement of the debtor and the creditor to be substituted as debtor, with the effect that the original debtor is discharged.

(2) A creditor may agree in advance to a future substitution. In such a case the substitution takes effect only when the creditor is given notice by the new debtor of the agreement between the new and the original debtor.

See: Ptk. draft (5:180.§-5:183.§)

<sup>44</sup> Ptk. Conception (2006.): 188-189. p.

<sup>45</sup> GÁRDOS, P. (2004.): 15. p.

<sup>46</sup> We find such regulations in the UNICTRAL Conventionyben (preambulum), and in the Principles of European contract Law (11:301. -11:401.

<sup>47</sup> MADLOVITS, Zoltán: A faktorálás alapjai a magyar jogban II. [The basics of the factoring in the Hungarian law]Céghírnök 2/1997. 11. p.

The European Union's regulation deals with this area. The European Union's provisions though the regulation of the objection limiting provisions is not made, but the inclusion right is bound to a condition.<sup>48</sup>

The double condition system declares alternatively that the offset has to be obtaining at time of the receipt of the notification, or has to be attached to the assigned claim tightly.

This latter exception broadens the inclusion right, since the offset not existing at the time of the notification is accountable if it is attached to the basic legal relationship, from what the claim derives.

Only the international law provisions imply the reclamation right expressly, but all the UNIDROIT, all the UNCITRAL Convention disposes on it.<sup>49</sup>

The reclamation right means that the debtor is entitled to reclaim the paid sum from the factor following the fulfilment, that even more problematic, than the issue of the objections

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<sup>48</sup> PRINCIPLES 11:307 Defences and Rights of Set-Off

- (1) The debtor may set up against the assignee all substantive and procedural defences to the assigned claim which the debtor could have used against the assignor.
- (2) The debtor may also assert against the assignee all rights of set-off which would have been available against the assignor under Chapter 13 in respect of any claim against the assignor:
  - (a) existing at the time when a notice of assignment, whether or not conforming to Article 11:303(1), reaches the debtor; or
  - (b) closely connected with the assigned claim.

<sup>49</sup> GÁRDOS, P. (2004.): 15. p.

## **THE IMPACT OF THE AGEING TO THE PENSION SCHEMES IN EUROPE**

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### **Introduction**

An ageing society is characterised by a growing proportion of the retired to the active working population. Societies age either when fertility rates decline so that fewer children are born, or when longevity increases, or both. Ageing affects virtually all societies today, but more so the industrial countries, which have generally experienced it over a longer period and for which further pronounced ageing is projected over the next four decades, at the end of which a peak in the proportion of the elderly is likely to be attained. Concerns about the challenges posed by ageing populations have moved to the forefront of the public policy debate in many countries.

In the industrial countries, public schemes for providing for the retired are predominantly of pay-as-you-go (PAYG) types, whose coverage is typically comprehensive, but which are frequently supplemented by funded schemes, mostly operated by the private sector. A standard PAYG system levies payroll taxes on the working population, while paying benefits to the retired, but usually without the close person-based relationship between individual contributions and benefits that characterises fully funded schemes.

In the early stages of a PAYG system, low contribution rates are sufficient to cover benefits of a relatively small number of beneficiaries, but as the scheme matures, benefits paid out tend to exceed contributions, requiring increases in payroll taxes or budget transfers. However, considerable additional fiscal stress is likely to emerge under a PAYG system as the proportion of the retired elderly rises. And if, as is typically the case, the PAYG scheme also involves various redistributive elements, there is further potential for fiscal stress, especially as the population ages. A failure to address the resulting fiscal stresses, coming on top of an already burdensome fiscal situation, could inflict serious macroeconomic and structural damage, both on the domestic economy and, in the case of large industrial countries through international linkages, on the world economy.

The potentially serious fiscal, economic, and social consequences of population ageing raise complex issues, not least of which are political issues that arise whenever the distributional impact of a major public program is reconsidered. In principle, individuals should be responsible for making adequate provision for their own retirement. In practice, this has not been judged appropriate for a variety of reasons, necessitating publicly supported schemes. In fact, public pension schemes are widely credited with having led to significant reductions of poverty rates among the elderly. Nevertheless, the issue of how the burden of supporting the aged is to be distributed may become particularly contentious as

the proportion of the working population declines, while at the same time the political strength of the elderly increases.

Growing recognition of the potential consequences of population ageing has prompted widespread discussion of the problems and of what to do about them. Among the most recent studies, a World Bank (1994) report forcefully advocates moving to a three-pillar system for providing old age security: a mandatory publicly managed pillar with the limited goal of reducing poverty among the elderly; a mandatory privately managed pillar providing fully funded pensions; and a voluntary savings pillar.

### **The characteristics of ageing population in Hungary**

Population ageing from a demographic point of view is a natural process, generated by demographic transitions. Fall in fertility and mortality from their high level in the predecline period to the recent low ones has involved not only robust changes in the population size, but also long-term transformation of the age-structure. This is called population ageing. Consequently, ageing is a basic process of population development in the 20<sup>th</sup>–21<sup>st</sup> centuries. In this light, ageing is not a demographic crisis, but quite to the contrary, it mirrors a general trend of human development aimed at achieving longevity and well-being.

The most documented feature of population ageing is the growing size of the elderly population and its increasing share of the total population. Other features include a rise in the average age of population, a decreasing proportion of children, increasing old age dependency ratio. When judged by these criteria, the ageing process is not a new demographic phenomenon in Hungary. In fact, population ageing in Hungary, as in other developed countries began over a century ago, with the onset of transition in fertility and mortality from high to low levels. At the dawn of the 20<sup>th</sup> century, Hungary's population was very young in demographic terms. Nearly half of the population was below 20 years of age. Children outnumbered the elderly (taken as those aged under 20 and 60 years and over, respectively) by 6 to 1.<sup>1</sup>

Between 1901 and 1949, the number of Hungarians aged 60 years and over increased almost two-fold, from 514 thousand to 1,073 thousand. Over the next 52 years, it has doubled again reaching 2079 thousand in 2001. This was much faster than the rise of the number of those in working ages or the growth of the total population. The number of young people under 20 even decreased, mostly and sharply after the 1960ies.

Population ageing means not the rising number of older people, but growing proportions of them, and, obviously, shrinking proportions of younger age groups. In Hungary proportion of those under 20 fell from 44,9 percent to 23,1 percent during the last century. Excess of young over the elderly has gradually disappeared. Share of people aged 60 and over increased from 7,5 percent to 20,4 percent.

Latest projections indicate that the population aged 60+ is expected to grow by about one million up to the middle of the century, to reach 2,941 thousand by 2050. This is expected to make up 33,6 percent of the total population projected. Large generations borne

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<sup>1</sup> László Hablicsek: *Demographics of population ageing in Hungary*, (Conference paper, Project on Intergenerational Equity, International Workshop, Institute of Economic Research, Hitotsubashi University, Tokyo, 20-21 February 2004.) 2.p.

in the 1950ies and 1970ies will accelerate the process when enter the group of elderly people.

At present there are about as many elderly as children in Hungary, in terms of age groups 60+ and 0-19. By 2050, there are projected to be at least 80 percent more elderly than children. New phenomenon of shrinking labour force poses new challenges for the society. The share of those in working ages is expected to decrease below 50 percent, while their number will falls to a level back before World War I, only 4 million.

In Hungary challenges of population ageing are strongly connected with the challenges of the population decline.<sup>2</sup> Population size has already decreased by 600 thousand since 1981. The decline is expected to continue, by 2050, there will be 8767 thousand inhabitants in Hungary, by almost 1.5 million less than now.

Population decline and ageing are in strong relationship in Hungary. One can say that the smaller the population size will be, the more developed stage the ageing process will reach. It means that population decline is not a solution of undesirable effects of ageing.

Population ageing has a very strong impact in many domains since it changes the dependency ratio. It is a fundamental economic issue that ageing alters the burden of transfers from those in work to the dependent population. In Hungary, old age dependency ratio almost doubled in the 20<sup>th</sup> century and it will happen also during the next 50 years. Nevertheless, the next period show an essential difference from the past regarding the total dependency. After a long period of low level caused mainly by below replacement fertility, Hungary will face to a sharply increasing total dependency ratio.

These estimations draw on the baseline variant of the 2001-based population projections for Hungary, which cover the period to 2050. This variant assumes that during the projection period, the life expectancy at birth for males will increase from 68,2 years to 76,5 years and for females from 76,6 years to 82.6 years. Concerning international movement, there will be a net migration gain of 12,000 persons per year.

Fertility also is assumed to increase to the medium level of 1.6 children per women.

Time series of population figures in the past and projected underline that ageing even takes place within the group of older persons. The fastest growing age groups in Hungary are the oldest old, those aged 85 years and older. Compared to 1901 its size is 14-fold now and it will be 34-fold by 2050 according to the projection.<sup>3</sup> It is also clear that the working-age population is getting older. Even among young people under 20, the average age is now older than it was in the past.

Population ageing is determined by the long-term joint effect of its determinants, fertility, mortality and migration. In Hungary, mostly general trend of demographic transition influenced the ageing process to the middle of the last century. In the time of communist regime between 1950 and 1990 the mortality crises slowed down the ageing process, while below replacement fertility combined with massive emigration flows influenced the process to accelerate. As a consequence, Hungary's population is rated to be very old in worldwide context at the present.

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<sup>2</sup> László Hablicsek, (2004) 3. p.

<sup>3</sup> László Hablicsek, (2004) 4.p.

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### Demography in the European Union

The population of the European Union is expected to slightly grow until 2025 due to immigration, but then it will start to shrink: in 2005 the population totalled 458 million, in 2025 it will total (not counting with the effect of enlargements) 469.5 million (+2 per cent), and it will equal 468.7 million by 2030. Between 2000 and 2030, the ratio of the European population to the rest of the world will decline from 12 per cent to 6 per cent. The setback is even faster and more significant among the working age citizens (from 15 to 64 years): between 2005 and 2030, the number of working age people will drop by 21 million.

Life expectancy, including healthy life expectancy is continuously rising due to improved healthcare services and the quality of life in Europe. This process is expected to continue in the future, too. The difference in life expectancy between men and women will shrink, and the birth-rate will remain permanently low. The baby-boomer generation has had fewer children than previous generations. The low birth-rate can be attributed to several factors: the difficulties in finding a job, lack and cost of housing, the older age of parents at the birth of their first child, or the change in attitude to higher education, career and family life.<sup>4</sup> The EU has lost its demographic engines: member states in which the population is not expected to shrink by the year 2050 represent an extremely small portion of the entire European population. From among the five most populous member states, only the population of Britain and France is expected to grow between 2005 and 2050 (by 8 per cent and 9.6 per cent, respectively). In certain member states, population decline will set in as early as before 2015, and in some cases it will exceed 10 per cent or even 15 per cent by 2050. Recently, immigration has mitigated the consequences of the low birth-rate in several countries, but it has also raised serious social problems. The situation of the two new member states (Bulgaria and Romania) further increases the demographic differences, and the forecasts pertaining to them also reinforce the negative tendencies (a population drop of 21 per cent and 11 per cent, respectively by 2030), just like the statistics of the UN and EU candidate, Croatia (-19 per cent). On the other hand, the population of Turkey is expected to grow by more than 19 million between 2005 and 2030 (+25 per cent).

However, the real problem is caused not by the decline in the total population of the EU- 25, but rather by the significant changes in the age structure. In the 40-year period beginning in 2010, the working age population (15 to 64 year-old citizens) will decline by 48 million, i.e. by 16 per cent, while the number of people over 65 will increase by 77 per cent. Thus, the number of people over 65 will double, and by 2050 they will account for 51 per cent of the population. If we do not count with young people below the working age, a dreadful and dangerous trend is evolving in terms of economic and social development: while currently there is one elderly person for every four workers, by 2050 there would be one elderly person for every two workers, i.e. the old-age dependency rate will double. Clearly speaking, this means that today four workers provide for one pensioner, and by the middle of the century only two workers will do the same!

The population decline has *benefits*, too: fewer people occupy a smaller area, and there is less fight for food and resources. The ageing of the population also means that people live longer, mostly due to their good state of health. The population drop is the

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<sup>4</sup> Attila Marján: *Ageing and the European pension schemes*. Public Finance Quarterly, Volume LIII., 2008/1. 55.p.



consequence of prosperity, as well as the social relations that have changed due to prosperity. However, prosperity means much more than high living standards. Today's western society with its concept of "everything is possible, so I want everything" is entrapped in many aspects due to its own level of development. Many women refuse to bear children so that they could continue their careers, but the loosening of family ties, and the "general life feeling" attached to the age of turbo-globalisation also result in the fact that much fewer people decide to have children than a couple of decades ago. This means that in the European society a declining number of people will live for a longer time. In other words, we are getting older.

Ageing is a multiple challenge. First, it weakens the performance of the economy, the potential for growth. Second, it puts astronomical costs on the state due to soaring pension and healthcare expenditures, and thus jeopardises the fundability of the national economies. Third, it leads to the significant restructuring of social relations, and may even cause serious tension between the generations, since the diminishing younger generations must undertake an increasing burden for older generations that are getting more and more populous.

How can Europe handle these enormous demographic changes? By the middle of the century the population of Europe will decline so dramatically that the ageing trend can only be partially offset by the increasing number of immigrants. Population decline equals ageing, and ageing means the decline in the EU's growth potential! Due to ageing, or the rise in the share of pension-age people, the EU's GDP growth capacity may drop from the current 2 to 2.25 per cent to 1.25 per cent by 2040, which will lead to the marginalisation of Europe.<sup>5</sup> If the growth rate of the global competitors exceeds ours by several fold, we can easily see that the lag between them and us is growing steadily and increasingly rapidly.

Most people already clearly understand that the ageing population of Europe severely jeopardises the public finances of most EU member states. At the same time, we do not pay sufficient attention to the economic impacts of ageing. According to the forecasts, the EU's employment rate will grow from 63 per cent in 2003 to 67 per cent in 2010, and in 2020 it will reach the rate of 70 per cent earmarked in the *Lisbon objectives*. This growth will be the result of the higher employment rate of women, which will grow from the current 55 per cent to 65 per cent. The employment of older job seekers will also rise. While today 40 per cent of the 55–64 age cohorts remains on the labour market, this ratio is expected to rise to 50 per cent by 2025. Naturally, this can be regarded as a positive development, but at the same time these changes result in a decrease in Europe's growth potential. In the EU-15, the current average annual GDP growth potential will decline from 2.3 per cent to 1.8 per cent between 2010 and 2030, and then to 1.3 per cent by 2050. The decline will be even more prominent in the ten new member states: it will drop from the current 4.3 per cent to 3 per cent between 2011 and 2030, and then to 0.9 per cent between 2031 and 2050.

All these projected changes make the EU face significant economic and budgetary challenges.

Immigration will be the key tool for population replacement. However, it will play a less significant role in labour replacement, since unemployment, in general, is much

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<sup>5</sup> Attila Marján: *Ageing and the European pension schemes*. Public Finance Quarterly, Volume LIII., 2008/1. 56.p.

higher among immigrants than the average unemployment rate. Therefore, in addition to social tensions, immigration also puts financial burdens on the governments. The growth in female activity also represents a considerable potential resource: the working age population will decline as early as in 2010, yet the actual employment rate will grow until 2017. Two thirds of this growth will be attributed to women entering the labour market. In this relation Europe needs to find out how the female employment rate can be increased without a further decline in birth rates. Due to the changing European lifestyle women decide to have children later in life. Often they wait until it is too late, and having children is becoming less important in a growing number of relationships.

Only in Great Britain as many as 90,000 – otherwise wanted – children are not born because the mothers decide to postpone giving birth and decide to continue with their careers, primarily for financial reasons. One in every three British women who have had children in their early twenties can only find less well-paying jobs after returning to the world of work. According to the estimates, a woman who has a child at the age of 24, suffers a financial loss of nearly 560,000 during her lifetime compared to a woman with similar qualifications and no children.

At the same time, however, the EU should make people aware that young people are becoming a rare treasure that is not sufficiently acknowledged. In December 2004, the unemployment rate among people under 25 equalled 17.9, while the same ratio was 7.7 per cent among citizens over 25. Young people are especially exposed to the risk of poverty, i.e. to an income level below 60 per cent of the average income. As many as 19 per cent of the 16–24 age cohort belongs to this category, compared to 12 per cent of the 25–64 age cohort. This rate exceeds even the poverty rate of elderly people over 65 years of age (17 per cent).<sup>6</sup> The growth of intergenerational tension is by no means a negligible social problem. Western European baby-boomers, i.e. the generation born in the wake of World War II, grew up in an environment of unprecedented economic growth, won the revolution of 1968, and can expect generous pensions. They represent the generation of the Golden Age of Europe, which in the midst of material growth “forgot” to have a sufficient number of children. Therefore, the subsequent generation, much smaller in number, must provide pensions for the well-off ancestors. However, the tension is caused not only by the imbalance of the intergenerational income transfer, but also by the fact that while the prosperity declines, the older generation prevents the new middle-class generation from gaining dominance.

The intergenerational problem is the gravest in France, where the current 20 to 40 year-olds represent the first generation in modern-time history that needs to prepare for lower living standards than their parents had. In 1973, only one in every 15 young graduates was unemployed, while today it is one in every four! Salaries have been far from keeping pace with real estate prices that have doubled or tripled in the past two decades, which makes it extremely difficult for young people to solve their housing problems. In addition to deteriorating the welfare conditions, this leads to rigid social relations, freezes intergenerational mobility and increases the disappointment of the younger generations. *Denis Jeambar*, the well-known French journalist – a baby-boomer himself – admitted ruthlessly bluntly in his famous article: “our children will hate us.”

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<sup>6</sup> Attila Marján: *Ageing and the European pension schemes*. Public Finance Quarterly, Volume LIII., 2008/1. 57.p.

Furthermore, ageing considerably increases healthcare and nursing costs. An ageing society represents a great economic challenge not only to the budget, but also to corporate pension funds and life insurance companies. Since these companies manage contracts of huge sums, i.e. they promise the payment of enormous amounts to their clients, demographic changes have very significant financial implications. For instance, when a space technology company called BAE reviewed the prospects of its corporate pension fund in 2005, ten years after the previous review, it increased its forecasts for the expected expenditure of the pension fund by GBP 2.1 billion (EUR 3.7 billion!) having calculated the predicted demographic changes.

On the London stock exchange, from among the top 100 companies Rentokill was the first to announce at the end of 2005 the closure of its corporate pension fund that had offered fix pensions to members, since it was struggling with a deficit of nearly 0.5 billion. According to estimates made by Deloitte and Touche, the deficit of the pension funds of the top 100 British firms totals more than GBP 100 billion!

Despite the deteriorating demographic trends, the employment rate will be high enough to save Europe's economic growth from a fatal blow. The precondition for this is to reverse the unemployment trends and start the reforms in time. Due to the shrinking labour base, Europe's only opportunity for economic growth is the improvement of economic efficiency, i.e. competitiveness. Ageing will slash the growth potential of European countries by half in a few decades. Central and Eastern European countries will be hit the hardest, since their current growth rate of 4.5 will drop below 1 per cent by 2030. Maybe the biggest source of danger associated with the ageing society is the unsustainability of the European pension schemes, wherefore one of the biggest tasks of the near future is the execution of the pension reform.<sup>7</sup>

### **Ageing and pensions in Hungary**

Hungary's retirement-income system combines an earnings-related public pension scheme with mandatory, private, defined-contribution plans. The private component is, by definition, funded while the public scheme is financed on a pay-as-you-go basis, whereby current contributions pay for current benefits. OECD projections suggest that, in the long term, around one-third of retirement incomes will come from the defined-contribution plan with the other two-thirds coming from the public earnings-related scheme.<sup>8</sup> Simulating the operation of the existing pension system under conditions of predictable demographic change reveals a large increase in future expenditures resulting from significant population ageing.

In Hungary, the pension problem started to become critical in the mid-1990s. The government faced the problem of a pension system that was becoming increasingly financially unsustainable. This was due to several developments:

- Population ageing reached an advanced stage; the share of 60+ exceeded 20 per cent

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<sup>7</sup> Attila Marján: *Ageing and the European pension schemes*. Public Finance Quarterly, Volume LIII., 2008/1. p. 58

<sup>8</sup> OECD (2007), *Pensions at a Glance: Public Policies across OECD Countries*, 2007 edition, OECD, Paris. pp. 50-51; due to differences in assumptions this result differs from that of national projections.

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- Pension rights rocketed due to the full employment situation during the former regime
  - The economic crisis and loss of millions of jobs boosted early retirement and the take-up of disability benefits
  - A dramatic fall in labour force participation resulted in a large downturn in contributions
  - The social support provided by the pension system began to exceed the limits of what was possible

In 1997, after heated discussions, five laws were passed in Hungary with a view to reforming the pension system. The main elements were:

- Keeping the PAYG system with defined benefits as a first pillar, with the intention of introducing individual accounts in the future
- Gradually increasing and harmonising the retirement age for males and females to 62 years
- Introducing a second mandatory pillar for new entrants into the labour market and providing at least 25 per cent of defined benefit in the first pillar
- Introducing a voluntary third pillar
- Supporting the second and the third pillar through tax reductions
- Introducing an old-age social benefit for those who have accrued no rights to a pension or who do not receive a minimum pension.<sup>9</sup>

The new pension system was introduced in 1998. People entering the labour market after 1998 have to contribute to the new scheme. Older workers could choose between the new mixed public-private system or remain with just a public pension (on reformed rules). The proportion of earnings contributed to (mandatory) private pension plans increased from 6% initially to 7% in 2003 and 8% from 2004 onwards.<sup>10</sup> Finally, workers have been able to switch back from the mixed public-private system to the purely public pension system at various times since the reform.

Other notable elements of the reform included an increase in the pension eligibility age. For men, this has risen from 60 to 62 years, and for women it will eventually also reach 62, from a starting point of 55. The indexation of pension benefits changed from the growth of average earnings to a 50:50 mix of real earnings growth and consumer price inflation. Finally, pension benefits used to be calculated on the basis of individual net earnings, but this will change to gross earnings from 2013 onwards.

The effect of these reforms is to increase expected retirement incomes. The net replacement rate – retirement income relative to earnings, after taxes and contributions – for an average earner with a full career (from age 20 to the normal pension age) is projected to be 102.2% under the new system, including the expected value of the defined-contribution pension.<sup>11</sup> This compares with 80% for women and 88% for men with a full career under the pre-reform rules.

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<sup>9</sup> László Hablicsek, (2004) 17. p.

<sup>10</sup> Pension reform: providing old-age income security in the face of population ageing reforms for stability and sustainable growth – ISBN -978-92-64-04376-3 OECD 2008. 87.p.

<sup>11</sup> OECD, 2007, Part II.1

However, the increase in retirement age offsets the effect of the higher net replacement rate. Net “pension wealth” – the present value of the lifetime flow of pension benefits – is projected to fall from 11.2 times annual earnings, for a man on average pay, to 10.8 times. For women, pension wealth falls from a comparable multiple of 15.1 to 13.4. Nevertheless, these reductions in lifetime benefits – 5% for men and 10% for women – are significantly lower than the average cuts in lifetime pension benefits entailed by reforms in other OECD countries. In the 16 countries that have had major retirement-income reforms since 1990, the overall effect was to cut benefits by an average of 22% for men and 25% for women.<sup>12</sup>

More limited changes to Hungary’s pension system, focused on improving incentives to delay retirement, were enacted in 2006-07. The first of these will restrict the ability to combine working and claiming an early-retirement pension. Government figures suggest that around 15% of people on early-retirement benefits continue working, of which between a third and a half are working full time. A second change will alter the reduction in pension benefits for people taking early retirement. For retirement at age 60 rather than 62, the reduction in pension benefits under previous rules was, at most, 2.4% per year. After the changes, this will increase to 4.2% per year.<sup>13</sup>

### **The costs of the pension system**

Hungary currently spends 10.4% of its gross domestic product (GDP) on pensions, around the same as the average for the 25 European Union (EU) member states (before the membership of Bulgaria and Romania). However, this is significantly less than in a number of EU countries, such as Austria, France, Germany and Italy.<sup>14</sup>

Looking ahead, public pension spending as a share of national income in Hungary is expected to rise steadily, both relative to other countries and in absolute terms. In contrast, recent reforms are expected to stabilise public pension spending in Austria, France, Germany, Italy and Sweden. With the partial privatisation of pension provision in Hungary, one might have expected that public spending on pensions would be contained in the long term, as in the case of projections for Poland and the Slovak Republic, which have enacted similar pension reforms; but this is not the case.

The average public pension in Hungary is larger (relative to income) than the OECD average. Nonetheless, because of the partial privatisation of retirement-income provision, it is less than in a number of other countries, including France and Italy. However, average public pension wealth is much lower in a number of countries, including Germany, the United Kingdom and the United States. At the far left of the spectrum, public pension wealth is lowest in two of the other countries that have partially privatised pensions: in Poland and the Slovak Republic, average pension wealth from public schemes is only about half the OECD average.

An important explanation for Hungary’s result on these measures of pension systems is the relatively low statutory retirement age. This will remain the case even when currently scheduled increases are fully in place. OECD countries plan, on average, to have a pension eligibility age of 65 years. At that age, life expectancy (expected duration of retirement) averages 18.5 years in half the OECD countries. Hungary’s planned retirement

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<sup>12</sup> OECD, 2007, Part II.1

age of 62 years coincides with an unusually low life expectancy by international comparison, especially among adult men.<sup>15</sup>

Following the reform, Hungary's public pension system exhibits a very strong link between earnings, contributions and pension entitlements. Replacement rates will be the same for all workers with the same career pattern, regardless of their earnings: there is virtually no redistribution from rich to poor in the system. Seven other OECD countries have retirement-income systems with similarly strong links between earnings and benefits. But the other 22 OECD countries have systems with higher replacement rates for lower-income workers. The principal objective of these arrangements is to avoid old-age poverty while containing public spending on old-age incomes.

The absence of such redistribution in Hungary may explain – in part at least – why the level of replacement rates is so high across the earnings range: if redistribution is precluded, then a very high replacement rate is needed to avoid old-age poverty among people with low lifetime incomes. Efforts to improve the fiscal sustainability of the Hungarian public pension system must be mindful of the consequences for low-income workers and those with less than full careers.

The Hungarian pension system covers a relatively small share of the population of working age. The number of active contributors amounts to 52% of the population aged 15-64.<sup>16</sup> This compares with an average of 64% in OECD countries as a whole. Relative to the labour force, coverage is 86% in Hungary, the same as the OECD average. This reflects the relatively low labour force participation rates in Hungary.

Relatively few older Hungarians participate in the labour market (Figure 4.4). For men, the participation rate for 50-64 year-olds of around 55% is the second lowest among the 30 OECD countries, substantially below the OECD average of 75%. Only around 45% of Hungarian women in this age bracket participate in the labour market. Although this is by no means the lowest figure for OECD countries, it is well below the OECD average of just over 50%.

Part of the explanation of these findings is that the effective retirement age for both men and women in Hungary is the second lowest among OECD countries. For both sexes, the average effective retirement age is less than 60, well below the statutory retirement age in Hungary.<sup>17</sup>

National figures show that only 6% of pensions are first drawn at the statutory retirement age, while 82% are drawn before that under early-retirement provisions. An additional 12% are drawn earlier than normal retirement age under privileged rules for certain occupations and industrial sectors. Between 1998 and 2003, the average age of men starting to draw pensions remained steady at around 60, despite the increase in statutory retirement age from 61 to 62 in 2000. For women, the pension eligibility age increased from 56 to 59 years over the period 1998-2003, while the average age of women starting to

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<sup>13</sup> An average of 0.3% per month for ages 61-62 and 0.4% per month for 60-61.

<sup>14</sup> Pension reform: providing old-age income security in the face of population ageing reforms for stability and sustainable growth – ISBN -978-92-64-04376-3 OECD 2008. 89.p.

<sup>15</sup> Pension reform: providing old-age income security in the face of population ageing reforms for stability and sustainable growth – ISBN -978-92-64-04376-3 OECD 2008. 90. p.

<sup>16</sup> The standard definition of "working age."

<sup>17</sup> Pension reform: providing old-age income security in the face of population ageing reforms for stability and sustainable growth – ISBN -978-92-64-04376-3 OECD 2008. 93. p.

draw pensions rose by two years (from 56 to 58) over the same period.<sup>18</sup> Women's average retirement age increased by a further year between 2003 and 2007.

There is no unambiguous answer to the question why people retire early in Hungary. However, there is evidence regarding how people retire early. Early retirement in Hungary occurs predominantly using the early-retirement provisions of the old-age pension system. Long-term unemployment is a relatively rare pathway into early retirement in Hungary, as is disability benefits (for men, at least).

There is ample evidence – from both national and cross-country studies – that the financial incentives embedded in the pension system affect retirement behaviour,<sup>19</sup> and changing retirement incentives has been a central concern of recent pension reforms, both in Hungary and elsewhere. Retirement incentives matter for reasons of fairness and equity as well as efficiency. People who work more and contribute more should have higher pensions.

Equally, those who are forced to drop out of employment early, perhaps through no fault of their own, need to have a reasonable standard of living. The aim should be to have a pension system that neither excessively subsidises, nor excessively penalises, early retirement.

### **The “pension bomb”**

Europe is sitting on a ticking pension bomb, i.e. the current European pension schemes cannot be sustained. The ratio of people in need of care is rapidly growing, especially in the oldest age cohort (which is a great challenge for insurance companies and private pension funds, too). This can be explained with several factors: baby-boomers, i.e. people that were born after World War II, are reaching the retirement age around these times. At the same time, the population of Europe is sharply declining, and life expectancy rises thanks to the ever improving healthcare services, which will double the old age dependency ratio by 2050 (50 per cent compared to the current 24 per cent). The fast ageing of the population threatens European public finances with a disaster, too, unless the member states implement radical reforms in their welfare systems. Ageing will increase public expenses by 3 to 7 per cent relative to the GDP by 2050. From 2010 on, the rise in pensions will be mostly responsible for the increase in public expenses. Without fundamental reforms, the costs of providing for the elderly population will put such financial burdens on the developed industrialized countries that in a few decades the currently AAA credit rating of even the biggest countries may plunge into the speculative grade – states the Standard & Poor's survey conducted at the beginning of 2005. According to the credit rating company's calculations, which project the current pace of growth in costs onto the next decades, assuming that there would be no significant change in the pension funding systems, by 2050, state debts will rise from the current GDP relative 65 per cent to 239 per cent in the

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<sup>18</sup> Pension reform: providing old-age income security in the face of population ageing reforms for stability and sustainable growth – ISBN -978-92-64-04376-3 OECD 2008. 94. p.

<sup>19</sup> International analyses comprise studies by the OECD (Blöndal and Scarpetta, 1998; Duval, 2003) and those by a group of national experts convened by the National Bureau of Economic Research (Gruber and Wise, 1998, 1999).

US, from 66 per cent to 235 per cent in France, and from 68 per cent to 221 per cent in Germany. If the trends really prevail, the current AAA credit rating of the four leading industrial powers will plunge into the speculative grade below BBB by 2035.

By 2030, as much as 25 per cent of the population in the five biggest EU member states (United Kingdom, France, Germany, Italy and Spain) will be over 65 years of age. In Germany, for example, pension expenditures will absorb 18.5 per cent of the GDP in 2035, when 36 per cent of the population will be older than 60. Based on this recognition, market based pension schemes were started to be developed even by those member states in which such schemes were previously non-existent. The German government is trying to defuse the demographic time bomb by reducing the guaranteed level of annuities paid from public finances, as well as with certain tax allowances, and by the introduction of an optional capital coverage pillar, which is reinforced by state support.<sup>20</sup>

The situation of European decision-makers is even more complicated by the *Stability and Growth Pact*, which maximises the public finance deficit of the member states at 3 per cent of the GDP for the security of the common currency, and thus limits the indebtedness of the pension systems, too. The problem is rooted in the fact that the current pension systems of the member states are mostly based on state pension (which finance current pensions from the contributions paid by working citizens). From among the current member states, the private pension segment is sufficiently well developed only Britain and in the Netherlands. British pension funds have for a long time favoured share investments, while the Dutch have only recently parted with bonds that are regarded more secure. (The ratio of share investments reached 40 per cent in 2003.) These countries propose the further liberalisation of private pension fund investments at EU level, but the spectacular bursting of the stock exchange bubble at the millennium, i.e. the devaluation of stock exchange investments makes many people cautious.

There exist *two types of pensions*: one of them accumulates assets, i.e. generates interest on the individual's savings, while the other is the traditional state pension scheme, which is based on tax revenues, i.e. the pension contributions paid by the employees and employers. In the traditional pension scheme the state imposes a tax on labour in order to be able to pay pensions to retired people. As the ratio of pensioners grows, the funds available for them decrease, or contributions paid by the workers rise, or both at the same time. If contributions are low, people experience poverty, if they are too high, the social costs are too big. We are wrong if we believe that accumulating pensions, i.e. pensions accumulated for ourselves on separate accounts and invested by the pension funds are not detrimentally affected by general ageing. With the fall in the number of active and demand generating employees the number of people ready to purchase and increase the market value of assets planned to be invested by the pension funds (i.e. the securities embodying the pensioners' pensions) will drop accordingly. This means that the cake is shrinking no matter what, although accumulative pensions are much more immune to ageing. If we also take into consideration that the pension problem is present especially in the high income countries, which cannot allow themselves to further raise their taxes – including pension contributions – due to the emergence of new and fearful competitors, we will understand

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<sup>20</sup> Attila Marján: *Ageing and the European pension schemes*. Public Finance Quarterly, Volume LIII., 2008/1. p. 59.



that we need to look for the real long-term solution on the other side of the formula: retirement age must be raised.

### **Pension system reform and the revised Stability and Growth Pact**

Traditionally, only the Netherlands, Denmark and the United Kingdom have featured a substantial funded pension pillar, while in most EU countries pensions are largely unfunded.<sup>21</sup> If strictly applied, a pure PAYG pension system means that contributions into the system exactly match the pension payments. Hence, the presence of such a system neither affects government deficit nor public debt. However, the consequence of a pure PAYG system is that over the coming decades fewer workers would have to finance the pension benefits of an increasing number of retirees. Hence, in the absence of a reduction in pension benefits or an increase in the retirement age, PAYG pension premium payments have to increase substantially. This has two major implications. One is a potentially unfair distribution of the ageing costs with future workers at the losing end.

The other is that high premium payments may distort the labour supply, although the precise effects depend on the intra-temporal trade off between income and substitution effects and on the scope for inter-temporal substitution in labour supply.<sup>22</sup> In addition to the rise in the number of pensions to be paid out for each working person, also other age-related expenditures, in particular health care and long-term care will increase. While the old usually do make contributions to the health care system, they receive a disproportionate share of its benefits.

The projected rise in the future financial burden on workers in the absence of reform may easily induce governments to take economically unsound measures. Governments may start to finance the rising expenditures by running deficits and issuing debt, thereby potentially violating the rules of the SGP. Alternatively, or in combination, they may resort to one-off measures such as the sale of public assets or substituting explicit debt for off-balance liabilities. For example, in the recent past some countries (France and Germany) received a cash-inflow in return for an increase in future pension liabilities<sup>23</sup>). Empirical evidence suggests that such budgetary gimmickry has been widely applied.<sup>24</sup> However, the reformed SGP at least partly addresses this issue, as the main fiscal indicator is the structural balance net of temporary factors and one-off measures.

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<sup>21</sup> An overview of European pension systems is found in European Commission (2006a), pages 52-56. A scheme of the pension reforms in the EU is contained in the European Commission (2006b), pages 28-31.

See also Whiteford and Whitehouse (2006).

<sup>22</sup> Disposable (after-tax) income falls. In order to (partially) make up for this reduction in consumption possibilities, individuals increase their labour supply. The substitution effect works in the opposite direction. Leisure becomes relatively cheaper in terms of the foregone net wage. This produces a negative effect on the incentive to work. What is the overall effect of these two forces depends on the specific preferences entertained by individuals. Inter-temporal substitution produces a shift in labour supply from periods when premium payments are high (and, thus, the net wage is low) to periods when premium payments are low.

<sup>23</sup> See Coeuré and Pisani-Ferry, 2005.

<sup>24</sup> See Milesi-Ferretti and Morriyama (2004), von Hagen and Wolff (2004) and Koen and Van den Noord (2005).

In anticipation of the rising ageing costs and to more evenly share the costs of old-age pension provision among the generations, countries have started to introduce both systemic and parametric reforms in their pension systems. Italy, Latvia, Poland and Sweden transformed their old Defined Benefit (DB) PAYG systems to Notional Defined Contribution (NDC) systems where the pension contributions earn an administratively determined return, basically equal (or closely related) to the rate of growth of the wage bill and the notional capital is converted at retirement into an annuity. This rule to a great extent takes care of adjusting pension according to the number of employees and change in longevity. The latter three of these countries also set up mandatory funded tiers with personal accounts. Some countries have introduced personal retirement accounts, often supported by tax incentives (for example, Estonia, Ireland, Germany and Lithuania) or made mandatory to new labour market entrants or specific groups (such as Hungary, Slovakia and Slovenia). Also, the role of funded private supplementary occupational pensions is increasing. Countries are also undertaking parametric reforms to ease the pressure on future public resources. Among those measures, most countries are gradually raising the retirement age, increasing the contribution period for a full pension, linking pensions to improvements in life expectancy, limiting early retirement and introducing bonuses for working longer. Also, indexation of pension benefits has in some countries been shifted from wages to prices (France and Austria). Furthermore, in some countries, pre-funding within or linked to public DB systems remains significant (Finland) or has recently been introduced (Belgium and Ireland). Overall, apart from measures to increase the effective retirement age, pension funding is acquiring a more important role in pension systems, although PAYG remains dominant so far.

Privatisation that (normally) replaces part of the public pension system by a private sector managed fully funded tier triggers a transition during which a stock of assets is built up in the newly established funded pillar, while at the same moment the pensions of the current retirees need to be financed.<sup>25</sup> To ease the transition, the government may start issuing debt, making some of the implicit debt explicit. However, the problem here is that the public deficit and debt increase, while the fall in implicit liabilities due to the reduction of future pension payments from the PAYG pillar is not recognised in the national accounts relevant for the SGP assessments. In addition, in most cases the emerging surplus in the new funded pillar will not be part of the government accounts as, according to the decision by Eurostat (2004), funded defined-contribution schemes should be recorded as part of the private sector.<sup>26</sup>

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<sup>25</sup> This is the counterpart of the windfall gain that the first generation of retirees receives when a PAYG public pension system is installed for which they did not have to contribute during their working life.

<sup>26</sup> This decision by Eurostat concerned the defined contribution, funded pension systems that may be managed by the government. It considered that the fund's assets are ultimately owned by the participants, who are the ones that bear the risk associated with the return on the assets. Therefore, they should be classified in the private sector. For the defined benefit schemes an important criterion is the degree of funding. The Dutch occupational defined-benefit system is classified in the private sector as it is fully funded while the Finnish partially mandatory defined-benefit system falls within general government as the degree of funding is only about a quarter.

The transition from the original system to a (partially) funded system outside the government accounts may thus lead to a potential conflict with the rules of the SGP. The preventive arm of the revised SGP takes this into account as follows:

"...The Council acknowledges that special attention must be paid to pension reforms introducing a multi-pillar system that includes a mandatory, fully funded pillar. Although these reforms entail a short-term deterioration of public finances during the implementation period, the long-term sustainability of public finances is clearly improved. The Council therefore agrees that Member States implementing such reforms should be allowed to deviate from the adjustment path towards the MTO, or from the MTO itself. The deviation from the MTO should reflect the net cost of the reform to the publicly managed pillar, provided the deviation remains temporary and an appropriate safety margin to the reference value is preserved. "

In the corrective arm the leeway provided by the revision of the SGP is specified in the following way:

"...Consideration to the net cost of the reform will be given for the initial five years after a Member State has introduced a mandatory fully-funded system, or five years after 2004 for Member States that have already introduced such a system. Furthermore, it will also be regressive, i.e. during a period of five years consideration will be given to 100, 80, 60, 40 and 20 percent of the net cost of the reform to the publicly managed pillar." (European Council, 2005; also ECOFIN Council, 2005).

We should note here that the allowed deviations from the (path to) the MTO and the reference deficit level as a share of the cost are falling over time and restricted to five years only, while transitions during pension reforms typically last for decades (for a detailed presentation of these rules, see European Commission, 2007).

Moreover, the new SGP provisions can alleviate only a shift from PAYG towards partial privatisation. Other reforms, such as reductions in the generosity of future pension benefits and increases in retirement age are not directly facilitated for the simple reason that they do not lead to short-run costs.<sup>10</sup> However, they are indirectly facilitated by the new SGP through the emphasis it puts on sustainability.

### **Solutions in the Member States**

*Germany* started to reform the oldest pension system of Europe, i.e. the one established by *Bismarck* 130 years ago already in 2001. However, the demographic forecasts are so grim (by 2050, the ratio of citizens above 80 years of age will rise from the current 4 per cent to 12 per cent) that these measures have proved to be far from sufficient. The introduction of the pension reform has recently provoked elemental social resistance in France and Austria, too. If the current demographic trends prevail, traditional pension schemes can only be sustained by raising contributions, by reducing pensions, or by increasing the retirement age. In other words, it is impossible to find a simple and popular solution. The replacement of the missing workforce is also a thorny problem, which is also indicated by the fact that after the enlargement almost every old member state closed its labour market to the new member states for years. It is obvious that for the time being the current political approach and strategic thinking based on the analysis of long-term

demographic trends do not get along. However, the situation is so grim that the reform mechanism has been started everywhere, albeit with jolts and jerks.<sup>27</sup>

Just like anywhere else in Europe, generations of the demographic wave following World War II have started to retire in *Britain*, too. In 1950, there were five working age people for each pensioner. However, by 2050 there will be only two active earners for each pensioner. In accordance with this – and despite the developed, market based pension pillar – the pension crisis is regarded as one of the biggest economic and social problems in Britain, too. Several reform concepts have developed and have fallen into oblivion for handling this issue. In 2005, the pension committee composed of renowned experts published its long-awaited reform proposal, which would gradually raise and unify the retirement age, which currently stands at 65 and 63 years. From 2030 and 2050 on, workers could retire at the age of 66 and 68, respectively. The new proposal will be more sensitive socially, since it will introduce the basic pension available for all. This will increase the pension related costs of the Treasury, yet the British Government will spend only half of the amount spent on pensions by the continental social market economies, like Germany (8 per cent of the GDP in 2050). By the way, apart from the US and Mexico Britain is the most tight-fisted country in terms of pension and healthcare costs. In the long run this, as well as the fact that it has the most developed market based pension funds – and knowing that the British care system is more modest than those of the continental countries in many aspects – is an important token of the sustainability of the budget. The British corporate and private pension schemes are struggling with serious funding problems, too, since their success basically depends on the stock exchange rates, i.e. they are hit hard by poor stock exchange performance. Corporate pension funds have accumulated a considerable deficit, wherefore they were compelled to cut back on promises to the members. In 1995, the membership of corporate pension funds promising fix pensions totalled over five million as opposed to the two million members in 2005.

The *German* society faces a similar problem: unless the trend changes, one in every three German citizens will be a pensioner in 2030. One may expect severe intergenerational conflicts, since the sacrifice for the social reforms, i.e. for tightening the purse-strings, will first of all have to be made by young people. The great coalition of the Christian Democrats and the Social Democrats will gradually raise the retirement age from the current 65 years to 67 years, which is expected to affect the generation born after 1970 first. The reform will freeze pensions and will raise the pension contribution by 0.5 per cent, which will serve as a temporary solution for the problems of the pension budget managing an astronomical amount (EUR 230 billion per year). These problems were further aggravated by the fact that after the reunification, the empty pension budget of East Germany also had to be filled by the west. The Bismarckian pension system has been continuously reformed lately: the most significant change was effected in 2001, when the multi-pillar pension system was introduced. The most important pillar is still the one based on mandatory pension contribution. However, the supplementary pillar, which is called *Riester pension* after finance minister *Walter Riester*, and is composed of payments made

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<sup>27</sup> Attila Marján: *Ageing and the European pension schemes*. Public Finance Quarterly, Volume LIII., 2008/1. p. 60.

by the employees and the state, is becoming more and more popular. In addition, there exist several private pension funds supported mainly by tax credits.

In the spring of 2003, the streets of Paris were again filled with demonstrators protesting against the pension reform under preparation. Yet, the reform, which raises the retirement age and pushes the system towards self-support, was passed. However, in accordance with the French traditions, the French act specifies a minimum pension, which shall be mandatorily disbursed to the retired citizen. People living on wages, farmers, self-employed handicraftsmen, as well as traders must receive minimum EUR 534 provided they have accumulated a service time of 40 years.<sup>28</sup> The situation is similar in the case of civil servants and public employees. Senior officials, people working in the private sector, entrepreneurs and managers may be eligible for the minimum pension of EUR 945 already for a service time of 25 years. At the same time, pursuant to the act, the pension is also linked to the minimum wage in force: according to this, from 2008 on, each citizen must receive minimum 85 per cent of the minimum wage in effect. The retirement age will be raised to 65 years, however one can retire as early as at 60 years in case he can prove that he spent 40 qualifying years in activity. The pension system is a multi-pillar system in France, too. Therefore, contribution can also be paid on a voluntary basis in hope of a higher pension, however such contribution cannot exceed 50 per cent of one's income. The huge state managed pension fund, the FRR, which was introduced amidst great ovation in 1999 to support the traditional state pension system, will presumably be able to accumulate only half of the planned capital of EUR 150 billion. The fund is fattened practically by state subsidies financed from taxes and privatisation revenues. The failure makes it clear again that the size of the cake is not growing but shrinking, and it is impossible to yield new revenues by merely renaming the resources.

By 2015, one fourth of the *Italian population* will be older than 65 years, while the life expectancy of men and women alike will start to exceed 80 years. This means, that the need for a pension reform is beyond all doubts. Based on the reform that will take effect in 2008, the retirement age will be 65 years or 40 years in active employment, but those who remain in employment even beyond that age, may receive a net surplus wage of 32 per cent. The reforms are needed badly, since the Italian pension funds are on the verge of collapse and the prospects of the state budget are not rosy either. Yet, the elderly are not poor, in fact the current 60 to 70 year-olds still have the highest living standards. In contrast with today's young people, their generation had secure jobs, they could save money and buy flats/houses: following the "dolce vita" of the 1970s and 1980s they receive stable and considerable pensions.

The *Portuguese government* adopted the pension reform, which is unparalleled in terms of depth in Europe, in the spring of 2006. This reform also stipulates that families with fewer than two children must pay higher pension contributions to the state under the principle of intergenerational solidarity. Employees may choose: they either work longer or pay more pension contribution. The new system will also include a so called "sustainability

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<sup>28</sup> Attila Marján: *Ageing and the European pension schemes*. Public Finance Quarterly, Volume LIII., 2008/1. p. 61.

coefficient”, the essence of which is that the amount of the pension may change on a continuous basis, in accordance with the expected rise in life expectancy. For instance, if during the next ten years life expectancy will grow by one year, the pension of people who will retire in ten years' time will decrease by 5 per cent. The reforms were badly needed, since the pension system was so generous (occasionally, some people's pensions were higher than their last earnings) that it would have financially collapsed by 2015. In addition, the birth-rate has also drastically decreased in the past 30 years (by 35 per cent). For the time being, citizens over 65 account for 7 per cent of the population, but in 2050 one in every three Portuguese citizens will belong to this age cohort.

Yet, there are some people who deny the existence of the pension bomb, and do not see any problem in the ageing of the society. According to a study prepared by a British research institute called Tomorrow's Company, the increasing productivity counterbalances the negative effects of the ageing society. They believe that instead of comparing the number of senior (65+) citizens and that of the working age population, much deeper consequences can be derived from the comparison of the number of active and inactive citizens.<sup>29</sup>I acknowledge that this methodology is valid in certain respect, however I find this optimistic approach false and dangerous. The governments do need to take the problem of ageing seriously, and must implement profound reforms in the pension systems as well as in other fields of the supply system. And this is valid not only for Europe. China is also rushing to strengthen its pension system, which is still in an embryonic state. The traditional pension system based on state administration and companies has fallen apart, and for the time being there is no alternative. The old system was a disbursing, allocating system without actual contribution payment. Efforts are now being made to replace this system with a contribution disbursement type system. The system of personal pension accounts has also been introduced. Self-employed people, migrant workers and farmers are being driven into this scheme; however, most things exist only at the level of intentions so far. The pension system of Japan is also undergoing great changes: private pension funds based on fix payments were introduced in 2001 following the US example. In four years as many as 1.5 million employees joined such funds.

#### **Possible solutions**

It is extremely important for the EU member states to combat the challenges of ageing. To this end, the governments must improve their budgetary positions, significantly decrease their state debts, and must inevitably implement the comprehensive reform of their pension and health insurance systems. During the labour market reforms it must be taken into account that the average life expectancy will rise (from 61.5 years in 2003 to 62.4 years by 2050). Therefore, one must move away from the static retirement age, and determine dynamically how long employees should stay economically active. This, of course, requires measures against discrimination by age, an appropriate wage and tax system, as well as the promotion of life-long learning. The presence of people over 55 on the labour market will continuously grow, wherefore companies will have to increasingly rely on the employment,

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<sup>29</sup> Attila Marján: *Ageing and the European pension schemes*. Public Finance Quarterly, Volume LIII., 2008/1. p. 62.

retainment and further training of “ageing” employees. During the development of the innovative corporate strategies the ageing of the society will become an increasingly important factor in the transport, tourist and financial service sectors alike. The significant rise in the ratio of the elderly population will entail a change in the structure of social consumption, which may bring certain products and services to the forefront. One of the most important objectives is to allow elderly people continue with their work or work part-time while receiving old-age pension, as it is shown by the trend developing in the US. While the employment rate in the 65 to 74 age cohort was only 5.6 per cent in the EU (in 2003), it was 18.5 per cent in the US.

The key word in the labour market reform must be flexibility, also in relation to young employees. It may happen that young workers would like to spend more time with their children; however, at a later stage in their lives they may wish to work more, wherefore jobs and employment must be organised in a new, more flexible manner. This is all the more so since the length of education is increasing. However, the most important task is to improve the employment willingness and opportunities of people over 55 years of age. This will only be possible if the member states change the current rules that make early retirement more desirable than staying on the labour market, e.g. by the adjusting their taxation, further training and wage policy concepts to the ageing society. It is also important to significantly improve the quality of healthcare services designed to serve the physical and mental health of the elderly.<sup>30</sup> A key tool for this could be the creation of a really single European healthcare market. This would mean that people could use the services of any healthcare system, just like they have been buying foreign consumption goods and using foreign services for decades. It is inevitable to raise the retirement age by several years, and probably, instead of setting a fix retirement age, a flexible system should be introduced that would take into account changes in the average age, i.e. the continuous rise thereof.

During the transformation of the pension system it must also be taken into account that in the traditional societies children took care of their old parents, i.e. having grown up, the young generations re-channelled resources to their parents who have lost their working abilities. The modern pay-as-you-go systems actually build on the same principle with the important difference that family relations no longer play a role in the system. This does not change the fact that the more young people are in the system, the more resources can be made available for the elderly. Naturally, it would make no sense to return to the intergenerational transfer based on large families, however, when calculating pension eligibility, taking into account the number of children with which a parent contributes to the social workforce, is far from being a thought from the devil. We could see that Portugal did introduce this logic during its own pension reform.

In the case of *private pension schemes* a shift must be made from contracts promising fix pensions to contracts specifying fix contributions, since it is impossible to guarantee fix payments due to the extremely extended years in retirement. The relevance of corporate pension funds must be reconsidered, too, in a world in which the employees no longer spend their entire active life at one company, but rather, adjusting to the conditions

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<sup>30</sup> Attila Marján: *Ageing and the European pension schemes*. Public Finance Quarterly, Volume LIII., 2008/1. p. 63.

of the fast pace and ever changing world, they swap workplaces several times even within a decade.

Corporate care about retired employees is an obsolete concept, and cases like that of Enron warn us: it is not sure that our pension is in good hands when trusted to our bosses.

Europe has got a tough job: it must increase its natural fertility, it must find the intergenerational social balance and justice, and must find the resources to be able to cover the rampant pension and healthcare related costs. Increasing costs may not lead to overspending, because it would jeopardise not only the common European currency, but also the balance of the national economies, and through this, social peace. The most important tools of the “escape forward” are encouraging childbirths, enhancing the efficiency of European work, i.e. the European workforce, keeping people at work as long as possible by modernising labour market and other rules, as well as by implementing the reform of the pension systems. Demographic policy should assume a new, horizontal approach that takes into account ageing and the declining birth-rate. Countries hit by the negative demographic trends are trying to mitigate the situation with different tools. In Japan, the growth of marriages is fostered by government sponsored dating and excursion services for single adults. In 2005, France announced that it would provide a “financial reward” to mothers that undertake to raise a third child. The Scandinavian countries are engaged in a somewhat more sophisticated policy, and are developing childcare services, as well as the system of maternity and child rearing leaves. There are countries in which the “demographic” reforms face a tougher fate, e.g. in Spain and in Germany because of the lingering memory of Franco's system and the Nazi past, respectively, or in England due to the fact that the state's interference with private life has been a political taboo for centuries. Immigration from outside Europe may offset the population decline until 2025, however, this itself does not provide a complete solution for the problems caused by ageing, and cannot substitute economic reforms either. At any rate, it will be thanks to immigrants that the European society will not decline in number in the coming decades. This also means that by 2050, Europe will need to find the recipe for peaceful coexistence with a Muslim minority of 70 to 80 million, which will probably not be an easy task. The promotion of the willingness to work, i.e. encouraging participation in the world of work is another way of ensuring economic growth. According to the calculations, the economic benefits of raising the employment rate by 7 per cent are at par with that of Europe taking in 1.3 million immigrants.

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## UNION CITIZENSHIP BASED ON RESIDENCE – WRITING THE FUTURE OR A NIGHTMARE?

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### Introduction

Union citizenship established by the Treaty of Maastricht is a unique institution. It is not useless without any practical meaning for the nationals of the Member States, neither a 'pie in the sky'<sup>1</sup>, an 'empty shell'<sup>2</sup> or a merely symbolical institution. Union citizens enjoy several rights under the dispositions of the EC Treaty: first of all, they can move and reside freely within the territory of the Member States. They have the right to vote and to stand as a candidate in elections to the European Parliament and in municipal elections in the Member State in which they reside, under the same conditions as nationals of that State. They have the right to diplomatic protection in the territory of a third country (non-EU State) by the diplomatic or the consular authorities of another Member State, if their own country does not have diplomatic representation there, to the same extent as that provided for nationals of that Member State, and they can apply petitions to the European Parliament and complain to the European Ombudsman. According to the case law of the European Court of Justice, the nucleus of this notion is the prohibition of discrimination on the base of nationality. "Union citizenship is destined to be the fundamental status of nationals of the Member States, enabling those who find themselves in the same situation to enjoy the same treatment in law irrespective of their nationality, subject to such exceptions as are expressly provided for."<sup>3</sup>

Consequently, this special status should be precious for the nationals of the Member States. It confers special rights for them without laying them under any expressed obligation such as paying taxes, performing military service or compulsory voting at the European Parliament elections.

At the present state of Community law, the Union citizenship is not an independent institution; its acquisition depends on whether the person in question is a national of a Member State or not. I will examine this issue in more details in the following subdivision of my paper. This autonomy might have repercussions for the exercise of the freedoms guaranteed by the Treaty. (See, in more details, the second subdivision.) Consequently, the question arises how these negative effects could be erased? Could this special status be a more independent one? Can we imagine a Union citizenship given directly by the European Union, under the dispositions of EU law, on the base of residence? Could it be the future or

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<sup>1</sup> D'Oliveira, Hans Ulrich Jessurun: European citizenship: its meaning, its potential. In: Dehousse, Renaud [ed.]: Europe after Maastricht: An Ever Closer Union? Law Books in Europe, München, 1994, p. 141

<sup>2</sup> Ibid, p. 147

<sup>3</sup> Case C-184/99 Grzelczyk [2001] ECR I-6193

is it only a ‘nightmare’ of the Member States which jeopardizes their sovereignty? I will deal this debate in the third part of my paper.

## **1. Acquisition of Union citizenship**

### **1.1. Acquisition of nationality belongs to the solely competence of national law**

Union citizens are the nationals of the Member States. Every person holding the nationality of a Member State shall be a citizen of the Union. This feature of Union citizenship is secondary nature. After the amendment of Amsterdam Treaty, Article 17 (1) EC states unequivocally that EU citizenship complements but does not replace national citizenship.<sup>4</sup> Moreover, the Treaty of Lisbon modifies the text of this disposition, and replaces the word ‘complement’ by the word ‘additional’. Although it seems to be an amendment without any practical importance, the commentators notified that it might be a sign of a more autonomous status of Union citizenship, which can be obtained without the holding of the nationality of a Member State. In this respect, this wording can be regarded as a movement into the direction of Union citizenship as a special kind of double nationality.<sup>5</sup>

We can draw up two conclusions from recent wording of Article 17 (1). Firstly, it clarifies the link between European and national citizenship. Two practical conclusions can be drawn from this. On the one hand, it is necessary to be a national of a Member State in order to enjoy citizenship of the Union. On the other hand, European citizenship will supplement and complement the rights conferred by national citizenship.

Consequently, the nationality laws of the Members States define the circle of Union citizens. Determination of nationality laws belongs to national sovereignty. As a general rule, Community law can not have competence in this field, as it is stated in Declaration on the nationality annexed to the Maastricht Treaty, reading as follows:

“The conference declares that, whatever in the Treaty establishing the European Community reference is made to nationals of the Member States, the question is whether an individual possesses the nationality of a Member State shall be settled solely by reference to the national law of the Member State concerned. Member States may declare, for information, who are to be considered the nationals for Community purposes by way of a declaration lodged with the Presidency and may amend any such declaration when necessary.”

Accordingly, such a declaration is a unilateral action of the State concerned, and its purpose is only information about the nationality law of the State involved. It is not necessary the approval of other Member States or of the Union of such a declaration and it does not bind the State itself.

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<sup>4</sup> The Declaration by the Birmingham European Council in October 1992 made clear that “...citizenship of the Union brings our citizens additional rights and protection without in any way taking the place of their national citizenship.”

<sup>5</sup> See in more details: Schrauwen, Antoinette Adriana Maria: European Union citizenship in the Treaty of Lisbon: any change at all? *Maastricht Journal of European and Comparative Law*, Vol. 15 (2008), no. 1, p. 59

The declarations of the United Kingdom and the Federal Republic of Germany (FRG) must be mentioned at this point. In the case of the United Kingdom, those declarations had the effect of restricting the number of UK citizens for Community purposes; in the case of the FRG on the contrary, the declaration made after the unification of the FRG and Democratic Republic of Germany (GDR), the implication has been to include some 20 million persons, members of the former GDR and *Aussiedler*. Negotiation on the accession of the GDR would have caused more complications than the anodine accession of five *Länder* to the territory of the FRG.<sup>6</sup>

Concerning the Declaration made by the United Kingdom on the nationality, the European Court of Justice reinforced in its judgments delivered in cases *Kaur*<sup>7</sup> and *Pereira Roque*<sup>8</sup> that this field belongs to the sovereignty of the Member State. At the actual state of the Community law, it has no competence to expand the Union citizenship.<sup>9</sup> Hence, Member States refuse that the Union or an other State interfere into the question of the determination of the circle of their own nationals, or the possibility that a citizen of another Member State could obtain national citizenship or any of the rights duties, privileges or advantages that are inherent in national citizenship by the intervention of Union citizenship.<sup>10</sup>

This 'reserved domain' is accepted by the international law. Article 1 of the Hague Convention of 1930 on Certain Questions relating to Conflict of Nationality Laws states, *inter alia*, that it is for each State to determine under its own law who are its nationals. Afterwards, this principle was confirmed by the Article 1 of the Europe Convention on Nationality, signed in the of 1997.

This general principle that States are competent to confer nationality on or to withdraw nationality from, predated the Hague Convention and was articulated by the Permanent Court of International Justice in its advisory opinion in *Nationality Decrees Issued in Tunis and Morocco*:

"The question whether a certain matter is or is not solely within the jurisdiction of a State is an essentially relative question; it depends on the development of international relations. This, in the present state of international law, questions of nationality are, in the opinion of the Court, in principle within this reserved domain."<sup>11</sup>

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<sup>6</sup> D'Oliveira, Hans Ulrich Jessurun: *Union Citizenship: Pie in the Sky?* In: Rosas, Alan - Antola, Esko [eds.]: *A citizens' Europe: In Search of a New Order*, Sage, London, 1995, p. 62

<sup>7</sup> Case C-192/99 *The Queen v Secretary of State for the Home Department, ex parte Manjit Kaur* [2001] ECR I- 1237

<sup>8</sup> Case C-171/96 *Pereira Roque v Lieutenant Governor of Jersey* [1998] ECR I-4607

<sup>9</sup> Reich, Norbert – Harbacevica, Solvita: *Citizenship and family on trial: A fairly optimistic overview of recent court practice with regard to free movement of persons*. *Common Market Law Review* (2003) 40 p. 618

<sup>10</sup> The Danish Declaration on Citizenship of the Union, annexed to the Treaty on the European Union. See: Marias, Epaminondas: *From Market Citizen to Union Citizen*. In: Marias, Epaminondas [ed.]: *European Citizenship*. European Institute of Public Administration, Maastricht, 1994, p. 16

<sup>11</sup> Permanent Court of International Justice, Series B, 4/1923, p. 24. See: Hall, Stephen: *Nationality, Migration Rights and Citizenship of the Union*. Martinus Nijhoff Publishers, Dordrecht, Boston, London, 1995, p. 17

It must be noted however, that the freedom of the States in the field of determination of nationality laws is not infinite. It is limited by the international law, and in the hand, by the Community law. Before the examination of these limitations, I give a brief study on the freedom exercised by the Member States in the field of the determination of nationality laws.

## 1.2. Diversity of the nationality laws of the Member States<sup>12</sup>

The citizenship legislation all Member States is based on *ius sanguinis* or *ius soli*, but some form of combination exists in all countries. Germany, for example, applies a strong principle of *ius sanguinis*, while Great Britain applies *ius soli*. Sweden has historically had a strong *ius sanguinis* tradition, but through its new Citizenship Act of 2001, *ius soli* has gained much importance. In Hungary, the principle of *ius sanguinis* serves as a general rule, and the principle of *ius soli* is only complementary, it can be applied solely in those cases when the parents of the child are unknown or stateless.<sup>13</sup>

With respect to naturalisation, the attitudes among the Member States vary. In several EU countries, such as Denmark, Great Britain or Ireland, there is a trend towards a stricter naturalisation policy, while other countries, such as Germany, Luxembourg or Hungary, has facilitated naturalisation. Naturalisation requirements also vary by State to State. In contrast to Sweden, language requirements exist in several countries. Several EU countries also have examinations on knowledge about the country.

The view as to dual citizenship also varies between the Member States. Sweden and Finland take a very liberal view and allow dual and multiple nationalities in every situation, while Denmark, Germany and the Netherlands as a rule do not allow it.

As to loss of citizenship, a clear development in the nationality law of European Countries is that more and more countries introduce the possibility of denaturalisation if the citizenship was acquired through fraudulent conduct (for example, in Hungary, in Finland, in the Netherlands, in Denmark, in Great Britain and in Ireland), but there is no correspondence to these regulation in Sweden.

Another example of differences between the nationality laws of the Member States concerns the relationship to their colonies and former colonies. In the case of the Netherlands, without an expressed declaration to the contrary, all the country's citizens should be considered as Union citizens. This has the consequence that residents of Aruba and Netherlands Antilles are Union citizens. On the contrary, persons from British colonies ('Qualified Commonwealth Citizens') are excluded from Union citizenship.

As a conclusion, it can be emphasized that there is no consensus in the area of nationality laws of the Member States and there is hard to find any common rules as concerns acquisition and loss of citizenship.

In the abovementioned European Convention on Nationality, the Council of Europe provides some minima-standards for nationality legislation. It proposes as general principle for acquisition of nationality the principle of *ius sanguinis*, and *ius soli* should be applied

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<sup>12</sup> See in more details: Bernitz, Ulf – Bernitz, Hedvig Konrad: Human Rights and European Identity: The Debate about European Citizenship. In: Alston, Philip [ed.]: The EU and Human Rights. Oxford University Press, London, 1999., pp. 192-195

<sup>13</sup> Article 3 of law LV of 1997 on nationality

solely as a complementary principle.<sup>14</sup> The problem is that until the end of 2008, this Convention has been ratified only in a few Member States, for example, in Austria, Bulgaria, Denmark, Finland, Germany, Hungary and Romania.<sup>15</sup>

### 1.3. Limits of national sovereignty in the field of determination of nationality laws

#### a) *International law*

The abovementioned Article 1 of the Hague Convention of 1930, besides that it accepted for each State to determine under its own law who are its nationals, limits their freedom in the following manner:

“This law shall be recognized by other States insofar as it is consistent with international customs and the principles of law generally recognized with regard to nationality.”

It means that it is not compatible with international law to grant nationality on a temporary or on a discriminatory base, or for unlawful purposes. In these cases, other States can ignore the acceptance of such a citizenship.<sup>16</sup> International conventions also limit this freedom. Thus, it is general principle of international law that the individuals have a right to have nationality.<sup>17</sup> There are several international agreements on the reduction and avoidance of stateless and on the regulation of certain aspects (military obligations, etc.) of the cases of multiple nationality.<sup>18</sup>

In the aforementioned advisory opinion in *Nationality Decrees Issued in Tunis and Morocco*, it was declared by the Permanent Court of International Justice that this reserved domain is limited by the international obligations of the States.<sup>19</sup>

In 1955, in its well-known judgement *Lichtenstein v Guatemala* (‘*Re Nottebohm*’),<sup>20</sup> a case involving a demurrer by Guatemala to the standing of Liechtenstein to bring a claim for damages allegedly inflicted by Guatemala on an individual who has a double, by the way of naturalisation a Liechtenstein national, and originally a German national. The International Court of Justice did not deny that Nottebohm had acquired the Liechtenstein nationality according to Liechtenstein law, but refused to accept that this nationality was strong enough under international law to be used as a basis for the exercise of diplomatic protection by Liechtenstein vis-à-vis Guatemala. It required a ‘genuine link’ between the state and the individual:

<sup>14</sup> Article 6

<sup>15</sup> <http://conventions.coe.int/Treaty/Commun/ChercheSig.asp?NT=166&CM=2&DF=11/12/2008&CL=ENG> [11.11.2008]

<sup>16</sup> Bernitz, *op. cit.*, p. 196

<sup>17</sup> See, *inter alia*, the Article 15 of the Universal Declaration of Human Rights and Article 24 (3) of the International Covenant on Civil and Political Rights.

<sup>18</sup> See, for example, European Convention on the Reduction of Cases of Multiple Nationality and on Military Obligations in Cases of Multiple Nationality and Council of Europe Convention on the avoidance of statelessness in relation to State succession.

<sup>19</sup> D'Oliveira, Hans Ulrich Jessurun: *Case C-369/90, M. V. Micheletti and others v. Delegacion del Gobierno en Cantabria*, Judgement of 7 July 1992. *Common Market Law Review* (1993) 30 p. 635; and Kunoy, Bjørn: *A Union of National Citizens: The Origins of the Court's Lack of Avant-gardisme in the Chen Case*. *Common Market Law Review* 2006 (43) p. 186

<sup>20</sup> ICJ Reports 1955, p. 4

“According to the practice of States, to arbitral and judicial decisions and to the opinions of writers, nationality is a legal bond having as its basis a social fact of attachment, a genuine connection of existence, interests and sentiments, together with the existence of reciprocal rights and duties.”

As a conclusion, it can be drawn up that international law can never question the national citizenship’s validity in national law, although they it can be questioned in their international relations on the base of international obligations. The limitations of international law are not static, but change over time, as the international obligations, including human rights obligations of the States, are changing.

*b) Community law*

Limitations on the freedom of States on the determination of rules on the acquisition and loss of nationality also appear in Community law. Thus, it is obvious, that Community law must refuse nationality which is based on the breach of principles of international law, human rights and fundamental freedoms guaranteed by international law or obligations prescribed by international conventions. Hence, for example, if the European Court of Justice would realize in a situation which belongs to its competence that a Member State gave citizenship on the base of religion, it should refuse the Union citizenship of this person and the rights deriving from this status.

More specifically, in a judgement delivered in 1975,<sup>21</sup> the European Court of Justice declared that the concept of ‘nationals’ contained in the Staff Regulations of officials must be interpreted in such a way as to avoid any unwarranted difference of treatment as between male and female officials who are, in fact, placed in comparable situations..

The judgement delivered in case C-369/90 Micheletti<sup>22</sup> recognizes, in one hand, the Member States’ competence to decide their own citizenship, and, in the other hand, the limitation of this freedom. This case concerned an Argentinian and Italian double national. Mr Micheletti possessed the Argentinian nationality according to Argentinian law (*ius soli*), and the Italian nationality, as born from two Italian parents, according to Italian law (*ius sanguinis*). Mr Micheletti, a dentist, saw his professional diplomas, acquired in Argentina and recognized by Spain, and was admitted provisionally as a Community Member State national on presentation of a valid Italian passport. When Mr Micheletti, some time afterwards, requested a definitive permission to stay and to establish himself as a dentist, the Spanish administration rejected his request, because he was considered, according to Spanish legislation concerning persons possessing more than one nationality, as a national of Argentina: according to the Spanish Civil Code, state that the nationality which coincides with habitual residence shall be taken into account. Spain considered that Mr Micheletti had his habitual residence in Argentina, whereas he claimed that he had transferred his residence in the meantime to Italy.

The Court of Justice examined this question on the base of freedom of establishment granted to the ‘nationals of the Member States’. It accepted that it belonged for each Member State to define the conditions of acquisition and loss of nationality.

“However, it is not permissible for the legislation of a Member State to restrict the effects of the grant of the nationality of another Member State by imposing an

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<sup>21</sup> Case 21/74 Airolo v Commission [1975] ECR 221

<sup>22</sup> [1992] ECR I-4239



additional condition for recognition of that nationality with a view to the exercise of the fundamental freedoms provided for in the Treaty. [...] The consequence of allowing such a possibility would be that the class of persons to whom the Community rules on freedom of establishment were applied might vary from one Member State to another.”<sup>23</sup>

In the opinion of d’Oliveira <sup>24</sup> and Blumann, <sup>25</sup> this reasoning rejects the Nottebohm theory which requires a genuine link such as habitual residence, effective residence or social ties in order to the proper functioning of nationality on international, or in this case, on intra-Community level. According to Blumann, this Italian nationality was completely artificial, and missed the real link. I do not agree with these reasoning, because Mr Micheletti had a link with a Member State, with Italy, although it based on ties of blood and not on the requirement of residence. Although it is unquestionable that beyond this ties of blood, Mr Micheletti did not have other attachment to Italy.

Advocate General Tesouro also argued against that the Nottebohm judgment of the International Court of Justice of any relevance whose origin lies in a ‘romantic period’ of international relations and, in particular, in the concept of diplomatic protection.<sup>26</sup> According to him, this case could be solved on the base of the international private law and Community case law, especially on the base of judgment delivered in case Gullung,<sup>27</sup> in which case the Court of Justice implicitly acknowledged that the person in question was entitled to rely on both nationalities in order to take advantage of the facilities offered by Community law.

It must be noted that in a judgement delivered in 1980<sup>28</sup>, the Court of Justice argued for the Nottebohm principle, and declared that the foundation of the bond of nationality is formed by a special relationship of allegiance to the state and reciprocity of rights and duties.

The Micheletti principle that it is not permissible for the legislation of the Member States to restrict the effects of the grant of the nationality of another Member State by imposing an additional condition for recognition of that nationality with a view to the exercise of the fundamental freedoms provided for in the Treaty, has recently been repeated by the Court of Justice in the Garcia Avello case<sup>29</sup> and in the Zhu and Chen case.<sup>30</sup> The former concerned determination of the surname of a Belgian and Spanish double national in Belgium, the latter concerned the right of residence a Chinese national and her Irish daughter. In case Collins,<sup>31</sup> which relate to the right for a social contribution of an United States and Irish double national who did not dispose an effective link with Ireland beyond a short traineeship several years ago, the Court of Justice also repeated the Micheletti

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<sup>23</sup> Paragraphs 10 and 12

<sup>24</sup> D’Oliveira: Case C-369/90 ..., p. 625

<sup>25</sup> Blumann, Claude: Citoyenneté européenne et champ d’application personnel du droit communautaire. *Revue des affaires européennes*, 2003-2004/1, p. 75

<sup>26</sup> Paragraph 5

<sup>27</sup> Case 292/86 Gullung v Conseils de l’Ordre des Avocats du Barreau de Colmar et de Saverne [1988] ECR 111, paragraph 12

<sup>28</sup> Case 149/79 Commission v Belgium [1980] ECR 3881

<sup>29</sup> Case C-148/02 [2003] ECR I-11613

<sup>30</sup> Case 200/02 [2004] ECR I-9925

<sup>31</sup> Case C-138/02 [2004] ECR I-2703

principle and the refusal of the application of Nottebohm principle. According to Advocate General Colomer, as “it [is] proven that Mr Collins is an Irish national and that he travelled to the United Kingdom with the intention of living and working there. Other circumstances relating to him are irrelevant, according to the case-law of the Court, when deciding whether the person concerned may rely on the principle of freedom of movement for workers.”<sup>32</sup>

As a conclusion, it can be pointed out that the Court of Justice did not follow the requirement of effective nationality established in case Nottebohm, and it leaves a wider discretion for the Member States when they determining the circle of their nationals. However, it has established another kind of limitation for this freedom, which relates to the cases of double citizen and require that Member States do not impose an additional condition for recognition of the nationality for the purposes of Union citizenship.

## **2. Problems arising from the exclusive power of the Member States for the determination of the circle of Union citizens**

This freedom for the Member States to define the circle of Union citizens on the base of their nationality laws implies the unequal access to Union citizenship. For example, there was a weak point in the ‘fortress of Europe’ in the field of determination of nationality: under its nationality law, Ireland allows any person born on the island of Ireland to acquire Irish nationality. By exploiting this regulation, more thousand third country nationals gave birth to their child on the island of Ireland which belongs to the United Kingdom and gained Union citizenship without an effective link with the Union.<sup>33</sup> This regulation has come to an end in 2004 when the Irish Nationality and Citizenship Act has been amended, and now it provides that a person born in the island of Ireland, who does not have at least one parent who is an Irish citizen is not entitled to Irish citizenship.

The contrary also can be imagined. A Member State – such as the United Kingdom – can determine the circle of their citizens so restrictively, that citizens of the colonies are cannot be regarded as Union citizens.

Generally, it can be pointed out that it would appear that access to Union citizenship would be easier through a Member State whose law of nationality is based primarily on *ius soli*, as opposed to a Member State whose law is based on *ius sanguinis*.<sup>34</sup>

This freedom of the Member States can violate the free movement of persons and the rights attached to it. Many national rules on acquisition and loss of nationality may hinder to some extent the complete exercise of this right on free movement, in some cases they even completely prevent the exercise of this right. These national rules may have a consequence the loss of nationality (and therefore the status of a citizen of the Union) due to several years of continuous residence abroad,<sup>35</sup> or the non-acquisition of nationality at

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<sup>32</sup> Paragraph 23

<sup>33</sup> See, for example, the abovementioned Zhu and Chen case.

<sup>34</sup> Garot, Marie-José: A New Basis For European Citizenship: Residence? In: La Torre, Massimo [ed.]: European Citizenship: An Institutional Challenge. Kluwer Law International, Hague, 1998, p. 232

<sup>35</sup> See, for example, the Netherlands nationality law which provides that Netherlands nationality would be lost by any national who also possesses other nationality and who lives (after having reached the age of majority) for a continuous period of ten years outside the Netherlands, even in an

birth.<sup>36</sup> A third problem can be that non EU-national spouses of Union citizens cannot access to Union citizenship, even if they have lived for many years (even a decade) in the European Union, because their EU-spouses' Member States of origin require residence in that Member State in order to become naturalised.<sup>37</sup> These cases can prevent a Union citizen from exercising his or her right to free movement.

Blumann suggests that one part of these problems, especially the problem of loss of Union citizenship in the case of loss national citizenship, could be solved on the base of the principle of protection of acquired rights.<sup>38</sup> However, Blumann also get this idea off his mind and argues that this kind of limitation of Member States' nationality acts is not in the objective of the Community law.<sup>39</sup>

Another problem is that a Member State is able to exclude some groups of its nationals from the rights of the EC Treaty? And can a Member State grant these rights to groups of individuals who do not possess the nationality of that Member State? These questions were answered by the Court of Justice affirmatively in two recent judgements delivered on the same day, 12 of September, 2006, in cases C-145/04<sup>40</sup> and C-300/04<sup>41</sup> which concerned their right to vote and to stand as a candidate in elections to the European Parliament. In the first judgement the Court of Justice accepted Commonwealth citizens residing in Gibraltar who are not British citizens, and, consequently, excluded from Union citizenship, have the right to participate at European Parliament elections. In the second case the Court declared that it is contrary to the principle of equal treatment that a Member State (the Netherlands) refuse the right to vote for their citizens residing in its overseas territory (in Aruba), while it grants it for the residents of other overseas countries (like the Netherlands Antilles). However, the Court accepted, that the definition of the persons entitled to vote and to stand for election to the European Parliament falls within the competence of each Member State.

### **3. Attempts to the solution of the problems arising from the diversity of Member States' nationality laws**

In theory, we can imagine three solutions for the problems drafted above: unification or approximation of nationality laws, and, finally, building an autonomous status of Union citizenship. The first and the third idea cannot be imagined only in a more remote future, while the harmonisation of nationality laws has been started on international level.

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other EU Member State. The Belgian nationality act also provides a correspondent rule, but, according to de Groot, a technical detail prevents this legislation from violating Community law: lodging a declaration to the Belgian authorities the loss of nationality can be avoided. De Groot, Gerard-René: The Relationship Between the Nationality Legislation of the Member States of the European Union and European Citizenship. In: La Torre, op. cit, pp. 136 and 138-139

<sup>36</sup> That is the case of the United Kingdom and the Netherlands. Ibid, pp. 139-142

<sup>37</sup> This is the case of the United Kingdom, the Netherlands and Belgium. Ibid, pp. 143-146

<sup>38</sup> Blumann, op. cit., p. 75

<sup>39</sup> Ibidem.

<sup>40</sup> [2006] ECR I-7917

<sup>41</sup> [2006] ECR I-8055

### 3.1. Unification of nationality laws and lifting it into Union level

The most radical way to solve every problems arising from the diversity of the nationality laws of the Member States is the unification of these laws and delegation of this competence of determination of the conditions of loss and grant of nationality to Union level. However, this solution calls into question a sacrosanct prerogative<sup>42</sup> of the States, i.e. to determine their own nationals. In this case it would be difficult to talk about ‘States’,<sup>43</sup> and the level of State would move into a higher level, into the level of the European Union. According to d’Oliveira,

„[a]s the Community is slowly developing from a market-integrating device towards a statelike phenomenon with more ambitious goals and objectives and is now reaching a stage which, in the Maastricht Treaty, is called a Union [...], the one-dimensional market citizen develops into a rounder figure composed of more aspects of existence: education, culture, environment and some political participation. The battle for definitional power, the right to decide who is ‘a national of a Member State’, if won by the EC, may harmonize the concept of ‘national’, but, paradoxically, will also be the end of Member States, as core element of their independence; their sovereignty and existence are jeopardized.”<sup>44</sup>

So, this solution cannot be imagined only in a federal structure, which is not the case at the present stage of development of the Union.

### 3.2. Approximation of nationality laws

Many of the problems arising from arising from the diversity of the nationality laws of the Member States could be solved by the harmonisation of these laws. The European Parliament called for the harmonisation of nationality laws of the Member States. In 1993, it considered that free movement and “extension of European citizenship call for the replacement of the principle of *ius sanguinis* by the principle of *ius soli* as a basis for citizenship.”<sup>45</sup> The Commission did not explicitly rejected this kind of ‘initiative’,<sup>46</sup> nevertheless, technical complication may limit harmonisation possibilities. There is no expressed or implied Union competence in this field, and neither Article 308 EC, nor Article 2, second paragraph, could serve as a legal ground for such harmonisation,<sup>47</sup> even in the light of the modifications of the Lisbon Treaty.

However, on international level it has been started a harmonisation of nationality laws of the States on the basis of common principles. The abovementioned Council of Europe Convention on the Nationality of 1997 has been established such principles, but as, I mentioned earlier, it has not been ratified in many Member States.

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<sup>42</sup> Garot, op. cit., p. 233

<sup>43</sup> D’Oliveira: Case C-369/90 ..., p. 627

<sup>44</sup> Ibid, pp. 627-628

<sup>45</sup> Paragraph 93 of the Resolution on the Respect for Human Rights in the EC ( report Bindi, Doc. A3-0300/91) [OJ 1993, C 115, p. 178]

<sup>46</sup> Evans, Andrew: Union Citizenship and the Constitutionalization of Equality in EU law. In: La Torre, op. cit., p. 279

<sup>47</sup> D’Oliveira: Case C-369/90..., p. 637; and Evans, op. cit., p. 279

At the present stage of Community law, only the instruments of the soft law can be served as tools for the determination of such common principles. Accordingly, the European Council of Tampere, in 1999, in accordance with the development the Union as an area of freedom, security and justice, endorsed the objective “that long-term legally resident third country nationals be offered the opportunity to obtain the nationality of the Member State in which they are resident.”<sup>48</sup> In order the implementation of this objective, in 2004, the Council adopted the Common Basic Principles on integration,<sup>49</sup> and, in 2005, the Common Agenda for Integration,<sup>50</sup> which suggests the practical execution of common principles. It contains, *inter alia*, propositions on the establish a coherent European framework for integration.

### 3.3. An autonomous status of Union citizenship

Developing a stronger concept for European citizenship, characterized by an autonomous status of Union citizenship could also resolve these problems. It means the dissolution the Union citizenship from national citizenship, and to grant political, civil and economical rights on a common principle. Such a solution also serves as a basis of the federalisation of the EU, although it leaves the traditional sovereignty for the Member States in the field of the determination of their nationals. This proposition has even a less threat for the autonomy of the States than the harmonisation of their nationality laws, since it relieves Member States from any European pressure to reform and harmonize their rules for determining national citizenship.

The base of the autonomic Union citizenship could be the residence. This solution would do away with the distinction between Union citizens and residents from third countries, so it would have an end the inequality treatment of long term non-EU residents. This proposition is based on the case law of the European Court of Justice, who required the lawful residence in order to the benefit of the rights provided for in the Treaty.<sup>51</sup>

According to Bauböck,<sup>52</sup> this type of Union citizenship could be granted automatically, as it has been suggested by the Migrants’ Forum, an organization representing the interests of immigrants at the European Commission and Parliament: “Citizenship of the Union should be extended automatically to all third country nationals who have been lawfully resident in the Union for a period of five years or more.”<sup>53</sup> The disadvantage of this idea is that it would probably freeze the present limitations of Union citizenship as well as the national framework for citizenship of the Member States and Union citizenship would be seriously devalued in the eyes of citizens of the Member States by reducing it to a generalized denizen ship.<sup>54</sup>

<sup>48</sup> Tampere European Council (15 and 16 October 1999) Presidency Conclusions, point 21.

<sup>49</sup> Council Document 14615/04 of 19 November 2004

<sup>50</sup> COM (2005) 389

<sup>51</sup> See, in this meaning, judgement delivered in case C-85/96 Sala [1998] ECR I-2691. Bernitz, op. cit., pp. 208 and 213.

<sup>52</sup> Bauböck, Rainer: Citizenship and National Identities in the European Union. Jean Monnet Working Papers 4/97, <http://www.jeanmonnetprogram.org/papers/97/97-04-.html> (2005.11.11.).

<sup>53</sup> Proposals for the Revision of the Treaty on European Union at the Intergovernmental Conference of 1996. In: The Forum Series No. 2, Brussels, 1996, p. 17. See: Bauböck, op. cit.

<sup>54</sup> Bauböck, op. cit.

According to Bauböck, it would be more desirable and it would make the Union citizenship more precious for the citizens by making direct access to Union citizenship for third country nationals rather optional than automatic. They could then acquire Union citizenship by naturalization directly at the European level. The conditions for naturalization at the European level would probably gravitate towards the most liberal standards among the Member States. A European naturalization procedure could also provide a yardstick for harmonizing those in the Member States. O'Keefe<sup>55</sup> argues that the Union could require for the purposes of naturalisation such requirements as legal entrance and residence, economic activity, loyalty with the aims of the Union, assimilation (language requirements, knowledge of the values of the Union, allegiance to the Union).

This solution could be useful for those stateless persons who reside in the Baltic countries, in Latvia and in Estonia, and belong to the Russian minorities.

The acceptance of this proposition implies the determination of the requirement of residence on Union level. Until now, there is no common definition for this notion; Community law always refers to national legislations at the interpretation of it.

### Concluding remarks

Although Declaration on the nationality of the Member States annexed to the Treaty of Maastricht emphasises, in conformity with international law, the exclusive autonomy of Member States in the determination of their nationality for Community purposes, I have argued that this autonomy is limited. In the first place, it is limited by international law, by international obligations of the Member States deriving from international agreements and principles of international law. The Nottebohm case law of the International Court of Justice and the requirement of effective citizenship are, however, do not limit the freedom of the Member States for the determination of nationality for *internal* purposes, and the European Court of Justice also does not follow this case law.

In the second place, this autonomy of the Member States for the determination of nationality must be limited by Community law, since certain rules of nationality acts of the Member States regarding the acquisition and loss of the nationality may conflict with the exercise of fundamental freedoms, especially the free movement of persons. In this respect, the Court of Justice has taken the first step and declared in case Micheletti that it is not permissible for the legislation of the Member States to restrict the effects of the grant of the nationality of another Member State by imposing an additional condition for recognition of that nationality with a view to the exercise of the fundamental freedoms provided for in the Treaty.

The most radical way to solve *every* problems arising from the diversity of the nationality laws of the Member States is the unification of these laws and delegation of this competence of determination of the conditions of loss and grant of nationality to Union level. This solution can be imagined only in a federal structure, so this is undesirable at this stage of Union.

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<sup>55</sup> O'Keefe, David: Union Citizenship. In: O'Keefe, David [ed.]: Legal Issues of the Maastricht Treaty. Wiley Chancery Law, A Division of John Wiley and Sons, London - New York - Chichester - Brisbane - Toronto - Singapore, 1994., pp. 105-106

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I argue for that an autonomous status of Union citizenship which is based on residence requirement could also solve these problems. Although it can be a nightmare for the Member States, in the reality it does not jeopardize their traditional sovereignty in the field of determination of the circle of their nationals. It has even less restrictive effect than the harmonisation of nationality laws under common principles.

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