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## WHAT PRICE FOR THE COMMUNITY ENFORCEMENT OF WTO DISPUTE SETTLEMENT BODY'S RULINGS?

by

Alessandra Arcuri and Sara Poli

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# WHAT PRICE FOR THE COMMUNITY ENFORCEMENT OF WTO DISPUTE SETTLEMENT BODY'S RULINGS?

by

Alessandra Arcuri<sup>♦</sup> and Sara Poli<sup>♦♦</sup>

## Abstract

Under the World Trade Organization (WTO) legal framework, when a violation is deemed to occur, Members have recourse to a quasi-automatic dispute settlement system. If the breach persists after the WTO Dispute Settlement Body (DSB) has adopted a ruling, Members hurt by the illegal measures can be authorized to retaliate against the scofflaw Member. Rights and obligations are, thus, centrally enforced within the WTO. The object of this article is the decentralized enforcement of WTO law, and more precisely of DSB rulings through the ECJ. The aim is to explore whether it is in the Community (EC) as well as in the WTO's interests to ensure that these acts are enforced before the Luxembourg Courts. Notoriously, the European Courts have been resistant to Community enforcement of DSB's rulings. Unlike many legal commentators that have criticized the European Courts, we conclude that the approach of the Courts is justified both from a purely legal standpoint and from a Law and Economics perspective. In relation to the latter, we develop a theoretical framework, building on Calabresi and Melamed's 'Cathedral', and show that the Community enforcement of DSB's decisions bears costs that outweigh the benefits.

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## **1. Introduction**

As is well-known, under the World Trade Organization (WTO) legal framework, when a violation of the covered agreements is deemed to occur, Members have recourse to a quasi-automatic dispute settlement system. If the breach persists after the WTO Dispute Settlement Body (DSB) has adopted a ruling, Members hurt by the illegal measures may be authorized to retaliate against the scofflaw Member. Rights and obligations are, thus, centrally enforced within the WTO.

The object of this article is the Community enforcement of of DSB rulings (that is the adopted reports by the Panels and the Appellate Body) through the European Court of Justice (ECJ).<sup>1</sup> By this we mean the

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<sup>1</sup> Although from a WTO perspective, the ECJ could be considered a regional court in the same way as the national courts of the WTO members are, we limit ourselves to focus on Community enforcement of WTO law. For a discussion on the desirability of domestic enforcement of WTO law ORTINO, RIPINSKY, 'WTO law and process, The proceedings of the 2005 and 2006 Annual WTO Conference, British Institute of International and Comparative law,' 2007, p. 93-110.

possibility for private parties to rely on the DSB's decisions for a double purpose: on the one hand, to use them as the parameters of the legality of a Community measure that the DSB has declared in breach of WTO law; on the other, to obtain compensation, under Art. 288 par. 2 of the Treaty on the European Community (TEC), for the damages arising out of the Institutions' failure to respect the decisions of the DSB.

Community enforcement of DSB rulings has been justified on several grounds. It has been claimed that the rulings of the WTO Tribunals should be made enforceable before the Community judicature since the cost of non-compliance with these decisions are particularly high for the Community.<sup>2</sup> Moreover, appealing arguments have been made in favour of Community's enforcement of these acts in the context of an action in damages. The first is that enabling private parties to use the DSB's decisions before the European Courts enhances compliance with WTO law and hence should be encouraged.<sup>3</sup> The second is that this course of action is in the interest of private parties who are the by-standers of the Community's illegal behaviour under WTO law.<sup>4</sup>

The contention of this article is that it is neither in the Community's nor in the WTO's interest to ensure that DSB decisions are enforced before the European courts. Although making possible for the ECJ to enforce DSB's decisions may be helpful for private parties to recover the damages that they incurred because of the Community's in-compliant behaviour, this prospect bears costs that outweigh such a benefit and also the alleged beneficial effects in terms of improvement of WTO compliance.

As is well known the ECJ has consistently refused to act as the enforcer of DSB rulings, as lately confirmed by the *FLAMM* and *Fedon* appeals<sup>5</sup> against the CFI's ruling.<sup>6</sup> These appeals, which are central to this study, square the circle on the place of WTO law within the EC legal remedies: WTO law, of which DSB's recommendations are part, cannot be used for the purpose of questioning the legality of EC measures or to obtain compensation for the damages arising from the Community disregard of international trade law.

This article makes an original contribution to the existing scholarship on this subject in two ways: on the one hand, it provides a legal analysis of the reasons excluding the desirability of Community enforcement

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<sup>2</sup> COTTIER, 'Dispute settlement in the World Trade Organization: characteristics and structural implications for the European Union,' *Common Market Law Review*, 1998, p. 365.

<sup>3</sup> See section n. 2.2 and 5.

<sup>4</sup> See section n. 9.

<sup>5</sup> Respectively Joined cases C-120/06 P *Fabbrica italiana accumulatori motocarri Montecchio SpA and Fabbrica italiana accumulatori motocarri Montecchio Technologies LLC* (together referred to as 'FIAMM') and C-121/06 *Giorgio Fedon & Figli SpA and Fedon America, Inc.* (together referred to as 'Fedon'), nyr.

<sup>6</sup> *T-69/00, FIAMM and FIAMM Technologies, T-151/00, Le Laboratoire du Bain, T-301/00, Fremaux, T-320/00, CD Cartondruck AG, T-383/00, Beamglow Ltd and T-135/01, Giorgio Fedon & Figli S.p.A., Fedon S.r.l. and Fedon America USA Inc v. Council and Commission*, in [2005] ECR II 5393. This ruling was appealed by FIAMM and Fedon. See above n. 5. For the sake of convenience we will refer to case T-69/00 *FIAMM and FIAMM Technologies* only.

of the DSB's rulings. In addition, it discusses how to address the drawbacks that the denial of direct effect to these acts may entail for private parties. On the other, it develops a theoretical framework to assess the efficiency of Community enforcement of WTO law and it is the first attempt to develop workable economic frameworks to better understand the consequences of endorsing different rules in relation to the legal status of DSB rulings within the EU legal system. In addition, taking both perspectives, this article offers comments on a new point of law raised by the appellants in the *FLAMM* and *Fedon* appeals: the principle of EC non-contractual liability for lawful acts, whose existence and conditions were discussed at length for the first time in the ECJ case-law.

The article is divided into ten sections. Section 2 gives a concise overview of the case-law denying direct effect to the provisions of the WTO Treaty, both for the purpose of reviewing the legality of an EC measure and for establishing the Community's non-contractual liability, under Art. 288, par. 2 of the TEC. Then, special attention is devoted to the direct effect of the DSB's recommendations since the case has been made that the effects attached to these acts are different from those of WTO substantive provisions and hence the former, by contrast with the latter, could be used to review the legality of Community measures. Section 3 summarizes the AG's conclusions and the Court's position in the appeal against the CFI's ruling in *FLAMM* and *Fedon*, the most recent case in which the ECJ discussed about direct effect of WTO law. Section 4 offers an in-depth analysis of the judicature's position to not allow DSB decisions to be invoked for the purpose of an action in damages, irrespective of the lawfulness or unlawfulness of the EU Institutions' behavior. In this section, we spell out the reasons that justify the ECJ's refusal to enable private parties to become enforcers of DSB rulings, without sparing criticism of certain aspects of the ECJ's ruling. The consequences of this judgment in the European legal order will also be illustrated.

In section 5 we briefly introduce the 'law and economics' approach to assess the desirability of enforcement of WTO law by European Courts. In section 6, we apply the property vs. liability rules framework (also known as the 'Cathedral'), originally developed by Calabresi and Melamed, to our questions. We submit that to fully understand the legal complexity of the WTO legal framework, the model needs to be refined; accordingly we conceptualize a rule that we call 'aspirational property rule operating through a temporary liability rule' and we use it to test the desirability of Community enforcement. In section 7, we test our conclusions against the exit and voice theoretical framework, originally articulated by economist Albert Hirschman and subsequently employed by Joost Pauwelyn to chart the evolution of WTO law. Section 8 offers an economic analysis of non-contractual liability for lawful acts, an issue central to the *FLAMM* and *Fedon* cases. In section 9, we discuss equity issues and highlight possible alternative avenues to address the inconveniences caused by private parties' inability to enforce DSB decisions before the ECJ. Section 10 presents the overall conclusions of our study.

## 2. *The direct effect of WTO DSB's recommendations within the EC legal order*

### 2.1 The lack of direct effect of WTO law

Since its early case-law, the ECJ has made clear that the possibility of *directly* relying on the provisions of an international agreement concluded by the EC depended on its specific features and, in particular, on its nature and structure,<sup>7</sup> and also on whether its provisions contained a clear and precise obligation. Although recent cases, such as *Pokrzęptowicz*<sup>8</sup> and *Simutenkov*,<sup>9</sup> could be read as meaning that the ECJ has begun to neglect the first limb of the direct effect test, by confining itself to an examination of the substantive provisions of the concerned agreement,<sup>10</sup> the *Intertanko*<sup>11</sup> case reaffirms the vitality of both criteria.<sup>12</sup>

The application of the 'direct effect' test to the GATT<sup>13</sup> first, and then, to the WTO agreements,<sup>14</sup> has led the ECJ to consistently deny that the *Member States* can rely on the latter to contest the legality of an EC measure conflicting with WTO rules.<sup>15</sup> The Court has also rejected *private parties'* requests to use the latter as the standard of review for EC legislation.<sup>16</sup>

The rationale for denying direct effect to the provisions of this Treaty was identified in *Portugal v. Council*.<sup>17</sup>

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<sup>7</sup> Case 104/81, *Kupferberg*, [1982] ECR 3641, par. 20-22. *Contra* see opinion of AG Saggio in C-149/96 *Portugal v. Council*, [1999] ECR I-8395, arguing that under art. 300, par. 7 (as it is now) international agreements concluded under this provision takes effect within the EC legal order from the moment they are concluded (par. 18).

<sup>8</sup> Case C-162/00, *Land Nordrhein-Westfalen v Beata Pokrzęptowicz-Meyer*, [2002] ECR I-01049.

<sup>9</sup> Case C-265/03, *Igor Simutenkov v Ministerio de Educación y Cultura and Real Federación Española de Fútbol*, [2005] ECR I-02579.

<sup>10</sup> JACOBS, 'Direct effect and interpretation of international agreements in the recent case law of the European Court of Justice,' in DASHWOOD, MARESCEAU, (eds), *Law and Practice of EU External Relations*, Cambridge University Press, 2008, p. 32

<sup>11</sup> Case C-308/06 *International Association of Independent Tanker Owners (Intertanko) and Others v Secretary of State for Transport*, of 3 June 2008, nyr.

<sup>12</sup> Here, the ECJ ruled that the United Nations Convention on the Law of the Sea, signed in Montego Bay on 10 December 1982 (UNCLOS), did not establish rules intended to apply directly and immediately to individuals and to confer upon them rights or freedoms capable of being relied upon against States. This is because the nature and the broad logic of UNCLOS prevents the Court from assessing the validity of a Community measure in the light of this Convention. Case C-308/06, cit., par. 64-65.

<sup>13</sup> Cases 21-24/72 *International Fruit Company*, [1972] ECR 1219. For critical comments on this case-law and its progeny see the literature quoted by MARESCEAU, 'The place of bilateral agreements in EC law,' *Recueil des Cours* n. 309, Martinus Nijhoff Publishers, 2004, p. 250, footnote n. 273.

<sup>14</sup> See decision n. 94/800/CE, in GUCE [1994], L 336/1.

<sup>15</sup> Case C-149/96 *Portugal v Council*, [1999] ECR I-8395.

<sup>16</sup> It should be emphasised that the judicial application of WTO law differs from that of international agreements characterized by asymmetric obligations. This is the case of association agreements entered into by the EC with third countries having close ties with the members of the EC. On the direct effect of these agreements see SNYDER, 'The Gatekeepers: the European Courts and WTO law,' *Common Market Law Review*, 2003, p. 334. In recent years, the ECJ has showed a remarkable attitude of openness to direct effect of agreements concluded by the Community. JACOBS, above n. 10, p. 32 and along these lines CREMONA, 'Competence, mixed agreements, international responsibility, and effects of international law,' *EUI Working paper*, 2006/22, p. 30. The case law denying direct effect to international agreements such those founding the GATT/WTO has been extended to the UNCLOS. See above n. 12.

<sup>17</sup> C-149/96, cit.



First, the WTO Parties are left free to negotiate the settling of disputes.<sup>18</sup> Should the ECJ decide to annul a Community legislation, breaching WTO law, it would deprive the political institutions (the Commission and the Council) of the freedom to apply that legislation and enter into negotiations with the Party that has invoked the WTO dispute settlement procedures, with a view to finding a ‘mutually acceptable compensation.’<sup>19</sup> Indeed, even if the DSB declared the EC legislation in breach of WTO law, the Community might still not follow the recommendations of this body.<sup>20</sup> In this case the Dispute Settlement Understanding (DSU) allows the successful complainant to ask for compensation or the suspension of concessions.<sup>21</sup>

The second reason supporting the denial of direct effect is related to the principle of reciprocity. Lack of reciprocity, as intended by the Court, refers to the fact that the EC’s major trading partners (the US and Japan) do not provide for direct effect of the WTO provisions in their domestic legal orders.<sup>22</sup> The assumption is that the lack of reciprocity in an agreement based on the principle of reciprocal and mutually advantageous arrangements<sup>23</sup>—as opposed to those that were based on asymmetric obligations of the Parties<sup>24</sup>—is detrimental to the Community’s interests.<sup>25</sup> Indeed, as the Court puts it, eventually, a unilateral conferral of direct effect would bring about a decrease of the freedom enjoyed by the EU institutions and also a lack of uniform application of the WTO agreements.<sup>26</sup> Uniformity and prejudice to the EU institutions’ s freedom of negotiation are the two main worries that the Court sees in connection

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<sup>18</sup> Par. 36. In *Portugal v. Council* the Court did not dwell on the limits of the executive and legislative bodies’ margin of discretion, thus leaving the following question open: are there circumstances under which the discretion of the EC institutions is definitely or at least substantially curtailed? The Court’s failure to define formal boundaries to the negotiating powers of the EU institutions may be interpreted as a way of leaving them an unfettered discretion.

<sup>19</sup> See art. 22, par. 2 of the Understanding on Rules and Procedure Governing the Settlement of Disputes.

<sup>20</sup> Art. 19 par. 1 of the DSU. On the legal effects of the DSB’s recommendations see section n. 2.2.

<sup>21</sup> Art. 22, par. 2.

<sup>22</sup> A recent study confirms that the ECJ’s pragmatic and selective approach to WTO law was inspired by the American one. KARAYIGIT, ‘Commonalities and Differences between the Transatlantic Approaches Towards WTO Law,’ in *Legal Issues of Economic Integration*, 2008, p. 94.

<sup>23</sup> Par. 45. Maresceau criticizes the Court for not explaining why agreements that create reciprocal relations for that simple reason cannot have direct effect. Above n. 13, p. 259.

<sup>24</sup> It should be noted that this reason is not convincing for Mengozzi who seems to find another well-founded justification for the exceptional treatment reserved to the WTO Treaty. This is the following: it is an agreement ‘*largely pervasive touching upon all of the Community competences and policies in relation with practically the entire world*’. MENGOZZI, *The impact of WTO law on judicial protection i the EU of the rights and interests of international traders*, in MENGOZZI, *Private international law and WTO law*, The Hague Academy of international law, Collected courses, The Hague, p. 316.

<sup>25</sup> AG Tesauro further elaborated on this point in his opinion in Case C-53/96 *Hermès International v. FHT Marketing Choice BV*, ECR [1998] I-3603. He argued that: ‘[...] In the absence of reciprocity, to recognise that the provisions in question have direct effect would place Community traders at a disadvantage compared with their foreign competitors. While the latter would be able to invoke provisions in their favour directly before the courts of the Member States, Community traders would be unable to do likewise in the States that refused to recognise that the provisions of the WTO agreements may have direct effect’ (par. 31).

<sup>26</sup> Par. 45-46.

with the lack of reciprocity.<sup>27</sup>

Before the creation of the WTO, the ECJ had devised situations in which GATT rules could exceptionally be invoked to review EC measures. The specific conditions making this possible were laid down in the *Fediol* and *Nakajima* cases.<sup>28</sup> As we learn from *Portugal v. Council*, this case-law also applies in relation to WTO law. In the seminal judgment mentioned above, the Court held that it was empowered to review the legality of the conduct of the EU Institutions in the light of WTO law, where the Community intends to implement a ‘particular obligation’ assumed in the context of the WTO (*Nakajima*) or where the Community measure ‘refers expressly’ to specific provisions of the WTO agreements (*Fediol*).

The ECJ found that the requirements of the *Nakajima* exception were met<sup>29</sup> in a few cases dealing with EC legislation on anti-dumping.<sup>30</sup> In principle, this is not the only area in which this exception may find application.<sup>31</sup> The case in which the scope of the *Nakajima* exception has been most extensively discussed at the request of the applicant is *Chiquita*.<sup>32</sup> However, thus far the Community judicature has been very parsimonious in applying the two exceptions;<sup>33</sup> in the framework of different judicial remedies,<sup>34</sup> the Court

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<sup>27</sup> This does not mean that the reciprocity argument is less important than the one on the margin of manoeuvre in denying direct effect to WTO law, as implied on several occasions by different Advocate generals. AG Alber argues that ‘reciprocity is really a commercial policy issue, decked out in the legal trappings of a principle of reciprocity. There appears to be considerable doubt as to whether the Community’s trading position might be weakened at all by recognizing the direct applicability of WTO law as a basis for a claim for damages.’ See Opinion of AG Alber of 15 May 2003 in C-93/02 P, *Biret International c. Council*, ECR [2003] I-10497, par. 102. On the same line, AG Tizzano considered it ‘a mere pretext for not complying with an obligation formally confirmed by the competent body,’ see his Opinion of 18 November 2004 in C-377/02, *Léon Van Parys NV c. Belgisch Interventie-en Restitutiebureau* (BIRB), ECR [2005], p. I-1465, par. 67. For a criticism of the Court’s interpretation of the principle of reciprocity see MARESCEAU, above n. 13. p. 294 and also GRILLER, ‘Judicial enforceability of WTO law in the European Union Annotation to case C-149/96, *Portugal v. Council*,’ in *Journal of International Economic Law*, 2000, p. 455-462.

<sup>28</sup> Case 69/89, *Nakajima v. Council*, [1991] ECR I-2069 and case 70/87 *Fediol v. Commission*, [1989] ECR 1781.

<sup>29</sup> There are authors who doubt that the *Nakajima* exception as defined in *Portugal v. Council* has ever been applied by the ECJ. On this issue see KUIJPER, BRONKERS, ‘WTO law in the European Court of Justice,’ *Common Market Law Review*, 2005, p. 1325-1327.

<sup>30</sup> Case C-76/00 P *Petrotub and Republica v Council*, [2003] ECR I-79, Case T-256/97 *BEUC v Commission*, [2000] ECR II-101, Case T-162/94 *NMB France*, [1996] ECR II-427, Case C-352/96 *Italy v Council*, [1998] ECR I-6397. The subject matter of anti-dumping is special since the recital of the “basic regulation” n. 384/96 (OJ 1995 L 56/1) refers to the need to bring the language of the new agreement (this is the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (OJ 1994 L 336/03) or “ADA”) into Community legislation as far as possible. Therefore, the Court has accepted to review the concerned EC legislation in the light of the ADA precisely because it “implemented a particular obligation” arising from the mentioned agreement.

<sup>31</sup> The CFI has not excluded that the *Nakajima* exception could apply in areas of EC law different from anti-dumping. On this issue see, Case T-19/01 *Chiquita Brands International, Inc., Chiquita Banana Co. BV and Chiquita Italia, SpA v Commission*, [2005] ECR II-00315, par. 124.

<sup>32</sup> T-19/01, cit.

<sup>33</sup> The CFI has, by its motion, ruled out the application of the so-called ‘implementation exceptions’ (*Nakajima/Fediol* case law) in T-30/99 *Bocchi*, cit., T-18/99 *Cordis*, cit. and T-52/99 *T. Port*, cit. The CFI excluded that the reports of the WTO Panel of 22 May 1997 which was adopted by the DSB on 25 September 1997 encompassed any special obligations which the Commission intended to implement in the contested Community regulation. The reasoning of the CFI was contested since the attacked EC measure had been adopted in order to bring it in line with a DSB’s recommendations. Therefore, this was considered an ideal situation for the application of the implementation exception. PEERS, ‘WTO dispute settlement and



has rejected the applicants' requests to this effect in the context of the common agricultural policy.<sup>35</sup> Moreover, the *Ikea* case,<sup>36</sup> decided recently, can be interpreted as a further narrowing of the scope of this exception.<sup>37</sup>

The case law on the effects of WTO law within the European legal order just outlined, justified by some<sup>38</sup> and criticised by others,<sup>39</sup> was shaped not only in annulment actions and preliminary ruling procedures,<sup>40</sup> but also in actions for non-contractual liability against the Community,<sup>41</sup> under Art. 288, par. 2 of the TEC.<sup>42</sup> Indeed, companies suffering financial damages, as a result of the infringement of GATT/WTO by the EC institutions, asked the Court to make the Community pay for the damages. However, they have never succeeded in fulfilling the very strict conditions of this action. Curiously, the grounds for rejecting

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Community law,' *European Law Review*, 2001, p. 610-612 and EECKHOUT, *External relations of the European Union – Legal and constitutional foundations*, Oxford, p. 321-322.

<sup>34</sup> C-377/02, *Léon Van Parys NV*, cit. (preliminary rulings), T-19/01 *Chiquita Brands International*, cit., C-93/02 P *Biret International c. Council*, cit., T-18/99, cit; T-30/99, cit; T-52/99, cit. (action in damages).

<sup>35</sup> The banana and hormones in beef WTO disputes, which are at the root of many private parties' actions, concern the agricultural policy.

<sup>36</sup> Case C-351/04 *Ikea Wholesale Ltd v Commissioners of Customs & Excise*, [2007] ECR I-07723.

<sup>37</sup> Although this case concerns anti-dumping law, the Court has excluded that a 1997 anti-dumping regulation could be reviewed in the light of the ADA since it considered clear from this regulation and subsequent ones that the Community did not intend in any way to give effect to a specific obligation assumed in the context of WTO law (par. 35). This reasoning, which has been criticised (HERMANN, 'Case C-351/04, *IKEA Wholesale Ltd v. Commissions of Customs & Excise*, judgment of the Court of Justice of 27 September 2007, second chamber [2007] ECR, I-7723,' *Common Market Law Review*, 2008, p. 1514) may imply that the ECJ does no longer consider the ADA a 'particular obligation' in the sense of the Nakajima test. HERMANN, cit., p. 1517.

<sup>38</sup> Amongst others see ROSAS, 'Annotation to Case C-149/96, *Portugal v. Council*. Judgment of the Full Court of 23 November 1999, nyr,' *Common Market Law Review*, 2000, p. 808-814; MARESCEAU, above n. 13, p. 262, ANTONIADIS, 'The European Union and WTO law: a nexus of reactive, coactive, and proactive approaches, The European Union and WTO law: a nexus of reactive, coactive, and proactive approaches,' *World Trade Review*, 2007, p. 84.

<sup>39</sup> Individual references to authors criticizing specific aspects of the Court's case-law are scattered throughout the article. In addition, the following sample of commentators may be mentioned. PETERSMANN has criticised the case-law on GATT and WTO for more than 25 years. See 'Application of GATT by the Court of Justice of the European Communities,' *Common Market Law Review*, 1983, p. 387 and more recently 'Multilevel judicial trade governance? On the role of domestic courts in WTO legal and dispute settlement system,' *EUI working paper* n. 2006/44. See also the critical comments of the following authors: HAHN, SCHUSTER, 'Les droits des Etats membres de se prévaloir en justice d'un accord liant la Communauté,' *Revue Juridique Droit International Publique*, 1995, p. 367; MANIN, 'A propos de l'accord instituant l'Organisation mondiale du commerce et l'accord sur le marchés publics; la question de l'invocabilité des accords internationaux conclus par la Communauté européenne,' *RTDP*, 1997, p. 399.

<sup>40</sup> See in particular preliminary rulings concerning the Trade-related intellectual property rights (TRIPs) agreement: Joined Cases C-300/98 and C-392/98 *Dior and Others* [2000] ECR I-11307 and more recently C-431/05 *Merck Genéricos-Produtos Farmacêuticos Ld v. Merck & Co. Inc.* and others, nyr. See also Order in case C-307/99, *OGT Fruchthandelsgesellschaft*, [2001] ECR I-3159; C-27/00 and C-122/00, *Omega Air*, [2002] ECR I-2569.

<sup>41</sup> T-18/99 *Cordis v. Commission* [2001] ECR II-913; T-30/99 *Bocchi Food Trade International v. Commission* [2001] ECR II-943; T-52/99 *T. Port v. Commission* [2001] ECR II-981.

<sup>42</sup> The cumulative conditions to establish the Community non-contractual liability for unlawful conduct of the EU institutions are the following: 1. the latter must have committed a violation which must be a sufficiently serious breach of the rule of law intended to confer rights on individuals; 2. this conduct has provoked damage; 3. there must be a causal link between the conduct and the damage suffered. See Case C-352/98 P *Bergaderm and Goupil v Commission*, [2000] ECR I-5291.

the Community's non-contractual liability have not been the same. At times, the Court held that the GATT/WTO did not confer rights on individuals and therefore could not be invoked for the purpose of an action in damages.<sup>43</sup> In a recent case, the Court rejected a request under Art. 288, par. 2 of the TEC, on the grounds that WTO rules are not among those by reference to which the Community courts review the legality of the Community institutions and therefore the WTO-inconsistent behaviour of the EC institutions did not amount to a 'breach,' one of the conditions to establish the non-contractual liability of the Community.<sup>44</sup>

A further issue raised by legal commentators in relation to the action in damages is that the latter should be de-linked from direct effect. This would ensure effective legal protection of private parties that do not have other judicial avenue to seek the protection of their rights. In support of this position it is also argued that the prospect of such an action would also cause welcome results in terms of WTO compliance since the EC would have incentives to give effect to the DSB's rulings.<sup>45</sup> We do not share this view, as we will see *infra*.

A distinctive feature of the case-law on the legal effects of WTO law, following the release of *Portugal v. Council*, concerns the quality of the applicants. Whereas privileged applicants, such as the Member States, quite early resigned themselves to the ECJ's position of refusing to review the EC legislation in the light of this agreement,<sup>46</sup> private parties did not. This is not surprising since companies directly suffer the consequences of the misapplication of WTO law. Sometimes the preservation of EC legislation infringing WTO law resulted in indirect damages to traders of goods totally unrelated to those that were the object of disputes between the EC and other WTO members. This was the case of FIAMM and Fedon.<sup>47</sup>

Having sound financial reasons to challenge the EC measures before the Court, private parties attempted to circumvent the dearth of case law on the direct effect of WTO law with a two pronged-strategy: first, to have a Community measure annulled or to make a claim for damages caused by such a measure, they emphasized that the contested Community legislation had been declared unlawful by a DSB decision.<sup>48</sup>

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<sup>43</sup> T-174/00, *Biret International v. Council*, [2002], ECR II-17, par. 61.

<sup>44</sup> See the CFI's ruling in T-69/00, above n. 6, par. 145-149.

<sup>45</sup> WIERS, 'One Day, You're Gonna Pay: The European Court of Justice in Biret', *Legal Issues of Economic Integration*, 2004, p. 148.

<sup>46</sup> The last case brought by a Member State was Case C-377/98 *Netherlands v Parliament and Council* [2001] ECR I-7079.

<sup>47</sup> See *infra* n. 3.

<sup>48</sup> For example in *Atlanta*, a company argued that such a decision, establishing once and for all that essential parts of the common organisation of the market in bananas were incompatible with WTO law, placed beyond doubt the illegality of the common organisation of the market under Community law. Case C-107/94 P, *Atlanta* [1999] ECR, I-6983, par. 17. The Court rejected the argument because it was raised too late in the appeal. However, the case is interesting since for the first time a private party sought to directly rely on a DSB's decision before the Court. See also Case T-254/97 *Frucht-handels-gesellschaft Chemnitz v Commission*, [1999] ECR p. II-2743. In *Banatrading* (T-3/99 *Banatrading v Council*, [2001] ECR II-2123, par. 38) the claimants argued that the EC was liable for failing to implement the DSB's

However, both the CFI and the ECJ have never considered this factor decisive.<sup>49</sup> Second, as the *Chiquita* case<sup>50</sup> shows, they tried to induce the Court to be more generous in applying its exceptions to the lack of direct effect. As shown in the next paragraph, this attempt fell on deaf ears. The CFI in *Chiquita* and the ECJ in *Van Parys*<sup>51</sup> both refused to relax the conditions under which WTO law was taken into consideration when reviewing EC law.

## 2.2 The DSB's recommendations in the DSU

Having provided a snapshot of the case law on WTO law, it is necessary to examine to what extent the principles defined by the ECJ in relation to the substantive provisions of the WTO agreements also apply to the decisions of its DSB.

Under the DSU, this body, whose legal nature is debated,<sup>52</sup> may approve the reports of the Panel or the Appellate Body adjudicating a dispute between its WTO members.<sup>53</sup> They identify possible breaches of WTO provisions in their reports; however, the DSU imposes that by so doing, these cannot 'add to or diminish the rights and the obligations of the WTO members.'<sup>54</sup> The DSB's recommendations, issued on the basis of the adopted reports, are binding on the parties,<sup>55</sup> who must accept them 'unconditionally.'<sup>56</sup> They do apply prospectively. 'Prompt' compliance with DSB decisions is deemed to be 'essential' to the effective resolution of disputes.<sup>57</sup> Alignment with them may be delayed for a reasonable period of time.<sup>58</sup> Full implementation of the recommendations is the favoured option under the DSU.<sup>59</sup> However, the latter also envisages the possibility that the defaulting Party fails to bring the measure found to be inconsistent with a covered agreement into compliance with it or otherwise comply with the DSB's recommendations

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recommendations within the prescribed time-limit.

<sup>49</sup> See section n. 2.4.

<sup>50</sup> T-19/01, *Chiquita c. Commission*, cit.

<sup>51</sup> C-377/02, cit.

<sup>52</sup> Commentators are also divided as to whether the DSB is a judicial body or an organ of political nature. The qualification of the DSB is also crucial within the EC legal system. Should this body be considered a "court," then the ECJ's opinion n. 1/91 on the European Economic Agreement ([1991] ECR I-6102, par. 39) would apply and the DSB's decisions should be considered legally binding on the Court. However, qualifying the DSB as a tribunal in the sense of the EEA Court is highly problematic.

<sup>53</sup> Art. 16, par. 4 and 17, par. 14 of the DSU.

<sup>54</sup> Art. 3.2 and art. 19.2.

<sup>55</sup> Appellate Body report in *Japan—Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, p. 13, of 4 October 1996.

<sup>56</sup> Article 17, par. 14.

<sup>57</sup> Art. 21, par. 1.

<sup>58</sup> Art. 21, par. 3.

<sup>59</sup> Art. 19, par. 1, art. 22 par. 1.

and rulings,<sup>60</sup> within the time limit afforded to the defaulting WTO member to do so. It is not clear how these determinations will be made.<sup>61</sup> By contrast, it is certain that the parties enjoy maximum autonomy in ensuring conformity to WTO law obligations<sup>62</sup> and that the parties may agree on ‘alternative remedies,’ with the aim of reaching a ‘mutually acceptable compensation.’ This may consist of a compensation or the suspension of concessions.<sup>63</sup> The latter, which must be authorised by the DSB, can take the form of an increase in customs duties on the products imported from the defaulting WTO member.<sup>64</sup> This ‘last available option’ is rarely invoked,<sup>65</sup> but reliance on it is increasing.<sup>66</sup> Is the purpose of this WTO remedy to give a form of temporary compensation to the successful party or to induce compliance with WTO obligations? This question is debated.<sup>67</sup> A further unsettled issue is whether the DSU allows the parties of a dispute to disregard the DSB’s recommendations or whether such a possibility is only available for a limited period of time. This is the time necessary to make possible for the defaulting Member State to perform internal adjustments to give full effect to the DSB’s decisions.<sup>68</sup> We are convinced that, although neither compensation nor the suspension of concessions is preferable to full implementation,<sup>69</sup> there should be cases in which the Parties to a dispute should be enabled to depart from the DSB’s recommendations.<sup>70</sup> It should be added that the DSU envisages a situation in which the defaulting Party to a dispute accepts to comply with the DSB’s recommendations but there is disagreement with the complaining Party as to ‘the existence or consistency with a covered agreement of measures taken to comply with the

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<sup>60</sup> Art. 22, par. 2.

<sup>61</sup> PALMETER, MAVRODIS, *Dispute settlement in the World Trade Organization*, 2004, Cambridge University Press, p. 279.

<sup>62</sup> Panel report, United States-sections 301-310 of the Trade Act of 1974, WT/DS152/R, 27 January 2000, DSR 2000:II 815, par. 7.102.

<sup>63</sup> Art. 22 par. 1.

<sup>64</sup> Art. 22, par. 2.

<sup>65</sup> Retaliation was requested and authorised in only six out of over one hundred cases. PETERSMANN, above n. 39, p. 13.

<sup>66</sup> On 14th January 2009, the USA decided to impose sanctions on European products on the basis of the so-called carousel legislation of 2000. The decision was taken in the context of the biotech dispute. See General overview of active WTO dispute settlement cases involving the EC as a complainant or a defendant and of active cases under the technical barrier to trade regulation ([http://ec.europa.eu/trade/issues/newround/index\\_en.htm](http://ec.europa.eu/trade/issues/newround/index_en.htm)).

<sup>67</sup> For a discussion on these interpretations see SEBASTIAN, ‘World Trade Organization remedies and the assessment of proportionality: equivalence and appropriateness,’ *Harvard International Law Journal*, 2007, p. 364-370. For an opinion favouring the interpretation that the suspension of concessions are aimed at inducing compliance see VAN DEN BROEK, ‘Power paradoxes in enforcement and implementation of World Trade Organization dispute settlement reports-Interdisciplinary approaches and new proposals,’ *Journal of World Trade*, 2003, 139.

<sup>68</sup> See Griller, above n. 27, p. 453. A few authors argue that WTO members are obliged to comply with the DSB’s decisions. The initiator of this line of thought is JACKSON who supported the idea that WTO members have an international law obligation to implement these decisions in ‘International law status of WTO dispute settlement reports: obligation to comply or option to “buy out?,”’ *American Journal of International Law*, 2004, p. 111. See also PERE, ‘Non-implementation of WTO dispute settlement decisions and liability actions,’ in *Nordic Journal of Commercial law*, 2004, p. 17, ZONNEKEYN, ‘The status of adopted panel and Appellate Body Reports in the European Court of Justice and the European Court of First Instance,’ *Journal of World Trade*, 2000, p. 102-103; COTTIER, above n. 2, p. 340). *Contra* see BELLO, ‘The WTO dispute settlement understanding: less is more,’ *American Journal of International Law*, 1996, p. 416.

<sup>69</sup> Art. 22, par. 1.

<sup>70</sup> On this issue see section n. 4.1.

recommendations and rulings.<sup>71</sup> This second stage of the dispute may require a Panel to decide on the whether there has been compliance.

### 2.3 The legal effects of the DSB recommendations in the ECJ case law

It is now appropriate to dwell on whether the ECJ considers itself bound by the DSB recommendations. The Community judicature seems unwilling to attach binding legal effects to these acts.<sup>72</sup> The CFI clearly took this position in *Chiquita*;<sup>73</sup> Advocate General Lèger followed the CFI in *Ikea*. The justification he put forward to deny that a report of the DSB can bind the Courts was that it would preserve the autonomy of the Community legal order.<sup>74</sup> The ECJ has not yet been so explicit on this issue.<sup>75</sup> However, it has been observed that the Community judges take into consideration the DSB's recommendations, under the principle of 'consistent interpretation.'<sup>76</sup> This means that the DSB's reports (and/or the same text of the WTO agreements<sup>77</sup>) are used to interpret EC law, transposing a WTO agreement,<sup>78</sup> although this does not amount to automatically apply the interpretation proffered by the Panels and AB to the merits of the case heard by the CFI or the ECJ.<sup>79</sup> This phenomenon has induced someone to argue that there is a muted

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<sup>71</sup> Art. 21, par. 5.

<sup>72</sup> For a favourable opinion on the binding nature see GATTINARA, 'On dice and doors: WTO dispute settlement decisions in the system of judicial protection of the European Union,' in DEL VECCHIO (ed.), 'New international Tribunals and new international proceedings,' Milano, 2006, p. 248. *Contra*, MCNELIS, 'What obligations are created by World Trade Organization dispute settlement Reports?,' *Journal of World Trade*, 2003, p. 670; KUIJPER, BRONKERS, above n. 29, p. 1328.

<sup>73</sup> T-19/01, cit., par. 162.

<sup>74</sup> C-351/04, cit., par. 79.

<sup>75</sup> In *Fiamm*, which is the last case in which the ECJ tackled this legal issue affirmed: "A recommendation or a ruling of the DSB finding that the substantive rules contained in the WTO agreements have not been complied with is, *whatever the precise legal effect attaching to such a recommendation or ruling* (emphasis added), no more capable than those rules of conferring upon individuals a right to rely thereon before the Community courts for the purpose of having the legality of the conduct of the Community institutions reviewed (C-120/06 and 121/06, above n. 5, par. 129).

<sup>76</sup> On this issue see GATTINARA, 'Sentenza del 9 settembre 2008 in cause riunite n. C-120/06 e 121/06,' *Diritto del Commercio e degli Scambi internazionali*, 2009, p. 75-77.

<sup>77</sup> For a recent example of a case in which the ECJ interpreted the basic regulation in the light of the WTO Anti-dumping agreement, see judgment of 8 July 2008, T-221/05 *Huvis Corp. v. Council*, nyr.

<sup>78</sup> For example, in *Shanghai*, the CFI used the AB's report in *Bed linen* to assess whether the Council had correctly applied anti-dumping measures on the basis of the basic regulation. See T-35/01, *Shanghai Teraoka Electronic Co. Ltd, established v. Council*, [2004] ECR, p. II- 3663, par. 140-141. In *Ritek*, the same Court used the anti-dumping Code and the 'Bed linen' report to evaluate whether the method chosen by the Council to calculate dumping margins, in the application of the basic regulation on protection against dumped imports from countries, was correct. See T-274/02, *Ritek Corp v. Council*, [2006] ECR, p. II-4305. In *Reliance*, the Court relied on the Anti-dumping agreement, the Anti-subsidy agreement and the report on Sunset Reviews of Anti Dumping Measures on Oil Country Tubular Goods from Argentina to review the Community legislation transposing the two agreements. T-45/06 *Reliance industries Ltd*, of 24 September 2008, nyr.

<sup>79</sup> For example, in the *Ritek* case, cit., the CFI did not consider that the AB's conclusion in the *Bed linen* report, holding the zeroing technique incompatible with the Anti-dumping Code, were also applicable to the case at stake.



dialogue between the Courts and DSB.<sup>80</sup> This presumes that regardless of the fact that the former do not explicitly acknowledge the interpretative authority of the rulings of the latter, there is a discernible intention of Community courts to follow them as much as they can. In the authors' opinion, there is not enough evidence to argue that the Courts actually follow the DSB's recommendations. However, the very same fact that they consider the interpretation of the WTO agreements proffered by DSB in deciding how a provision of an EC measure, implementing the concerned WTO agreement, should be interpreted, is a way to give 'effet utile'-so to speak- to the rulings of the DSB. This may be considered a satisfactory state of affairs and therefore, it may be unnecessary to formalise the relations between the European courts and the WTO Tribunals.

Finally, it should be noted that the approach of the ECJ vis-à-vis the DSB's rulings is not too far from that of the US courts, considering the DSB's decisions as 'persuasive authority.'<sup>81</sup>

#### **2.4 Direct effect of DSB's recommendations vis-à-vis non direct effect of WTO substantive provisions?**

One of the most recurrent legal issues raised in recent case-law is whether DSB decisions, holding the EC legislation incompatible with WTO law, are capable of being directly invoked by applicants seeking to challenge the EC measure disregarding WTO law. In particular, the purpose of such an action is to review the legality of an EC measure declared unlawful by the DSB or to establish the non-contractual liability of the Community for failure to bring the EC legislation into compliance with these decisions. The theoretical problem underlying this issue is whether the direct effect of the DSB's rulings is autonomous from that of WTO law. An authoritative author such as Jackson<sup>82</sup> does not consider the two issues as separate. Others take the opposite view and have contended that when a violation of WTO law is established by a DSB decision, the binding character of the agreement and the principle of legality should trump any lack of direct effect.<sup>83</sup> Along the same lines, another author has advocated that DSB recommendations should have direct effect since their implementation affects individuals, although they are addressed to WTO members.<sup>84</sup> A third scholar has emphasised that the direct effect of DSB rulings is unlikely; however, he

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<sup>80</sup> BRONCKERS, 'From "direct effect" to "muted dialogue"-Recent Developments in the European Courts' Case Law on the WTO and Beyond,' *Journal of International Economic Law*, 2008, p. 886.

<sup>81</sup> For a recent in depth study see GATTINARA, 'The relevance of WTO dispute settlement decisions in the US legal order,' *Legal Issues of Economic Integration*, 2009, p. 295.

<sup>82</sup> He affirms that: 'I would like to argue that the DS report does not have direct application any more than the Treaty would.' JACKSON, *Sovereignty, the WTO, and the changing fundamentals of International law*, Cambridge University Press, 2006, p. 193.

<sup>83</sup> EECKHOUT, 'The domestic legal status of the WTO Agreement: interconnecting legal Systems,' *Common Market Law Review*, 1997, p. 53. COTTIER also supports this position. See above n. 2, p. 371 and also ZONNEKEYN, above n. 68, p. 93.

<sup>84</sup> THIES, Annotation to T-69/00, FIAMM and FIAMM technology, T-151/00, Le Laboratoire du Bain, T-301/00, Fremaux,



considers that the provision of the WTO Treaty, whose violation has been identified by a ruling of the DSB, may, instead, be directly invoked.<sup>85</sup>

Eeckhout's position introduces a temporal distinction that deserves special attention. He argues that the DSB's rulings could be used to set aside Community measures adopted *after* the release of those acts (since the DSB's decisions do not apply retroactively). In his opinion, this would not have dramatic consequences. He contends that applicants should be able to rely on DSB decisions in an action for damages, if they can prove that a 'sufficiently serious breach' has occurred.<sup>86</sup> It has been noted that the first part of Eeckhout's proposal could not lead to the annulment of past Community measures (adopted *prior* to the DSB's ruling). Therefore, it would be of no use to rely on the DSB's rulings in these circumstances. Certainly, the fact that the DSB's decisions apply *ex nunc* would not represent an obstacle for an action for damages.<sup>87</sup> Leaving aside the difficulty of satisfying the strict conditions of an extra-contractual liability action, especially when the supposed breach concerns a DSB ruling,<sup>88</sup> we wonder whether it is appropriate to allow private parties to rely on these acts for an action in damages. Comments on this issue will be made in the analysis of the ECJ ruling in *FLAMM*, which addresses this problem.

Having sketched out the opinions of academic commentators on the legal value of DSB's recommendations, it is appropriate to provide a short account of the Community judiciary's position on this subject. Advocate generals Alber in *Biret*<sup>89</sup> and Tizzano in *Van Parys*<sup>90</sup> had claimed that these acts could be directly invoked respectively in the context of an action for damages and in a preliminary ruling procedure. The CFI seems to have taken a negative view in *Comafrika*.<sup>91</sup> However, in more recent cases, the

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T-320/00, CD Cartondruck AG, T-383/00, Beamglow Ltd and T-135/01, Giorgio Fedon & Figli S.p.A., Fedon S.r.l. and Fedon America USA Inc., Judgments of 14 December 2005, Grand Chamber of the Court of First Instance, nyr, *Common Market Law Review*, 2006, p. 1162.

<sup>85</sup> GATTINARA, 'La responsabilità extracontrattuale della Comunità europea per violazione delle norme OMC,' *Diritto dell'Unione europea*, 2005, p. 143, 145. This solution has been suggested by AG Alber in *Biret*, above n. 27, paras. 94-96 and is also supported by Tizzano, in *Van Parys*, above n. 27, par. 73.

<sup>86</sup> ORTINO, RIPINSKY, above n. 1, p. 98.

<sup>87</sup> *Ibidem*, p. 99.

<sup>88</sup> For example, the wide margin of discretion granted to the Community to put its legislation in compliance with WTO rulings is considered sufficient to exclude the Community's liability. DE MEY, IBÁÑEZ COLOMO, 'Recent development on the invocability of WTO law in the EC: a wave of mutilation,' *European Foreign Affairs Review*, 2006, p. 75.

<sup>89</sup> He held that WTO law should be granted direct effect for the purpose of an action in damage when a DSB's decision has ascertained the unlawfulness of the EC legislation. Above n. 27, par. 91. For a criticism of AG Alber's reasoning and arguments against the prospect of an action in damage for breach of DSB's recommendations see VON BOGDANDY, 'Legal effects of World Trade Organization decisions within the European Union law: a contribution to the theory of legal acts of international organizations and the action for damages under Article 288(2) EC,' *Journal of World Trade*, 2005, p. 49-59.

<sup>90</sup> Tizzano shared the AG Alber's conclusions in *Biret* on the effects of the DSB's decisions and deduced from the ruling of the Court in that same case that they could be directly invoked by private parties. See above n. 27, paras 76-78.

<sup>91</sup> T-225/99 *Comafrika and Dole Fresh Fruit Europe* [2001] ECR II-1975. The Court held that the EC had different options for implementing a WTO ruling. Since a discretion is left in this respect, such a ruling may be taken to imply that the Court considered DSB's recommendations as lacking direct effect.

CFI's attitude was more ambiguous. For example, in *Biret*<sup>92</sup> the Court held that applicants could not invoke the SPS agreement because it lacked direct effect and did not consider whether the DSB's decisions produced autonomous legal effects.<sup>93</sup> In *FLAMM and others*<sup>94</sup> the CFI did not straightforwardly address the direct effect of the DSB's recommendations; rather, it excluded the application of the *Nakajima/Fediol* exception. Turning to the ECJ, it had had the chance to address this issue in *Atlanta* where it had linked up direct effect of the DSB's decisions to that of general WTO provisions, thus implicitly excluding it.<sup>95</sup> However, in *Biret* the Court seemed to have taken the opposite view;<sup>96</sup> eventually, the possibility of relying on the DSB's decisions was denied in *Van Parys*<sup>97</sup> and even more explicitly in *FLAMM and Fedon*.<sup>98</sup>

### 3. *The FIAMM and Fedon cases*

#### 3.1 The factual and legal context

Between 1999 and 2001, both FIAMM and Fedon's products (stationary batteries and spectacle cases respectively) were hit, amongst those of other companies,<sup>99</sup> by a heavy increase in custom duties<sup>100</sup> enacted by the US, under the authorization of the DSB, to offset the level of nullification and impairment due to the persistent application of a WTO incompatible measure related to the import of bananas. The EC legislation on the import of bananas had been found in breach of WTO rules on several occasions<sup>101</sup> but

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<sup>92</sup> T-174/00, *Biret International v. Council*, cit., par. 61.

<sup>93</sup> The CFI's failure to consider whether the DSB's rulings could produce autonomous legal effect was criticised by the ECJ. See C-93/02 P, cit, par. 56-58.

<sup>94</sup> T-69/00, cit.

<sup>95</sup> '[...] A decision [of the DSB] could only be taken into consideration if the Court of Justice had found GATT to have direct effect in the context of a plea alleging the invalidity of the common organisation of the market.' C-107/94 *Atlanta*, above n. 48, par. 20.

<sup>96</sup> By holding that a review of the Community legislation at stake in the light of DSB's decisions, was not possible in an action in damages, before the expiry of the reasonable period for compliance (par. 62 of C-93/02 P, *Biret*, cit), commentators were induced to believe that private parties could invoke those decisions in the context of an action of the same, after the expiry of the mentioned time-limit.

<sup>97</sup> In this case the Court held that the DSB's decisions cannot be taken into consideration to review the validity of an EC measure. The reason is that changing the EC legislation, in the light of the DSB's decisions, does not mean that the EC is implementing a particular obligation arising from the DSB's decisions. This amounts to a 'general obligation.'

<sup>98</sup> C-120/06 and 121/06, above n. 5. See section n. 3.

<sup>99</sup> See above n. 6.

<sup>100</sup> Import duties were imposed at a rate of 100%. The duties were reduced to their initial rate (between 3% and 4%) after the EC and the United States concluded a memorandum of understanding in April 2001 and a new regulation on import of bananas was enacted. See T-69/00, cit., par. 43-45.

<sup>101</sup> The 1993 EC regime for the import of bananas has been deemed in breach of WTO by a Panel and an Appellate Body, constituted at the requests of the United States and Ecuador. In September 1997 the DSB adopted the reports of the two bodies. In 1998 the EC changed its legislation in order to comply with the WTO rulings. However, the United States considered the EC's move a cosmetic operation and decided to enact cross-retaliatory measures in an effort to put pressure on the EU institutions to abide by the 1997 DSB's decision.

the EC's inadequate efforts to bring its legislation in line with WTO law had spurred the US' application of the described retaliatory measures. This legal context had induced the applicants, often referred to as 'innocent victims',<sup>102</sup> to introduce an action in damages against the Community, under Art. 288 par. 2 of the TEC before the CFI.

The applicants' first argument in support of the Community's liability was that the EU Institutions, by failing to comply with WTO law, were liable for the applicants' damages as a result of the retaliatory measures adopted by the US. The Court had rejected the applicants' contention on the ground that the Community had not committed any 'breach' (constitutive element of an action in damages) since even if it had undertaken to conform to the DSB's decisions, by failing to do so, it had not violated a 'particular obligation',<sup>103</sup> within the meaning of *Nakajima*.

The applicants' second argument was that the EC was liable in the absence of unlawful behaviour. On this issue, for the first time ever, the CFI had admitted that the Community could have been held liable under Art. 288, par. 2. However, the substantive conditions for this form of liability to arise were not met. In particular, the economic consequences of the US' suspension of concessions were not of an unusual nature for business operators such as FIAMM and Fedon.<sup>104</sup>

The ECJ appealed against the CFI's ruling on the following grounds: that the Court had failed to address whether the DSB's decisions had direct effect and had wrongly evaluated that the Institutions had not committed a 'breach.' In the appellants' views the CFI has wrongly assimilated the consequences of an action in damages to those of an annulment action. In their opinion, the former would not have the inconveniences of the latter since it would not force the Community legislators to remove the WTO-incompatible act from the Community legal order but would merely confer a right to claim for damages on the applicants.

Finally, FIAMM and Fedon claimed that the CFI has not correctly evaluated the conditions of the Community's liability in the absence of unlawful behaviour, in particular, that the risks of collateral damages would not be inherent to operators in the sector concerned. In the next sections we will examine

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<sup>102</sup> This is because their activity is affected by retaliatory measures adopted in connection with a WTO dispute involving products that have nothing to do with those of the victims.

<sup>103</sup> Indeed, conforming to these decisions was not the only viable option for the EC to solve the banana dispute. T-174/00, cit., par. 115.

<sup>104</sup> Under the ECJ case-law a damage is unusual when exceeds the limits of the economic risks inherent in operating in the sector concerned (par. 202). However, this was not the case of the losses incurred by FIAMM and Fedon since their financial losses were not in excess of the limits of the risks inherent in their export operations (par. 203). In particular, the possibility that concessions being suspended is among the vicissitudes inherent in the current system of international trade (par. 205). For a criticism of the CFI's ruling on the ground that the unfulfilled condition of the Community's liability should have been the absence of causal link between the Community's activity and the damage suffered see BLÁZQUEZ NAVARRO, 'Sobre la responsabilidad extracontractual de la Comunidad Europea por el incumplimiento de las decisiones del Órgano de Solución de diferencias de la OMC,' *Revista española de derecho europeo*, 2005, p. 374.

both the ECJ's ruling and the AG's opinion<sup>105</sup> and then provide an analysis of the judiciary's position. We will explain why we share the Court's position to deny direct effect to the DSB's decisions. In the subsequent section, we will criticise the AG's arguments in favour of the Community extra-contractual liability for lawful activity and we will single out the reasons to support the Court's denial of the existence of this remedy in relation to a conduct of the EU institutions related to WTO law.

### **3.2 The Community non-contractual liability for unlawful acts: the position of the AG and of the ECJ**

Both AG Maduro and the ECJ hold that the Community cannot be declared liable for the damages arising out of its breach of a DSB's decision.

The former points out that the crucial question in the case is whether the Community's legislative and executive organs may still claim that the DSB's decisions leave them political freedom of negotiation, after the expiry of the implementation period. His answer is positive and therefore the conclusion is that these acts cannot be relied upon in an action for damages. Particularly interesting is the way Maduro departs from Tizzano's view in *Van Parys*. In this case the suggestion was made that the finding of a solution to a dispute, which is alternative to implementing the DSB's recommendations, does not mean that the EU institutions enjoy freedom of negotiation; the alternative solution may be considered another way of implementing the DSB decision. As Maduro convincingly states, it does not matter how one interprets the freedom to reach an alternative solution (i.e. be it freedom to choose the means of implementing DSB decisions *or* the freedom to choose an alternative implementation of the decision), *'it still constitutes freedom of choice.'*<sup>106</sup>

Secondly, Maduro shows that the EU institutions' margin of manoeuvre *vis-à-vis* the complaining Party is jeopardised by an action in damages as it is in the context of an annulment action. This is because *'the finding of unlawfulness by the Community court nevertheless constitutes res judicata. Hence, the political organs of the Community could not allow such unlawfulness to persist, short of disregarding the principle of a Community based on the rule of law. They would be under an obligation to eliminate that unlawfulness by repealing or withdrawing the legislation concerned.'*<sup>107</sup>

Since the prospect of an action in damages forces the political organs of the Community to eliminate the Community measure found incompatible with the WTO rules, it also restricts the freedom of conduct they

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<sup>105</sup> See opinion of AG Maduro of 20 February 2008 in Joined Cases C 120/06 P, C 121/06 P, above n. 5. For an extensive comment see ALEMANNI, 'The Fiamm judgment or "going bananas"- a missed opportunity to distribute the costs of European Community non-compliance with the WTO rulings across society,' in FONTANELLI, MARTINICO, 'The ECJ under siege-new constitutional challenges,' 2008, Hyderabad, (India), p. 226; see also BRONCKERS, above n. 80, p. 885-898.

<sup>106</sup> Par. 47 of Maduro's opinion above n. 5.

<sup>107</sup> Par. 49.

are permitted under the legal order of the WTO.<sup>108</sup>

Finally, Maduro wonders whether postponing the possibility of introducing an action in damages to a time when the dispute has been settled could make this action admissible. Would the EU institutions not be free to negotiate in these circumstances? He concludes that *‘establishing the principle of liability for unlawful conduct by the Community by reason of its failure to comply with a DSB decision [...] would be a sword of Damocles hanging in future over the freedom of the political organs of the Community within the WTO sphere.’*<sup>109</sup>

The ECJ rejected the appeal to the CFI’s ruling, confirming that notwithstanding the expiry of the period of time allowed for implementing a decision of the DSB, the Community courts may not, in the circumstances of the case at issue, review the legality of the conduct of the Community institutions in the light of WTO rules.<sup>110</sup>

Taking up Maduro’s suggestion, the Court posits that the CFI had, albeit implicitly, ruled on the direct effect of the DSB’s decisions for the purpose of an action for damages. Its finding that these decisions were not capable of being directly invoked was considered correct. The justifications to deny direct effect are drawn from *Van Parys*: first, by attempting to comply with the DSB’s decision the EU institutions did not intend to implement a ‘particular obligation’ within the meaning of the *Nakajima* ruling; second, in the resolutions of disputes, options other than the withdrawal of the unlawful measure are possible. The adoption of a DSB decision against the EC does not imply that the EC has exhausted all the possibilities of finding a solution to the dispute. In addition, the business operators in the WTO trading partners of the EC do not have the possibility to rely on the DSB’s decisions in courts.<sup>111</sup> Drawing inspiration from Maduro’s conclusions, the Court states that these reasons apply both to the review of the legality of the Community measures and to actions in damages against the Community.<sup>112</sup>

By so ruling the Court squares the circle on the effects of WTO law within the EC legal order: the concerned agreement cannot be invoked either to question the legality of a Community measure or in the context of an action under Art. 288, par. 2 of the TCE: in both cases the EU institution’s margin of manoeuvre is equally hampered. A point that the ECJ did not consider is whether the freedom of negotiating a settlement to the dispute at WTO level would continue to stand in the way of admitting an action in damages *after* the concerned dispute has been settled. Arguably, an action in damages at that stage of the dispute would not be a Damocle’s sword on the political institutions since they would have already carried out their task of negotiating a settlement of the dispute which is convenient for the Community.

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<sup>108</sup> Par. 50.

<sup>109</sup> Par. 51.

<sup>110</sup> Par. 133.

<sup>111</sup> Par. 119.

<sup>112</sup> In particular see par. 124.

We will come back on this issue.

The second interesting part of the ruling concerns the distinction between the direct effect of the DSB's decisions and that of the WTO's substantive provisions, a point Maduro did not touch upon in detail. In the present case, the ECJ openly confirms the lack of direct effect of the DSB's decisions since they cannot be distinguished from WTO law. In particular, they leave the political bodies of the defaulting WTO member scope for negotiation *vis-à-vis* their trading partners (the complainants) as far as the adoption of measures intended to respond to the ruling or recommendation are concerned. This even after the expiry of the time limit to implement these acts.<sup>113</sup>

The Court puts forward a second argument against direct effect of the DSB's rulings, which had never been raised or discussed in the ECJ case-law on WTO law: "*As is apparent from Article 3(2) of the DSU, recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the agreements concerned. It follows in particular that a decision of the DSB finding an infringement of such an obligation cannot have the effect of requiring a party to the WTO agreements to accord individuals a right which they do not hold by virtue of those agreements in the absence of such a decision.*"<sup>114</sup>

Although we will comment on and overall support the Court's ruling later, it is necessary to clarify that this second argument is not convincing. Art. 3(2) was inserted in the DSU to avoid 'judicial activism' by the WTO Tribunals.<sup>115</sup> The fact that the DSB's decisions interpret WTO law and do not confer additional rights or obligations on WTO members was not meant to determine the internal effects of WTO law and to curtail the possibility for private parties to rely on these decisions before the ECJ.<sup>116</sup> Hence, this argument is not at all decisive to deny private parties the possibility to rely on those decisions before the ECJ. However, as we will see in subsequent sections, the first justification put forward by the Court to deny the reliance of private parties on the DSB's decisions before the ECJ, may be considered in itself sufficient.

### **3.3 The Community non-contractual liability for lawful activity**

#### **3.3.1 The position of Advocate General Maduro**

The AG's opinion in the FIAMM and Fedon appeal argue in favour of the non-contractual liability of the Community in the absence of unlawful conduct or 'non-fault based liability.'<sup>117</sup> Moreover, the conditions to

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<sup>113</sup> Par. 130.

<sup>114</sup> Par. 131.

<sup>115</sup> JACKSON, above n. 82, p. 183.

<sup>116</sup> *Contra*, see ANTONIADIS, 'The Chiquita and Van Parys judgments: rules, exceptions and the law,' *Legal Issues of Economic integration*, 2005, p. 471.

<sup>117</sup> This is the expression used by AG Maduro, in par. 17.



establish such an action are considered fulfilled.

AG Maduro states: “*Ensbrining in Community law a principle of no-fault Community liability would advance the case-law from potential to settled, from the era of uncertainties to that of solutions.*”<sup>118</sup>

First, he notes that Art. 288, par. 2 does not confine the principle of the Community’s extra-contractual liability to circumstances in which the Institutions have carried out an unlawful activity. Second, the Advocate general emphasises that this principle can be found in French and German law. In the former legal context, where the public authorities, acting in the general interest, cause particularly serious damage to certain individuals, they must provide compensation in an effort to restore balance to the burdens suffered by citizens. Indeed, all citizens should bear equal burdens from public activity. When a close circle of citizens more fully bears these burdens, compensation should be awarded to those citizens and the costs are borne by society via taxation. The ‘Sonderopfertheorie’ of German law, laid down in the German Civil Code and in the Constitution, goes in the same direction of the French principle of equality of citizens in bearing public burdens. Indeed, as Maduro describes it, “*individuals who, by reason of lawful public action, suffer a ‘special sacrifice’, that is to say damage equivalent to expropriation, must be granted reparation.*”<sup>119</sup> He argues that a parallel can be made between the German right to reparation for expropriation and the right to receive damages on the basis of the non-fault Community liability, where the right to property, falling within the general principles of Community law, is breached. The latter right is also mentioned by the ECJ but in a totally different context and to support the fault-based liability.<sup>120</sup>

The fact that only two Member States recognised such a principle, engenders some doubt as to whether it is ‘common to national legal orders of the Member States,’ as required by Art. 288, par. 2. However, in Maduro’s view, this is not an obstacle if it can be shown that the acknowledgment of such a principle is in the interest of the Community. In fact, the conclusion he draws is that this principle is appropriate to the needs and specific features of the Community legal system. He provides three reasons in support of his contention, defines a limited-scope *ratione personae*<sup>121</sup> and sets out the criterion to channel liability.<sup>122</sup> Furthermore, he devises a wide-scope *ratione materiae*<sup>123</sup> and restrictive substantive conditions of application. This article will only consider the reasons put forward to recognise the non-contractual liability of the Community in the absence of fault.

The first is that this principle “*makes possible, in the interests of justice, to offset the severity of the conditions for the*

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<sup>118</sup> Par. 61.

<sup>119</sup> Par. 63.

<sup>120</sup> See section n. 9.

<sup>121</sup> Par. 68.

<sup>122</sup> Par. 65.

<sup>123</sup> Par. 66-67.

*incurring of fault-based Community liability.*"<sup>124</sup>

The second argument is that it meets the requirements of good governance. This is because the political authorities, having decided to maintain the WTO-incompatible legislation, “*assess better the costs that could ensue for citizens of the Union and [...] set them against the advantages that would accrue to the economic sector or sectors concerned if the Community legislation were retained.*”<sup>125</sup>

Maduro’s third reason for recognizing a principle of no-fault liability is that it “*would leave it to the Community legal system to allocate within the Community the consequences of the institutions’ freedom of action in the WTO context. It would no longer be for trading partners to choose in their discretion, through the retaliatory measures they adopt, which category of Community economic operators must bear the cost of that freedom; it would be for the Community to decide whether that cost must be borne solely by the undertakings affected by such measures or distributed over society in general.*”<sup>126</sup>

### **3.3.2 The position of the ECJ**

Instead of evaluating whether the CFI’s assessment of the unusual nature of the damage was correct, the ECJ examines the alleged foundations of the principle of Community liability in the absence of an unlawful conduct attributable to the EU institutions. The ECJ had never ruled out that Art. 288, par. 2 could cover non-contractual liability in the absence of unlawful conduct. On the contrary, it had left this issue open<sup>127</sup> and had even engendered confusion in defining the conditions of such liability in *Dorsch Consult*.<sup>128</sup>

Departing from the opening of the CFI and the AG’s conclusions, the ECJ denied that such a principle existed.<sup>129</sup> It is submitted that the justification provided by the Court to clear the ambiguity of its case-law is weak: it states that the conditions of *Dorsch Consult* were laid down in a hypothetical case that this principle was recognised.<sup>130</sup> This justification is lacking since the Court should have never defined the conditions of a principle before recognising its existence.

Regardless, the substantive reason to rule out the existence of the principle of Community liability in the absence of lawful activity essentially is that the examination of the Member States’ legal systems does not

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<sup>124</sup> Par. 57.

<sup>125</sup> Par. 59.

<sup>126</sup> Par. 60.

<sup>127</sup> See for example Case 59/83 *Biovilac SA v. Commission*, [1984] ECR. 04057, par. 28.

<sup>128</sup> T-184/95 *Dorsch Consult v. Council of the European Union and Commission*, [1998] ECR II 667.

<sup>129</sup> Par. 175 states: “[...]While comparative examination of the Member States’ legal systems enabled the Court to make [...] the finding [...] concerning convergence of those legal systems in the establishment of a principle of liability in the case of unlawful action or an unlawful omission of the authority, including of a legislative nature, that is in no way the position as regards the possible existence of a principle of liability in the case of a lawful act or omission of the public authorities, in particular where it is of a legislative nature.”

<sup>130</sup> Par. 148.

support the conclusion that they converge in the establishment of a principle of liability in the case of a lawful act or omission of the public authorities,<sup>131</sup> in particular where it is of a legislative nature.<sup>132</sup> Hence, the ECJ feels it is unable to apply Art. 288, par. 2 of the TEC since the no-faulted based liability is not anchored to the general principle familiar to the legal systems of the Member States.

The Court may be applauded for such a position and at the same time it may be criticised for leaving an ambiguity. It is not clear from the Court's position whether such a principle cannot be invoked in an action in damages in which the damages are specifically caused by a Community infringement of WTO law or whether it is not available altogether to private parties as a Community remedy. This doubt is instilled by par. 176 in which the Court states that: '[...] It must be concluded that, as Community law currently stands, no liability regime exists under which the Community can incur liability for conduct falling within the sphere of its legislative competence *in a situation where any failure of such conduct to comply with the WTO agreements cannot be relied upon before the Community courts.*' Reading the sentence in italics, it appears as if the unavailability of an action in damages in the absence of unlawful conduct was dependent on the lack of direct effect of the WTO agreements. The implication would be that absent this specific situation, this remedy may be available to private parties. The Court will have the chance to clarify this point in future cases.

Having denied that the appellants could rely on the Community non-contractual liability for lawful behaviour, the Court consequently left FIAMM and Fedon without a remedy, as Maduro rightly emphasises.<sup>133</sup>

As the Court is always keen on showing that the Community system of remedies is complete, the two closing remarks of the ruling, showing that private parties enjoy a special position within the Community legal order, are not at all surprising. However, the judiciary points out a judicial avenue that is not very promising to the innocent victims of trade wars: an action in damages against the Community for unlawful conduct consisting in breaching the applicant's rights to property or the right to pursue a trade activity, which qualify as general principles of Community law. It is striking that, after having raised the applicants' hopes, the Court immediately dashes them, by pointing out the strict conditions that must be fulfilled for such an action to succeed. Finally, the Court's emphasis that an economic operator, carrying out its activity

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<sup>131</sup> As the Commission rightly points out any obligation to pay compensation as a result of a lawful State act reflecting a broad discretion, on account for example of considerations of solidarity or fairness, is unknown to the law of a large number of Member States (par. 151). When recognized in the legal orders of certain Member States, it is, as a general rule, limited solely to administrative acts. Only French law clearly accepts this type of liability in the case of legislative activity but only under specific circumstances and on account of the fact that the Conseil d'État is precluded from examining the constitutionality of laws (par. 152).

<sup>132</sup> Par. 175.

<sup>133</sup> Par. 58.

in other Member States, must bear the possibility of being subject to suspension of concessions must have sounded like mockery to the applicants. Admittedly, the Court sets a very high standard for an extra-contractual liability action to succeed, thus it is doubtful that the present and future applicants will benefit from the Court's suggestion; but what counts more, at least in the eyes of the Court, is that the façade of a complete system of Community remedies is preserved.

The Luxembourg judges raise a further point whose implications will be discussed in section n. 9.<sup>134</sup> They remind the applicants that the Institutions enjoy the discretion to provide certain forms of compensation where a given legislative measure provokes harmful effects. This suggestion is certainly more interesting for victims of collateral damages than the first one. The Court also emphasizes that there are precedents for legislative measures of this kind. For example, the regulation whose validity was indirectly challenged in *Booker Aquaculture*<sup>135</sup> provided for forms of compensation to be given to companies forced by national authorities to destroy fishes in order to prevent the spreading of animal diseases.

#### ***4. Analysis of the Court and the AG's position***

##### **4.1 The ECJ's refusal to enforce the DSB's recommendations: justifications and consequences**

In the *FLAMM and Fedon* appeal the Court excludes the possibility of distinguishing between the direct effect of the DSB's decisions, identifying a violation of WTO law, and that of WTO substantive provisions. It seems to us that the systemic reasons leading the judiciary to an attitude of self-restraint in enforcing WTO law remain valid for the DSB's decisions. It is true that these acts differ from 'ordinary' WTO provisions since they identify a violation of WTO law and as a general rule, the members of this organization should abide by them. In fact, most of the time these decisions are complied with<sup>136</sup> and this very same fact ensures the success of the DSU. However, regarding the rulings of the WTO Tribunals as an 'absolute parameter' in the settlement of a trade dispute belies an underestimation of the importance that diplomacy maintains in the DSU even after the Panel and the AB have adjudicated the dispute and the reasonable time of art. 21, par. 3 has expired. There may be cases in which the parties of a dispute may find it more convenient to agree upon a solution that departs from the DSB's recommendations. For example, the losing party may consider it preferable to avoid compliance and accept that its traders will be subject to retaliatory measures. These alternatives are temporary under the DSU; but does this mean that ultimately the DSB's decisions should be strictly implemented? The DSU leaves space for negotiating a

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<sup>134</sup> Par. 181.

<sup>135</sup> C-64/00 *Booker Aquaculture and Hydro Seafood* [2003] ECR I-7411.

<sup>136</sup> *Contra*, JACKSON, above n. 82, p. 159.

mutually satisfactory solution, which does not necessarily have to coincide with that envisaged by the DSB's recommendations. The best illustration of this is the temporary agreement between the Community and the US on the hormone-in-beef dispute (May 2009). The two parties found a provisional solution to an ultra decennial dispute. However, the memorandum of understanding cannot be considered a way of implementing the DSB's recommendations which, back in 1997, found the EC legislation on hormones incompatible with WTO law. On the contrary, the agreed compromise enables the EU institutions to maintain their WTO incompatible legislation and, at the same time, the suspension of concessions continues to apply, although its application is subject to review.<sup>137</sup> These facts show that it is preferable for the parties of a trade dispute to depart from the DSB's rulings, when this is of mutual advantage and it eases the definitive settlement of a dispute. This consensual solution is in the interests of the Parties, along with those of traders of beef and European consumers. These three categories would have been worse-off, had the EC political institutions been forced by the ECJ (through the weapon of direct effect) to implement the DSB's recommendations imposing to change its legislation on the levels of hormones in beef.

As it has been suggested, should the ECJ (or national courts) decide to judicially enforce the DSB's rulings, this would imply a modification of the same DSU.<sup>138</sup> It should be added that the complexity of the WTO agreement make (regional) courts ill-equipped to interpret that agreement.<sup>139</sup> One could object that these inconveniences did not prevent the ECJ to institute the decentralised enforcement of Community law. However, it may be rebutted that the WTO system is very different from the EC system of remedies and the DSB does not have a weapon such as the preliminary ruling to ensure that EC law is correctly and uniformly applied.

Having considered the possible negative effects of *granting* direct effect to WTO law (including the DSB's recommendations) in the EC legal order on the WTO system, let us consider what drawbacks of the ECJ's *refusal* to enforce the DSB's rulings may be identified.

It may be claimed that the DSB's authority could be undermined since the Court somehow authorises the Community not to comply with the recommendations made by this body. This argument may be rebutted: the DSU was not intended to confer on regional courts the role of enforcer of the DSB's ruling. Should the ECJ decide to perform this role, would this mean that it shows a strong commitment to international law and to the DSU? We consider that the answer is negative and quite the contrary the ECJ would not pay due respect to the rules that were agreed by the WTO Parties.

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<sup>137</sup> Press release, MEMO/09/239, of 13/05/2009.

<sup>138</sup> ROSAS, above n. 38, p. 811-812.

<sup>139</sup> *Ibidem*.

Does the fact that the ECJ has not granted direct effect to WTO so far has undermined the authority of the DSB? No, the few cases in which the parties opted to depart from the recommendations of this body left the DSB's authority unaffected. It should be emphasised that should the parties be forced to stick to the DSB's settlement findings at all costs, this may inject into the DSU's rules a rigidity that may be detrimental to the current satisfactory observance of these rules by the WTO members and even nurture hesitations on their side in submitting a dispute to the DSB. In other words, WTO members may lose faith in the DSB if they were required by their courts, *via* the direct effect of DSB's rulings, to strictly respect the findings of the Panel or the AB in highly sensitive disputes.

Let us now turn to the justifications adduced by the Court to exclude private parties from using the DSB's rulings in an action for damages. In the authors' opinion, the Court's conclusion whereby invoking the DSB decisions in the context of the mentioned action bears the same consequences as relying on them, in the framework of an action for annulment (or a preliminary ruling), is correct. Indeed, in both cases the freedom of negotiation of the EU institutions to settle a WTO dispute is affected. This proclamation is apparently disrespectful of the autonomous nature of the action in damages with respect to that seeking the annulment of a Community act.<sup>140</sup> However, although the purposes of the two remedies are different (i.e. to obtain damages in the former case and to remove an unlawful measure from the EC legal order in the latter), this does not exclude the fact that the two categories of actions have overlapping negative consequences that need to be addressed through identical measures. Indeed, a successful action for damages does not merely compel the EU institutions to grant damages to private parties, but has repercussions on the conduct required of the Institutions *vis-à-vis* the measure causing damages exactly as it does in an action reviewing the legality of EC measures.<sup>141</sup> This is because the inner logic of the EC remedies implies that Art. 233, imposing the removal of an illegal measure from the EC legal order, applies, by analogy, to an action in damages. Precisely for this reason, although reliance on the DSB's decisions, after the expiry of the time limit, would be technically feasible in the context of an action in damages,<sup>142</sup> enabling private parties to sue the Community for its non-compliant behaviour with WTO law, is not opportune. Would this conclusion apply even after the dispute has been settled and the Community has already used the margin of discretion that the ECJ wishes to preserve by denying direct effect? The answer is positive. The reasons are on the one hand, that this prospect would engender an enormous incentive to litigation to private parties and pose a potential financial threat to the Community budget; on

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<sup>140</sup> The first case in which the Court held that the two remedies were autonomous is 4/69, *Lütticke c. Commissione*, in *Racc.* 1971, p. 325. For further references see GATTINARA, above n. 85, p. 150.

<sup>141</sup> Contra see THIES who claims that the margin of discretion of the EU institutions is not hampered by an action in damages. She states that: "The possibility for the Community to accept retaliation instead of complying with (primary) WTO law obligations is not restricted by being (financially) held liable "internally". See above n. 84, p. 1158.

<sup>142</sup> See the discussion under section n. 4.2.



the other hand, it would hamper the ‘effet utile’ of the DSU. Indeed, should the ECJ admit an action in damages in the mentioned circumstances it would frustrate the rebalancing effects of the sanctions that the Parties to a dispute imposed on the Community for its non-compliant behaviour. Finally, the possibility to obtain past damages would sit uncomfortably with the prospective nature of the remedies under the DSU. It has been argued that parties should be able to sue the EU institutions for damages at least where the Community has not taken any measure to implement the DSB’s rulings and the reasonable time limit of art. 21, par. 3 of the DSU has expired.<sup>143</sup> Would this proposal have beneficial effects on the position of private parties? It is submitted that it is not realistic to expect that where the Community succumbs in a WTO dispute, the EU institutions will remain completely inactive and will not do anything to implement their legislation. It is far more recurrent that the Parties do not agree on how to implement the DSB’s recommendations. Therefore, conferring direct effect to WTO law with the limits just described, de facto would not have any beneficial effects on private parties.

In conclusion, the broader implication of the *FLAMM* and *Fedon*’s rulings is that the persistent denial of direct effect of WTO substantive provisions as well as of the DSB’s recommendations, regardless of the objective of the actions brought by private parties, makes clear that a change on this issue may only be brought about by “political motion” and in a multilateral context, that is to say if it is agreed upon by WTO members, as suggested by AG Alber in *Omega Air*.<sup>144</sup>

#### **4.2 The weak case for a Community’s non-contractual liability in the absence of fault**

Let us turn to the principle of a Community’s non-contractual liability in the absence of fault. We support the Court’s refusal to recognise this principle. Conversely, none of the reasons put forward by Maduro in favour of its acknowledgement seem persuasive to us.<sup>145</sup> The AG’s solution looks attractive since the rights of private parties (to carry out their business activity and also their right to property) are given full protection. However, on closer scrutiny, it amounts to interpreting Community remedies in such a way as to ‘rectify’ the inequities of the global trade system. This is a mission that does not fall on the Court, at least when Treaties of almost universal application, such as that forming the constellation of the WTO, are at stake.<sup>146</sup>

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<sup>143</sup> This option is discussed by Dani, ‘Remedying European legal pluralism The FIAMM and Fedon litigation and the judicial protection of international trade Bystanders,’ Jean Monnet working paper n. 6/09, p. 36-39.

<sup>144</sup> He considers that it is not sensible that individual legal systems unilaterally bring about direct effect of WTO law. Opinion of AG Alber of 20 September 2001, joined cases C-27/00, C-122/00, *The Queen v Secretary of State for the Environment, Transport and the Regions ex parte Omega Air Ltd*, [2002] ECR, p. I- 2572, par. 95.

<sup>145</sup> *Contra*, see DANI, above n. 143, p. 7, 41-45.

<sup>146</sup> The situation may be different if we consider other Treaties of universal application such as that founding the UN. In the well known Kadi’s appeal before the ECJ (Joined cases C-402/05 and C-415/05, judgment of 3 September 2008, *Yassin Abdullah Kadi and Al Barakaat International Foundation v Council of the European Union And Commission*), the

Let us start from the AG's arguments. The first one, based on the creation of a new remedy to make up for the strict requirements of a fault-based liability, in the name of the principle of justice, lacks any legal basis in Community law; neither are there precedents in the case-law that could support such a judicial approach. On the contrary, it is necessary for the Court to adopt the opposite solution to avoid accusations of incoherence. For example, the case-law denying legal standing to individuals, in the framework of an action for annulment against Community measures, shows that the Court has never accepted manipulating the wording of Art. 230, par. 4 to make it easier for natural and legal persons to challenge these measures.<sup>147</sup> Secondly, upholding an action for damages would be inconsistent with the case-law denying privileged applicants any possibility of invoking the DSB to review the legality of Community measures. It would be paradoxical to enable private parties to rely on DSB decisions when privileged applicants do not have the same ability.<sup>148</sup> In addition, should the grant of a remedy to innocent victims be in the Community's interest (and we believe it is not<sup>149</sup>), a relaxation of the conditions of the non-contractual liability for unlawful conduct would be sufficient. There is no need to create new remedies.

The 'good governance' argument, the second reason supporting the AG's position in favour of non-contractual liability, suggests that the decision not to comply with the DSB's recommendations should be taken after a cost-benefit analysis. Given that this argument seems to draw on an economic logic, we will offer a detailed analysis of this issue in section 8.

The third argument in favour of extra-contractual liability is that Community institutions would enjoy enhanced discretion in deciding how to distribute the costs of retaliatory measures. For example, they could decide whether private parties should suffer the consequences of these measures or whether the European citizens as a whole should share the burden. In the current system, they do not have this choice and therefore they must accept what WTO partners decide.

It is submitted that should the EU institutions wish to distribute the costs of retaliatory measures on the taxpayers they could do so by using the Community budget to set up a fund reserved for by-standers of collateral damages.<sup>150</sup> The creation of a new remedy is unnecessary and we agree with the Court's position that the proposal to embed the Community with extra-contractual liability, in the absence of unlawful

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Community judge conferred Community protection to suspected terrorists whose human rights were not adequately safeguarded in the UN context. It is submitted that whereas the ECJ's stance in *Kadi* is welcome, in view of the kind of rights that were violated, of the intensity of the violations and of the lack of any other alternative avenue of protection, a similar solution in the context of the *FIAMM* and *Fedon* cases would have not been appropriate. Indeed, the Italian companies were hit by an increase in custom duties for one year. Are the ensuing financial losses really comparable in terms of nature and intensity with the violation of the human rights to the freezing the assets in the context of the UN sanction system?

<sup>147</sup> C-50/00 P, *Unión de Pequeños Agricultores c. Concil* [2002] ECR, I-06677.

<sup>148</sup> I wish to thank you Marise Cremona for attracting my attention to this point.

<sup>149</sup> See section n. 4.1.

<sup>150</sup> See section n. 9.

behaviour, within Art. 288, par. 2, is contrary to the Treaty. The Court's exclusion that the principle of liability in the absence of unlawful behaviour has a legal basis in the Treaty is convincing, since only two out of 27 Member States provide for a principle along the lines of extra-contractual liability in the absence of lawful conduct and only in very special circumstances, as well illustrated by the Commission.<sup>151</sup> Such being the situation of national legal orders, it is highly doubtful that that principle could be deemed 'common' to national legal orders, as required by Art. 288 par. 2. Ignoring the extent to which the principle finds its roots in the national context would amount to a breach of Art. 288, par. 2 (and of Art. 220), requiring the decision on the Community non-contractual liability to be made on the basis of 'common principles' of the national legal orders. It is true that this Treaty provision does not prescribe that the principle must be common to *all* Member States. However, two of them are certainly not enough to make this a principle of general application, considering its broad financial, redistributive and constitutional implications.<sup>152</sup> In view of its 'nuclear weapon' nature, it is not sufficient that Art. 288, par. 2 does not rule out its use as a Community remedy. Certainly, it is true that the lack of an explicit acknowledgment of the principle of State liability amongst the 'common traditions of Member States' did not prevent the Court from recognising a new remedy such as the principle of State liability in *Francovich* and its most radical progeny such as *Köbler*.<sup>153</sup> The Court could follow the same pattern of judicial activism and overlook the absence of the principle of no-fault liability in the traditions of the Member States so as to create another new remedy. However, it is notorious that the Community and Member States' actions are not regarded through the same lens by the Court. The *Fiamm* and *Fedon* cases are nothing but another example of this consolidated judicial trend.

### ***5. Community enforcement of WTO law: what costs for increased compliance?***

After having shown that the ECJ denies direct effect to WTO law, including DSB rulings, both for the purposes of an annulment action and of the Community non-contractual liability, we now assess the Court's position from an economic perspective. In the legal arena several authors have highlighted the beneficial effects specific to the action in damages (a form of private enforcement), brought by private parties against the non-compliant Community.<sup>154</sup> In general, when concerned with the overall welfare of

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<sup>151</sup> Above n. 131.

<sup>152</sup> POLI, I limiti di "enforcement" delle decisioni dell'Organo di Risoluzione delle Controversie dell'OMC nell'ordinamento comunitario alla luce della sentenza *Fiamm e Fedon*, *Diritto del Commercio internazionale* n. 2/2009, p. 10-11.

<sup>153</sup> DANI, above n. 143, p. 44-45.

<sup>154</sup> For instance, Alemanno argues that: 'Holding a WTO losing member liable for non-compliance with DSB reports would contribute to the health of the WTO dispute resolution by providing an adequate incentive for members to comply with their

the WTO membership, it may be tempting to judge Community enforcement positively because of its likely effects of increasing compliance with WTO law.<sup>155</sup> However, following a law and economics logic, compliance should be assessed in terms of its costs and benefits. Normatively, the optimal level of compliance rather than full compliance is desired.<sup>156</sup> This means that, even when concerned with the welfare effects of the WTO membership, the efficiency of Community enforcement must be rigorously assessed before reaching any conclusion; increasing compliance per se does not tell us much in relation to efficiency.

The efficiency analysis will be presented in the next sections. We develop two alternative theoretical frameworks to assess the efficiency of Community enforcement of WTO law. These two perspectives are complementary: the first is general, drawing from a 'classic' law and economics framework on the law of remedies; the second is more specific to the realm of WTO law and politics.

After having concluded this analysis, we investigate a specific case of private enforcement in section 8: the non-contractual liability for lawful acts, which has been raised in *FLAMM* and *Fedon*. As the effects of this rule on compliance are less clear, we will accordingly rely on alternative economic arguments to assess its desirability.

## ***6. Aspirational property rules and temporary liability rules: Another view of the Cathedral***

In one of the cornerstone contributions of law and economics, '*Property Rules, Liability Rules and Inalienability: One View of the Cathedral*,' Calabresi and Melamed (C&M) developed a general theoretical

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obligations under WTO rules [...].’ See ALEMANNI, ‘Private parties and WTO Dispute settlement system, in CHAISSE, BALMELLI, ‘Essays on the future of the World Trade Organization,’ volume II, 2008, p. 277. On a similar vein, Lavranos argues that ‘a change of the jurisprudence of the ECJ and CFI ... would also be a forceful argument for the EC institutions, notably the Commission and the Council, to get serious about implementing WTO dispute settlement reports instead of openly refusing to do so and thereby undermining the whole WTO dispute settlement mechanism – which cannot be in the interest of the EC.’ LAVRANOS, ‘The Chiquita and Van Parys judgments: an exception to the rule of law,’ in *Legal Issues of Economic Integration*, 2005, p. 459. More generally, see PETERSMANN, ‘Judging Judges: From “Principal-Agent Theory” to “Constitutional Justice” in Multilevel “Judicial governance” of Economic Cooperation among Citizens’, *Journal of International Economic Law*, 2008, p. 827–884.

<sup>155</sup> This link has been made by Professor Piet Eeckhout. In one of his most recent contribution, the author argues: ‘It is obvious that a legal system which is monist, and which recognizes that WTO law forms part of domestic law, will make its own, *strong contribution to compliance*. That is in particular so where the system also recognizes that internal legislation needs to comply with the international norm (primacy), and empowers courts to uphold that norm. ...If such an approach were generalized, WTO law itself would be in a lesser need of providing for an effective remedy.’ (emphasis added) in EECKHOUT, ‘Chapter 15 - Remedies and Compliance,’ in BETHLEHEM, MCRAE, NEUFELD, VAN DAMME (eds), *The Oxford Handbook of International Trade Law*, Oxford University Press, 2009, p. 455.

<sup>156</sup> For a general law and economics framework of compliance in International Law see GUZMAN, ‘A Compliance-Based Theory of International Law,’ *California Law Review*, 2002, p. 1823–1887.

framework to study the functioning of alternative legal remedies (hereinafter the Cathedral).<sup>157</sup> Under property rules, legal entitlements cannot be taken from the owner without her consent whereas under liability rules, entitlements can be taken without consent, provided that some form of compensation is paid.<sup>158</sup> In the following, we employ the Cathedral to assess the desirability of enforcement of WTO law at the Community level. It should be noted, however, that while this framework for understanding legal remedies has been successfully applied to many areas of law,<sup>159</sup> employing the Cathedral in the context of the WTO dispute settlement system has proved rather controversial.

Authors are divided in characterizing the remedies established by WTO law as property or liability rules.<sup>160</sup> Such a divide likely stems from the complex and unique structure of the WTO remedies.<sup>161</sup> On the one hand, the system establishes certain measures, i.e. ‘compensation’ or ‘suspension of concession’ ex Article 22 DSU, to be applied when Members fail to comply with dispute settlement reports. These rules, taken in isolation seem to suggest that the type of remedies envisaged by the WTO legal system corresponds to a liability rule. However, the legal framework is somewhat more complex; while the system establishes compensatory/retaliatory measures in cases of non-compliance, its goal is achieving full compliance, at least in the long term. In other words, non-compliance and authorized-retaliatory measures are meant to be

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<sup>157</sup> CALABRESI, MELAMED, ‘Property rules, liability rules and inalienability: one view of the cathedral,’ *Harvard Law Review*, 2002, p. 1089-1128. The Cathedral has generated an enormous body of scholarship around it. One of the issues disputed is the nature of legal rules that are better described by the Cathedral. We follow the view that the Cathedral is most suitable to shed light on the mechanism underlying remedies rather than any other dimension of norms.

<sup>158</sup> Calabresi and Melamed distinguish also a third category, inalienability rules, i.e. rules that bar the owner to part from the entitlement, such as laws forbidding the sale of bodily parts; the reason to have also this set of rules is in the view of Calabresi and Melamed the existence of a particular type of externalities that they call ‘moralisms.’ We do not discuss this typology of rules because it is not significant for our analysis. For further analysis of these issues, see CALABRESI AND MELAMED, above n. 157, p. 1111-1115.

<sup>159</sup> Most importantly the framework has been widely applied in the field of private law to study property law, tort law and contract law. For an overview see RIZZOLLI, ‘The Cathedral: An Economic Survey of Legal Remedies,’ 2008. Available at SSRN: <http://ssrn.com/abstract=1092144>

<sup>160</sup> Defending the view that the DSU embodies a property rule see JACKSON, above n. 68, p. 109-25, PAUWELYN, *Optimal Protection of International Law: Navigating between European Absolutism and American Voluntarism*, in RIZZOLLI above n. 159 and NZELIBE, ‘The Credibility Imperative: The Political Dynamics of Retaliation in the World Trade Organization’s Dispute Resolution Mechanism,’ 2005, *Theoretical Inquiries in Law*, p. 215-54. Defending the opposite thesis see SCHWARTZ, SYKES, ‘The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization,’ *Journal of Legal Studies*, 2002, p. S179-S204. Other authors, while not explicitly endorsing the Law and Economics jargon of liability rules seem to conceptualize these rules as liability rules; see for instance LAWRENCE, *Crimes & punishments?: retaliation under the WTO*, Peterson Institute, 2003 where the author argues, ‘The WTO allows rebalancing through suspension of concessions to allow the plaintiff to redress some of the harm from the breach, but it does not permit sanctions. Such suspension also provides countries with a *de facto opt-out mechanism that allows them to avoid compliance ...*’ at p. 95. David Palmeter and Stanimir Alexandrov also stress the point that the remedies set up at the WTO are not meant to force compliance; cfr. PALMETER, ALEXANDROV, ‘“Inducing Compliance” with WTO Dispute Settlement,’ in KENNEDY, SOUTHWICK (eds.) *The political economy of international trade law: essays in honour of Robert E. Hudec*, Cambridge University Press, 2002, at pp. 646-666.

<sup>161</sup> For a critique of the remedies provided by WTO law see: CHARNOVITZ, ‘Rethinking WTO Trade Sanctions,’ *The American Journal of International Law*, 2001, p. 792-832.



*transitory* provisions only.<sup>162</sup> Looking at the system from this perspective, WTO remedies are best seen as a property rule. This brief overview of the remedies provided by the WTO leaves us with the question: are the WTO remedies property or liability rules and what does this entail for a hypothetical rule introducing Community enforcement?

John Jackson, one of the founding fathers of the WTO legal scholarship, has defended the thesis that a legal obligation to fully comply with DSB rulings is well enshrined in the DSU.<sup>163</sup> Several authors have thereafter followed this interpretation and have characterized the WTO dispute settlement system chiefly as a property rule.<sup>164</sup> Contrasting this view, Warren Schwartz and Alan Sykes (S&S) have argued that the system as such is not meant to be binding and in fact the party can ‘buy-out’ their rights; thus the WTO dispute settlement system is better characterized as a liability rule.<sup>165</sup> Likewise, Joel Trachtman, by distinguishing the formal text from the law in action, has argued that, ‘as a matter of *fact* and *practice*, if not as a matter of legal doctrine, the WTO legal system is best characterized as employing a liability rule, rather than a property rule’ (emphasis added).<sup>166</sup>

We believe that, as a matter of legal doctrine, Jackson has made a convincing case, detailing eleven provisions that are part of a coherent legal framework establishing a legally binding obligation of compliance on WTO Members.<sup>167</sup> However, if we want to apply the Cathedral, for the sake of accuracy, we need to include the specific features of the remedies envisaged by the WTO, which are better captured by the S&S framework and by the subsequent Trachtman analysis. While these visions seem discordant, we argue that they can be reconciled.

A way to pay due respect to the legal text and at the same time provide an appropriate characterization of the rules at hand is to slightly refine the original theoretical framework of Calabresi and Melamed by introducing a *temporal dimension*. As is well-known, the C&M article was meant to be ‘only one of Monet’s

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<sup>162</sup> Article 22 (1) DSU provides that ‘Compensation and the suspension of concessions or other obligations are *temporary* measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to *full implementation* of a recommendation to bring a measure into conformity with the covered agreements’ (emphasis added).

<sup>163</sup> Jackson, above n. 68, p. 109-25. Jackson’s main point is well captured in this passage: ‘I would argue that there is overwhelming support for the view that the result of a WTO dispute in a panel or (sometimes) appellate report that rules that the laws or other measures of a respondent nation are inconsistent with its WTO obligations is to create an international law obligation to *comply* with that report.’ (emphasis added), at p. 123.

<sup>164</sup> PAUWELYN above n. 160, p. 138-39; RIZZOLLI above n. 159, p. 62. Other authors, while following a different jargon (e.g. specific performance), have reached analogous conclusions; in particular Jide Nzelibe made a normative argument favouring specific performance, see NZELIBE above n. 160, pp. 242-54.

<sup>165</sup> SCHWARTZ, SYKES, above n. 160, p. S181-83.

<sup>166</sup> TRACHTMAN, ‘The WTO Cathedral,’ *Stanford Journal of International Law*, 2007, p. 146. It should be noted that, while Trachtman, as self-described legal realist, defends the position that WTO remedies correspond to a liability rule, he also concedes that, as a matter of legal doctrine, the reasoning of Jackson is the most accurate.

<sup>167</sup> JACKSON, ‘The WTO Dispute Settlement Understanding--Misunderstandings on the Nature of Legal Obligation,’ *The American Journal of International Law*, 1997, p. 63.



paintings of the Cathedral at Rouen. To understand the Cathedral one must see all of them.<sup>168</sup> Adding a temporal dimension to their framework is a means of capturing the dynamics of a relatively well-functioning dispute settlement system in the international legal arena, where time plays a crucial role. Our view of the Cathedral is as follows: the WTO system of remedies is a *mixed* rule, which we call an ‘aspirational property rule operating through a temporary liability rule.’<sup>169</sup>

The aspirational property rule, coupled with a temporary liability rule, signifies a legal obligation to fully comply; however, the legal obligation leaves a margin of time during which full compliance can be realized.<sup>170</sup> In this period, non-compliance is tolerated under an evolving sanction; more precisely, the sanction’s costs increase over time, as detailed in the analysis below.

Let us now apply this view of the Cathedral to our original question. We said that the system as it currently exists, is best interpreted as a mixed rule. How would the mixed property/liability rule change if we added a rule, according to which WTO DSB rulings could be enforced within the EC legal order? The mixed rule would be transformed into a pure property rule. This is because the Community enforcement would de facto highly limit the possibility of non-compliance, which is now available to the Community institutions. Thus, to test the efficiency of Community enforcement, the efficiency of a mixed rule must be compared to that of a pure property rule.

The following analysis is divided into three subsections, where we show that: neither a pure property rule nor a pure liability rule are efficient solutions, whereas the mixed rule, suggested here, is likely to provide a framework conducive to efficiency.

## 6.1 Pure property rules

Under a pure property rule, Members would have to fully and immediately comply with the DSB rulings. If it is difficult to conceive of a pure property rule in international law, allowing direct effect is surely one scenario that would best approximate such a rule. A few problems with this scenario exist, however. First, as observed by S&S, renegotiation in cases of inefficient compliance is likely to be extremely costly due to the strategic behaviour of other Members (particularly in holdout problems).<sup>171</sup> This is all the more true if we pause to reflect on the specifics of the WTO dispute settlement system, where DSB rulings, most often, do not specify the behaviour necessary to achieve compliance. Generally, a recommendation of

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<sup>168</sup> CALABRESI AND MELAMED, above n. 157, at p. 1090 in ft 2.

<sup>169</sup> An analysis of other forms of mixed rules has been previously performed by? BELL, PARCHOMOVSKY, *Liability Rules* (October 12, 2003), *Michigan Law Review*, 2002. Available at SSRN: <http://ssrn.com/abstract=1282862>

<sup>170</sup> It is pertinent to note that we are not referring to the reasonable time that is granted before the measure is brought into compliance, as provided by Article 22 DSU.

<sup>171</sup> SCHWARTZ, SYKES, above n. 160, at p. 187.

compliance is formulated, but no guidance is given on the specific ways in which compliance is to be achieved. This means that a margin of discretion is left to Members in selecting the means of implementation. In other words, DSB recommendations do not always clarify rules in a positive way; they just decide on the negatives, ‘the don’ts’. In the post-dispute settlement phase something has been clarified but not everything, leaving the property right not fully defined. As is well-known having well-defined property rights is a pre-condition for reaching an efficient allocation of resources through market-mechanisms;<sup>172</sup> because property rights are not well-specified in the post-dispute settlement phase, it is plausible to assume that renegotiation will not by itself lead to efficiency. Thus, also for this reason, property rules are likely to be inefficient.

To better understand this point, it is worth recalling the analysis by S&S where the wide-ranging WTO Agreements are characterized as an incomplete contract. While the analogy may not be perfect, it is certainly apt to describe a situation where the parties could not have specified all the relevant circumstances for the interpretation and implementation of all the WTO Agreements concluded during the Uruguay Round. It is pertinent to note that the WTO package-deal concluded in 1994 consists of more than 30.000 pages of documents, covering widely disparate issue-areas such as trade in services, design of sanitary and phytosanitary domestic laws and intellectual property rights. Against this background it is difficult to disagree with S&S:

‘Indeed, if one is to claim that the purposes of the WTO members would be better served by compliance in all circumstances, it seems that one must believe that at the time the WTO rules were devised, the drafters were able to anticipate every situation in which the costs of compliance would exceed the benefits of compliance and include provisions to excuse compliance in all of these circumstances. ... In short, it seems clear to us that the WTO system contemplates departures from specified obligations when the costs of compliance exceed the associated benefits.’<sup>173</sup>

While agreeing with this part of their analysis, we disagree with the conceptualization of the remedies envisaged by the WTO dispute settlement mechanism as a pure liability rule because, as noted above, the dispute settlement system is not designed to allow Members to remain *indefinitely* in a state of non-compliance. Not only do we disagree as a matter of legal interpretation, but we will also show that pure liability rules are equally problematic from an economic standpoint.

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<sup>172</sup> COASE, ‘The Problem of Social Cost,’ *Journal of Law and Economics*, 1960, p. 1–44, p. 19..

<sup>173</sup> SCHWARTZ, SYKES, above n. 160, p. 191-92.

## 6.2 Pure liability rules

If the remedies for non-compliance with WTO obligations were constructed as a pure liability rule, the following problems would arise. First, when we look at positive law, we know that the retaliation (technically ‘suspension of concessions’), which is the most commonly used remedy, does not correspond to the damage suffered by the victims because it is temporally limited (being only prospective and not retroactive). Thus from a deterrence point of view, this system is not able to provide adequate incentives for ‘efficient breach’ as it systematically under-prices the right. One reason to keep retaliation limited, however, is that it does impose great costs to the system as it reduces overall trade liberalization.

One could argue that this is not a major problem because reputational losses may add up to the costs of retaliation, correcting for the under-pricing of ‘prospective retaliation.’ However, *framing* the rule as a pure liability rule is likely to cancel the reputational losses. If parties are entitled to buy-out rights, reputation will not be affected by non-compliance because Members that suffer retaliation will be perceived as complying with the system. The effects of framing the WTO system of remedies as a pure liability rule would thus undermine the incentives to comply provided by reputational losses. This phenomenon can be compared to the so-called crowding-out effect, according to which motivations to follow certain norms are undermined if a market is established. For instance, when a market for blood is created, the number of donors will decrease because the intrinsic motivations of pre-market blood-donors are crowded out. Studies in experimental economics have shown that the crowding-out effect is a significant phenomenon.<sup>174</sup> Likewise, it is plausible to assume that in a legal system, the formulation of the law has an influence on behaviour; in our case, if the law is written to permit a payment to buy-out the right, this may influence behaviour that stimulates defection rather than compliance.<sup>175</sup> In the international legal order, known for its compliance deficit, such a system is likely to impose additional costs to the multilateral undertaking.

Another reason why pure liability rules function imperfectly is that not all Members are equally capable of resorting to retaliation; in particular, least developed countries (LDCs) and developing countries will not always be able to retaliate, which makes the system asymmetric and skewed against poorer countries.<sup>176</sup>

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<sup>174</sup> For a general overview of the phenomenon see FREY, *Not Just for The Money. An Economic Theory of Personal Motivation*, Cheltenham: Edward Elgar, 1997, and FREY, OBERHOLZER-GEE, EICHENBERGER ‘The Old Lady Visits Your Backyard: A Tale of Morals and Markets,’ *The Journal of Political Economy*, 1996, p. 1297-1313; for a survey of empirical studies showing the wide spread existence of crowding effects see FREY, RETO, ‘Motivation Crowding Theory: A Survey of Empirical Evidence’, *Zurich IEER Working Paper No. 26*, 2000; *CESifo Working Paper Series No. 245*. Available at SSRN: <http://ssrn.com/abstract=203330> (last visited June 16, 2009).

<sup>175</sup> This reasoning is related to the question of the expressive function of the law. On this issue see SUNSTEIN, ‘Law, Economics & Norms, on the Expressive Function of the Law,’ *University of Pennsylvania Law Review* p. 2021-2045, 1996.

<sup>176</sup> Less powerful WTO Members are likely to experience difficulties in resorting to retaliation because they may be harmed by the retaliation and/or the retaliatory measures may have little impact on the markets of more developed economies. One way to solve this problem is to allow cross-retaliation, a practice which is legal but controversial; see ABBOTT, ‘Cross-Retaliation in TRIPS: Options for Developing Countries’, *ICTSD Programme on Dispute Settlement and Legal Aspects of*

While several suggestions have been advanced to improve the liability rule,<sup>177</sup> the scope of our analysis is limited to the question of the efficiency of the liability rule given the current legal framework and, in this context, the existing imbalance of power renders a pure liability rule incapable of providing adequate incentives when poorer countries are involved.

### **6.3 Aspirational property rule operating through a temporary liability rule**

Let us now turn to demonstrate why the mixed system of aspirational property rules/temporary liability rules is superior. The time for non-compliance should be seen as a space for clarification and renegotiation. The DSB recommendation set the boundaries of the renegotiation space, by indicating the behaviour to be corrected. In the time span of non-compliance, we will observe a mixed process of renegotiation and clarification of the rules in the shadow of the law. In this space, the temporary liability rule works as a sanction that puts pressure on the violator while ironing out some of the problems relating to strategic behaviours of Members that would arise under a pure property rule.<sup>178</sup>

The aspirational property rule, by underlying the idea that the system is geared to achieve full compliance means that in the temporal space of non-compliance, the strength of the sanction evolves. At the beginning, when uncertainties over the specific features governing the norm are higher and the policy space for renegotiation more open, a light sanction exists. This may be compared to a weak-property rule coexisting with a strong-liability rule, meaning that the system allows the Member to take the entitlement under a light sanction. However, as time passes, norms get clarified and renegotiation should progress. This means that the situation of non-compliance becomes progressively heavier for the system, increasing the sanction in at least two forms, by raising: 1) reputational losses and 2) internal political costs.

As is well known in international law, reputation works, to certain extents, as a mechanism to induce compliance.<sup>179</sup> The reputational losses increase because the status of the scofflaw as violator will become

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*International Trade, Issue paper No. 8*, April 2009. Available at SSRN: <http://ssrn.com/abstract=1415802> (last visited June 16, 2009). More generally on the problems of participations of least developed countries in the dispute settlement mechanism see BOWN, HOEKMAN, 'WTO Dispute Settlement and the Missing Developing Country Cases: Engaging the Private Sector,' *Journal of International Economic Law*, 2005, p. 861.

<sup>177</sup> For a comparative analysis of different means to improve the enforcement mechanism at the WTO, see TRACHTMAN, above n. 166; also, CHARNOVITZ, above n. 161.; *contra*, arguing that the retaliatory system is efficient see NZELIBE, above n. 160.

<sup>178</sup> Some authors have further shown that liability rules may work in the sense of facilitating trade AYRES, TALLEY, 'Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasian Trade' *Yale Law Journal*, 1995a, p. 1027-117 and AYRES, TALLEY, 'Distinguishing Between Consensual and Nonconsensual Advantages of Liability Rules' *Yale Law Journal*, 1995b, p. 235-53. See also KAPLOW, SHAVELL, 'Property rules liability rules: an economic analysis,' *Harvard Law Review*, 1996, p. 713-790.

<sup>179</sup> GUZMAN, *How International Law Works: A Rational Choice Theory*, Oxford University Press: Oxford, 2008, chapter 3 and quoted literature; see also GUZMAN, 'A Compliance-Based Theory of International Law,' *California Law Review*, 2002,

more pronounced as time progresses and non-compliance persists. Internal political costs are also likely to increase because the retaliatory measures are supposed to last for the time of the violation. Thus the longer the violation, the higher the penalties and the related discontent of the internal constituency hit by the consequences of the violation (mainly, the so-called collateral victims). Accordingly, as time progresses, the sanction turns into a heavy sanction where the property rule gains prominence over the liability rule. The increasing sanction can be compared to the kicker in the C&M framework. As put by Rizzoli, '[t]he original cathedral speaks of an indefinable *kicker*. Since the goal is deterrence, we could generally identify as property rules those remedies that add *substantial costs* to the transfer when the taking occurs without the owner's consent'<sup>180</sup> (emphasis added and internal citation omitted). Our framework, by including time, turns the kicker into an evolving variable that increases over time, mediating the problems created by strategic behaviour in the renegotiation phase with the needs of moving towards increased compliance in the long run.

This system proves superior because it is based on a 'guidance norm' of compliance, leaving a space for limited defection.<sup>181</sup> The flexibility of this mixed rule sets favourable conditions for renegotiation and clarification of the rules and it works as a mechanism to lower transaction costs; accordingly renegotiations are facilitated and rules can be defined (where they were previously unclear) in a welfare-enhancing fashion. As explained earlier, introducing enforcement of WTO DSB rulings within the EC legal order would transform this mixed rule into a pure property rule. In other words, it would increase compliance in the short-run; however, as noted above, it would do so at a great cost for the system. From an economic perspective, thus, Community enforcement is not desirable because it is not likely to lead to an efficient allocation of resources.

## ***7. The transformation of the WTO and the costs of increased compliance***

Another way to investigate our question from an economic perspective is to apply the theoretical framework articulated by international legal scholar Joost Pauwelyn, who has charted the evolution of WTO law through the exit and voice interpretative grid.<sup>182</sup> In this framework, originally devised by

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p. 1823–1887. For a discussion of the role of multiple reputations see DOWNS, JONES, 'Reputation, Compliance, and International Law,' *Journal of Legal Studies*, 2002, p. 95–114. More skeptical of the role of reputation GOLDSMITH, POSNER, *The limits of international law*, Oxford University Press US, 2005, p. 100-104.

<sup>180</sup> RIZZOLLI, above n. 159, at p. 8

<sup>181</sup> The concept of guidance rules as opposed to enforcement rules, has been articulated by Nance; cfr. NANCE, 'Guidance Rules and Enforcement Rules: A Better View of the Cathedral,' *Virginia Law Review*, 1997, p. 837-937.

<sup>182</sup> PAUWELYN, 'The Transformation of World Trade,' 2005, *Michigan Law Review*, p. 1-65. In a similar fashion, the exit

economist Albert Hirschman, the decline and/or success of an organization depends on the balance of the 'exit and voice options.'<sup>183</sup> Both exit and voice can work as recovery mechanisms when an organization is facing problems; for one, because exit and voice can be understood as 'signals' of the problem. Under exit, a subject is free to leave, as in the case of the customer who, dissatisfied with a certain product, can switch to a different one. Under voice, the problem is addressed through negotiating means, as in the case of a consumer association directly negotiating with companies or governmental bodies. The ratio of exit and voice is inversely related in a successful organization, so that if exit is low, problems can be solved through voice and vice versa.

In Hirschman's analysis exit belongs to the realm of economics and voice to the realm of politics.<sup>184</sup> By 'slightly bending and extending Hirschman's concepts,' Pauwelyn characterizes 'exit' as 'the lack of law or discipline or the thickness of a system's legal-normative structure, which offers easy options to defect from the cooperative regime.'<sup>185</sup> The 'economics-politics' schism introduced by Hirschman is thus turned into the 'law-politics' schism by Pauwelyn. In this framework, lower degrees of legalization correspond to high-exit and a higher degree of legalization to low-exit. To put it differently, increased legalization entails the closure of exit options. The inverse relationship between exit and voice, which is a necessary condition for the success of an organization, also holds true in the context of international organizations. Employing Pauwelyn's analytical grid, we can thus easily conclude that high levels of legalization should correspond to high levels of participation or politics.

To better understand the implications of Pauwelyn's analysis for our work, it is worth to briefly describe the evolution of the WTO dispute settlement system in terms of the exit/voice framework. In the transition from the GATT 1947 regime to the WTO, the dispute settlement system underwent one of the most momentous changes in the international trade arena; by shifting from a system where Panels' rulings had to be adopted by consensus (under GATT 1947), de facto allowing a veto power to dissenting Contracting Parties, to a system where Panels and Appellate Body (AB) rulings are adopted quasi-automatically, the system has drastically reduced the exit options. This change was offset by a gradual

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and voice theoretical framework was earlier applied by Joseph Weiler to study the evolution of the European Community (EC). WEILER, 'The Transformation of Europe,' *Yale Law Journal*, 1991, p. 2403.

<sup>183</sup> PAUWELYN, *ibidem*, p. 4-5. See also HIRSCHMAN, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, Harvard University Press, Cambridge, Mass (1997), p. 120-26. It should be noted that the work of Hirschman has not attempted to find an optimal mix of exit and voice; in his own words: '[b]ut a word of caution is now needed about what our approach *cannot* yield: it does not come out with a firm prescription for some optimal mix of exit and voice ... it is very unlikely that one could specify a most efficient mix of the two that would be stable over time. *The reason is simple: each recovery mechanism is itself subject to the forces of decay which have been invoked here all along*' (emphasis in original), p. 124.

<sup>184</sup> HIRSCHMAN, *ibidem*, at p. 15.

<sup>185</sup> PAUWELYN, above n. 182, at p. 5.



increase in voice, where consensus has been adopted as the dominant rule in the decision-making process.<sup>186</sup>

As seen in the previous sections, the dispute settlement system has left a tiny margin for exit; Members, even after a ruling has been adopted, can linger in a state of non-compliance under the conditions that they either ‘compensate’ within the meaning of Article 22 DSU or that the other Members may impose retaliatory measures against them (‘suspension of concessions’). Granting direct effect to WTO DSB recommendations for the purpose of the annulment or non-contractual liability actions would increase compliance by removing this residual exit option. For the purposes of this analysis, increasing compliance by means of Community enforcement can thus be conceptualized as a form of increased legalization through the *closure of an exit option*. It remains to be seen whether such an increase in compliance matched by a marginal closure of exit options would be efficient.

## **7.1 Community enforcement: a tipping point in the transformation of the WTO?**

According to Pauwelyn, the WTO is currently out of balance: ‘the situation after ten years of WTO is ... one of too much discipline or law for the prevailing levels of participation and politics.’<sup>187</sup> In our view, Pauwelyn’s thesis is an accurate reflection of the state of affairs at the WTO, where the stalling negotiations of the Doha Round can be seen as evidence of this imbalance. In this context, it is opportune to reflect on the dynamics underlying the evolution of WTO law today. The goal of further market integration of WTO Members has important effects on the Members’ legal systems. One obvious reason is that as tariffs go down world-wide (as they dramatically have), there is an increased demand to lower non-tariff barriers, which in turn means that legal systems should find convergences in relation to the standards adopted in various areas of law. The paradigmatic example is health and safety regulations, which typically restrict trade. To promote trade, Members must give up some of their sovereignty in the politically sensitive field of health and safety regulation. Given the low level of exit options already in place, Members find it more difficult to concede for the promotion of market integration and this partly explains the deadlock of the Doha negotiations. The point is that in a system where other values are at stake (e.g. health and safety, political equilibria among Members with a difficult history, protection of intellectual property, etc.), leaving to the Members a safety valve for non-compliance in cases that are politically sensitive appears to be a

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<sup>186</sup> PAUWELYN, above n. 182, p. 20-24 and p. 26-28. Even though consensus is the norm, some exceptions are provided to resort to qualified majority voting for specific decisions when consensus cannot be reached, as specified Article IX: 1 WTO Agreement; it is to be noted that majority voting has in practice almost never taken place.

<sup>187</sup> PAUWELYN, above n. 182, p. 34.

good compromise. In the words of Joel Trachtman, ‘... if a standard of “perfectionism” in compliance is established, the WTO legal system will come up embarrassingly short. The point is that there are important values that contend with compliance, not the least of which is democratic legitimacy.’<sup>188</sup> Paradoxically, allowing a margin of non-compliance appears, at this point in time, the only viable route for a system that seeks to increase compliance.

It is then plausible to conclude that the marginal reduction in the exit options that would occur should private parties be able to rely on the DSB rulings before the ECJ, could constitute a tipping point. Under this scenario, Members may block further integration and look for means to withdraw from commitments. The danger is that, next to closing the door on the dialogue for further liberalization, Members could also fall back on a disproportionate use of facially licit behaviors, such as the imposition of anti-dumping measures, that offer *de facto* exit options and overall increase protectionism. We thus believe that the decline of the organization could manifest by a degeneration of a system that would progress towards protectionism by means of the over-use of existing inefficient norms, such as in the area of anti-dumping, rather than by the threats to leave the organization, which appears to be an extreme scenario.<sup>189</sup>

If our characterization of the current balance of exit and voice is correct, it follows that Community enforcement is inefficient, as it would push a system aimed at trade liberalization towards more protectionism. By stretching for a moment the scope of compliance beyond isolated legal rules and thinking of compliance with the system’s fundamental goals, that is trade liberalization and promotion of economic welfare, we may conclude that an extreme attempt to achieve full compliance will plausibly trigger opposite effects; the overambitious goal of full compliance may thus backlash into nemesis.<sup>190</sup>

One important caveat applies to our analysis: things may change! The assessment of the question of compliance through the exit and voice framework as performed in this article has a dynamic feature. The main conclusion is that, given *the current state of imbalance of exit and voice (or law and policy)*, a marginal increase in compliance is likely to be inefficient. However, if the exit-voice ratio were different, with for instance higher levels of politics and participation than we have today, a marginal increase in compliance

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<sup>188</sup> TRACHTMAN, ‘Bananas, Direct Effects and Compliance,’ *European Journal of International Law*, 1999, p. 660.

<sup>189</sup> In this context one may consider what the impact of growing regionalism is. We do not believe that this is a threat in the immediate present; what is challenging now is to having the regional and multilateral system to evolve harmoniously. Yet, the fast developments of regional integrations may in the future become a threat to the WTO. In this context it is important to maintain the multilateral setting as an attractive option for countries; accordingly, the process of legalization should not come at all costs.

<sup>190</sup> In the Greek mythology, nemesis refers to divine redistribution against the sin of hubris. The concept has been used as a powerful metaphor in other social sciences; see ILLICH, *Medical Nemesis: The Expropriation of Health*, 1975, London: Marian Boyards.

may turn out to be efficient.<sup>191</sup> This also means that in the future, if the scenario changes, increased compliance via Community enforcement could become desirable from an economic perspective. This caveat similarly applies to the liability/property rule framework discussed in the previous section; if the system moves towards a more complete contract, a pure property rule may become more attractive from an economic standpoint and so would Community enforcement.

### **8. Non-contractual liability for lawful acts and good governance: friend or foe?**

The desirability of non-contractual liability for lawful acts of the Community (under Article 288(2)) can be assessed from different perspectives: fairness, distributive justice, efficiency, legitimacy, internal consistency of the system studied, etc. We have already shown in section 4.2 that the availability of such a remedy within the EC legal order is highly contested. In the following analysis we focus on the efficiency dimension only.

Non-contractual liability for a lawful act (hereinafter referred to as no-fault liability) is challenging from an economic perspective: assessing the effects of no-fault liability on compliance is rather complex. First, there is no empirical data to be studied because the rule has never been employed in these cases. From a purely theoretical perspective, it is also difficult to find models on which to build a sound analysis to answer this question and articulating a new theory is beyond the scope of this paper. More modestly, we start from the observation that the effects of a no-fault liability rule on forcing compliance are ambiguous and thus we are unable to find an answer on the desirability of a no-fault liability rule taking only its effects on compliance into consideration.

We consider it more interesting to look at the arguments articulated by AG Maduro in favor of no-fault liability in his opinion in *FLAMM* and *Fedon* and to verify whether they are tenable. In particular, we focus on the hypothesis that introducing a system of no-fault liability could enhance good governance. As detailed in section 4.2, AG Maduro argued that such a rule would force ‘the political authorities ... to assess better the *costs* that could ensue for citizens of the Union and to set them against the *advantages* that would accrue to the economic sector or sectors concerned ...’ The perspective of AG Maduro appears inspired by a law and economics logic: allowing a no-fault liability rule can be understood as a way to force public authorities to take the opportunity costs of non-compliance into account.

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<sup>191</sup> For instance Pauwelyn advocated for an increase in politics and participation, where ‘the consensus rule must be maintained but participation of individual WTO members as well as nonstate actors increased.’ PAUWELYIN, above n. 182, p. 57.

While interesting, we do not find Maduro's reasoning entirely convincing. It is true that the idea of good governance is often associated with the undertaking of some form of regulatory cost-benefit analysis (CBA). It should be noted, however, that this vision is far from controversial. One of the major critiques is that the quantification of costs and benefits is not always feasible and/or desirable.<sup>192</sup> It is pertinent to note that, at the decision-making level, the technique endorsed to promote good governance in the EU is Regulatory Impact Analysis, far broader than CBA.<sup>193</sup> Moreover, if the idea is to stimulate the use of CBA, it is questionable whether endorsing no-fault liability is the best route.<sup>194</sup> In fact, there are strong reasons to believe it is not.

First, by engaging in a process of calculating damages the Court could at best help the political institutions assess some of the costs stemming from the Community's illegal measures. The Court does not perform any assessment of the 'advantages' (or benefits) of the violation. Thus, we would be in the presence of a biased analysis, focusing only on costs. Consider the hypothetical case of a health regulation, found to be in violation of WTO law, which entails substantial benefits for European citizens that are far higher than the costs of retaliation. In this case, a well-performed CBA demands the continuation of the illegal measure, at least until a better solution is agreed upon by the parties. However, if the reasoning of the political institutions is only driven by the determination of the damage by the Luxembourg Courts, this course of action (with positive net benefits) would be foreclosed because only the costs generated by the retaliatory measures would be considered; this is obviously not a desirable outcome. Thus, the facially appealing link of no-fault liability with a form of CBA turns out to be misguided.

Let us add that, if the logic of no-fault liability would be introduced, symmetrically some form of charges should be introduced anytime a gain falls on private parties because of WTO related measures. This symmetry was indeed considered by AG Maduro in his opinion. The difference between our reasoning and AG Maduro's on this issue is subtle. In fact he contends that 'all public activity is assumed to benefit society *as a whole*' and thus, generally, compensation for losses ought not be paid; only 'serious damage to

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<sup>192</sup> The literature raising critiques to the application of CBA to legal field is wide; the references given here are therefore limited. For a general critique to quantification of non-market goods see RADIN, 'Market-Inalienability,' *Harvard Law Review*, 1987, p. 1849-1937 and SAGOFF, 'Economic Theory and Environmental Law,' *Michigan Law Review*, 1981, at 1410-1418. For a critique of the use of CBA in the context of environmental regulation see ACKERMAN, HEINZERLING, MASSEY, 'Applying Cost-Benefit to Past Decisions: Was Ever Environmental Protection *Ever* a Good Idea?', *Administrative Law Review*, 2005, p. 155-192. For an account of the way costs may be exaggerated and how the focus on numbers may lead to overlooking important methods used to draw the numbers see HEINZERLING, 'Regulatory Costs of Mythic Proportions,' *Yale Law Journal*, 1998, p. 1981-2070.

<sup>193</sup> For an overview of the way RIAs have been implemented in the EU see RENDA, *Impact Assessment in the EU – The State of the Art and the Art of the State*, CEPS, Brussels, 2006. See also MEUWESE, *Impact Assessment in EU Lawmaking*, E.M. Majers Institute of Legal Studies, Leiden University, 2008.

<sup>194</sup> It is worth noting that a similar reasoning has been developed by Susan Rose-Ackerman in her economic analysis of regulatory takings, i.e. the case in which regulation limits the value of someone's property. ROSE-ACKERMAN, *Rethinking the Progressive Agenda, The Reform of the American Regulatory State*, Free Press pp.135-140, 1992.

certain individuals and to them alone ... must give rise to compensation' (emphasis added).<sup>195</sup> However, in several instances, specific government acts do benefit specific groups. In relation to trade, for instance, after a Round is concluded, some groups receive benefits and others suffer losses. Should the benefited groups be charged and the negatively affected ones be compensated? If this were the case, after the Uruguay Round was concluded, exporting companies of products subject to IPR regimes should have been charged because of the large payoffs stemming from the conclusion of the TRIPS Agreement. Obviously such a system would be extremely complex to administer; for example, how would the groups to be charged be selected? How would the charges be quantified? Ex ante, by constructing models on the basis of counterfactual scenarios? Or ex post, after some years of the regime being operative? These questions exemplify the sort of issues that would have to be dealt with in such a system. The administrative costs of a system of damages and charges are likely to be so high as to offset any remaining benefits.

These considerations notwithstanding, it may still be claimed that granting damages has benefits that could eventually enhance good governance. This could be argued from a public choice perspective, according to which public institutions maximize their own, rather than the collective interest.<sup>196</sup> Under this framework, awarding damages may work as a constraint on the government, if the parties affected by an illegal measures are weak groups. In other words, a no-fault liability rule would force the government to take into account the interest of a constituency that otherwise would remain unheard. The reasoning of AG Maduro is surely more salient in this context. However, even in cases when the policy maker is not a perfect agent, the efficiency of the compensation requirement depends on the ability of interests groups to influence government. If the affected parties are powerful groups, a compensation requirement is not necessary because these groups will be able to defend their interests in the political arena anyway. In the WTO context, retaliation is usually targeted at strategic industries, as the goal of the retaliating Members is to put pressure on the violator. As has been noted in relation to US legislation concerning retaliatory schemes, '[t]he legislation attempts to put pressure on the foreign governments, through their domestic exporters, to bring their measures into conformity with the WTO Agreements.'<sup>197</sup> Thus, it is plausible to assume that in most cases, the victims of retaliatory measures will be powerful groups capable of exerting pressure on the government. Accordingly, even from a public choice perspective, awarding damages is not necessary as a tool to align the interests of the agent and principal. This reasoning further supports our conclusion that no-fault liability is not likely to enhance good governance.

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<sup>195</sup> Opinion of AG Maduro, above n. 5, Par. 62.

<sup>196</sup> For an overview of public choice theory see OGUS, *Regulation: Legal Form and Economic Theory*, 1994, Oxford: p. 58-75.

<sup>197</sup> ALEMANNI, 2008, above n. 154, p. 259.

At first sight the idea of awarding damages to collateral victims may appear to be compelling; at a second look, however, it becomes less so as it is the nature of trade policies to unevenly impose costs and benefits on society. While we agree that checks and balances are important in this area, we fail to see how a no-fault liability rule could work towards this end.

### ***9. Redressing the inequities of the FLAMM and Fedon cases***

Having explained in the previous sections that we agree with the Court's position in *FLAMM and Fedon* as both a matter of legal doctrine and economic analysis, it must be acknowledged that the outcome of the case leaves open issues of equity.<sup>198</sup> The widely-used expression 'collateral victims of trade wars' evidences a shared perception that the applicants of these cases do bear inequities. This feeling of discomfort may be shared, especially if one considers that the financial consequences suffered as a result of the banana war came unexpectedly to the applicants since the imposing country enjoyed full discretion as to the 'target products.' In this respect the CFI's assessment that the increase in custom duties was part of the 'rules of the game' for a business operator in the Community market may be meaningful from an economic perspective, but it falls short of equity considerations; while it may be factually true that the possibility of being hit by retaliation should be known to any exporting business, in practice it has been shown that very low-probability events, and more generally events having negative effects, are routinely underestimated, a phenomenon known as optimism bias.<sup>199</sup> The conclusion then seems plausible that, in the circumstance of *FLAMM and Fedon*, the costs of the (Community) non-compliance with WTO rules are unfairly borne by private parties.<sup>200</sup>

Secondly, the innocent victims are left without a remedy against the Community since they cannot use any of the actions provided for by the Treaty. For this reason, applicants who failed an action in damages before the ECJ, turned to the Strasbourg Court in the hope that it could found a violation of art. 6 and 13

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<sup>198</sup> Fairness considerations, in fact, appear to be the main underlying rationale for the advocates of the non-fault based liability. In his opinion AG Maduro states: 'Establishing a principle of no-fault Community liability would make it possible, *in the interests of justice*, to offset the severity of the conditions for the incurring of fault-based Community liability, linked in particular to the need for a sufficiently serious breach of a rule of law protecting individuals [...]' (par. 57) (emphasis added). Moreover, '[u]nable to rely on WTO rules, individuals who have reason to complain of conduct of Community institutions contrary to the WTO agreements cannot [...] plead the unlawfulness of that conduct. They are consequently denied access both to an action for annulment and to a reference for a preliminary ruling as to validity or an action for damages on grounds of fault. In the absence of the enshrinement of the principle of no-fault Community liability, even those who, as a result of the unlawful conduct, have suffered particularly serious damage would be deprived of all judicial protection' (par. 58).

<sup>199</sup> See generally JOLLS, SUNSTEIN, 'Debiasing through law', *Journal of Legal Studies*, 2006, p. 199-241 and SUNSTEIN, *Behavioral Law and Economics*, Cambridge, Cambridge: Mass., 2000, p. 291.

<sup>200</sup> This argument has been put forward by ALEMANNI, above n. 154, p. 249.



of the ECHR.<sup>201</sup> This being the situation, it is therefore important to identify the other avenues that are open to companies unjustly hit by trade sanctions, if the Community decides to retain WTO-incompatible legislation.

While it is beyond the scope of this article to articulate detailed solutions, it is submitted that there are at least two different options whose feasibility could be further explored. The first is that all operators who feel threatened by increases in custom duties due to the suspension of concessions should obtain insurance against these risks. The weakness of this solution is that it is not known whether this economic instrument is available, especially given the cognitive biases towards risks.<sup>202</sup> Market-based insurance would likely need to be coupled with some form of regulatory intervention, for instance in the form of compulsory insurance. However, if measures will be applied more and more often in the near future, it is likely that a demand for such a product will quickly develop, thus stimulating the supply of these products. The second option is that the EU institutions create a compensation fund available to innocent victims such as the applicants. This option, which seems to be suggested by the Court's ruling,<sup>203</sup> would be sustainable only if the financial pocket were open to a limited number of parties, e.g. only collateral victims suffering exceptional damages and not to all private parties affected by Community measures adopted in connection with WTO law. This option would have the advantage of correcting some of the inequities. Since it would be a political decision in the discretion of the EU institutions, the freedom of negotiation of these institutions would not be hampered as much as in the case of the Court empowering itself to grant damages to innocent victims. We should add, however, that the WTO compatibility of such a scheme is not certain. In fact, a compensation fund for the victims of retaliation may be considered as a subsidy.<sup>204</sup>

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<sup>201</sup> GATTINARA, above n. 76, p. 79.

<sup>202</sup> See JOLLS AND SUSTEIN, above n. 199.

<sup>203</sup> See *infra* section n. 3.3.1 (the position of the ECJ).

<sup>204</sup> Note that we do not argue that such a fund would constitute a subsidy; rather we believe that, given the broad definition of subsidy, the question may be raised, should such a fund be established. A subsidy is defined in Article 1 of the Agreement of Subsidy and Countervailing Measures as following:

For the purpose of this Agreement, a subsidy shall be deemed to exist if:

- (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:
- (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
  - (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)<sup>204</sup>;
  - (iii) a government provides goods or services other than general infrastructure, or purchases goods;
  - (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;

or

- (a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994;

and

- (b) a benefit is thereby conferred.

More generally, by neutralising the effects of the ‘suspension of concessions,’ it may be considered as upsetting the balance underlying the WTO remedy system, making nugatory the instituting provisions of the DSU, especially if the view is taken that its main function is to induce compliance with WTO law.<sup>205</sup>

## ***10. Concluding remarks***

With the *FLAMM* and *Fedon* ruling, the denial of direct effect of DSB’s rulings has become truly ‘absolute’<sup>206</sup> since the Court’s findings in *Van Parys* (a preliminary ruling) are extended to an action for damages. Unlike many legal commentators who have criticized the European Courts, we conclude that the judicial approach of refusing to enforce the DSB rulings within the Community legal order is supported by good legal reasons and has a sound economic rationale.

Given the importance of diplomacy in WTO law, we believe that it is inappropriate for the Court to rectify the effects of trade sanctions imposed by a WTO member. If private parties suffer as a result of WTO non-compliance, it is up to the defaulting State, and in particular to its political institutions, to deal with these problems.

Most important in our economic reasoning is the application of the Cathedral. In particular, we have argued that under the WTO legal system a mixed property/liability rule operates, which we called an ‘aspirational property rule operating through a temporary liability rule.’ By introducing Community enforcement, this rule would be transformed into a pure property rule, which we have shown would be inefficient and, eventually, counterproductive for the system. Similar conclusions have been reached by applying the exit and voice framework originally articulated by Hirschman. We have also shown that introducing a system of no-fault liability, as advocated by AG Maduro in *FLAMM* and *Fedon*, is unlikely to work towards better governance at European level.

Two important caveats apply to our analysis. While briefly suggesting that equity gaps are better addressed through risk insurances policies or alternative compensation mechanisms, we did not attempt to shed light on issues of equity in an accurate fashion. Moreover, most of our conclusions rest on the present circumstances underlying the WTO legal and socio-economic system. Changes in this system may alter our

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<sup>205</sup> For a discussion on the function of the suspension of concessions within the DSU, in particular on whether the corresponding provisions are aimed at ensuring compliance with WTO law or to provide the successful complainant a form of temporary compensation, see SEBASTIAN, ‘World Trade Organization remedies and the assessment of proportionality: equivalence and appropriateness,’ *Harvard International Law Journal*, 2007, p. 364-370.

<sup>206</sup> The expression is drawn from AG Colomer’s conclusions of 23 January 2007 in C-431/05 *Merck Genéricos-Produtos Farmacêuticos Ld v. Merck & Co. Inc.* and others, par. 71.

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results.

Finally, while our analysis has focused on the enforcement of WTO law by Community institutions, future research can be done to generalize our law and economics analytical framework and, accordingly, to apply it to other cases of domestic enforcement of WTO law.