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Reflexive Governance in the Public Interest

Fundamental Rights

Regulatory Competition in Europe after Laval

By Simon Deakin

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Regulatory Competition in Europe after Laval

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Abstract

This paper considers the implications for regulatory competition of the recent judgment of the European Court of Justice in *Laval*. This case is potentially the most important decision on European labour law for a generation. The Court has greatly extended the scope for judicial review of state-level labour laws on the grounds that they restrict freedom of movement from one member state to another. It has also undermined the principle of the territorial effect of labour legislation and has given a strictly pre-emptive interpretation to social policy directives. The *Laval* judgment is, however, open to attack on a number of grounds. It fails to mount a coherent economic case for judicial intervention on the scale envisaged, and is, more generally, incompatible with the recent experimentalist or reflexive turn in European governance represented by the open method of coordination.

Keywords: regulatory competition, experimentalism, labour law, free movement of workers, *Laval* case.

JEL Codes: J83, K31.

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*Leaving aside cases of overt discrimination and interventions aimed at favouring certain firms or modes of production, legislative and regulatory provisions may have such an impact on costs and prices that it will be necessary to consider with the greatest care whether, either by virtue of their own impact or by reason of disparities between two or more countries, some of them may have the effect of distorting conditions of competition among the national economies as a whole or in particular branches of economic activity... But at the same time it will be necessary to identify very precisely the limits of whatever action is necessary, and to dispel certain misunderstandings...*¹

I. INTRODUCTION

The purpose of this article is to consider the implications of *Laval*² and other recent decisions of the ECJ³ for regulatory competition between the Member States in the field of labour law. In addition to its importance for the law governing the posting of workers, *Laval* raises issues of an institutional nature concerning the relationship between Community law and the laws of the Member States. Firstly, it seems to provide the courts, when applying the law of free movement, with a power to review national regulatory standards not simply where such standards operate above an abstractly-defined threshold of undue restrictiveness, but more concretely where they operate in excess of the standards applying in the *least regulative*

¹ Comité Intergouvernemental créé par la conférence de Messine, *Rapport des Chefs de Délégation aux Ministres des Affaires Etrangères*, Brussels, 21.4.1956 (the ‘Spaak Report’), at 60 (the author’s translation).

² Case C-341/05, *Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundet*, Judgment of 18 Dec 2007 (hereinafter ‘*Laval*’).

Member State which is relevant to the issue at hand. Secondly, it implies that there might be a right of economic actors to access the laws of this ‘least regulative’ state regardless of the precise location of their own activities, as long as those activities have a loose connection with the jurisdiction concerned or there is some transnational element involved in the issue at stake. Thirdly, *Laval*’s reading of the Posting of Workers Directive seems to be driven by a view that directives and regulations aiming to harmonise the laws of the Member States should be read as imposing maximum, not just minimum standards, at least in contexts where issues of free movement arise.

In all these respects, *Laval* is a potentially ground-breaking decision. However, the judgment is by no means clear on some critical points. Sections II and III below explore two central issues. The first is the question of the conditions under which differences in regulatory legislation across Member States can be said to constitute a restriction of, or barrier to, free movement, with the focus on the issue of the freedom to provide services which was directly raised in *Laval*. The second is the issue of how to interpret directives and regulations which aim to set basic common standards for the Member States, with the focus here on the Posting of Workers Directive. In section IV the question of institutional structure is addressed. Section V concludes.

II. THE REACH OF ARTICLE 49

In *Laval* the Court held that industrial action taken by the Swedish construction workers’ trade unions with the aim of persuading a Latvian-based service provider to sign a collective

³ Case C-438/05, *International Transport Workers’ Federation v Viking Line ABP*, Judgment of 11 Dec 2007 (hereinafter ‘*Viking*’); Case C-346/06, *Dirk Rüffert v Land Niedersachsen*, Judgment of 3 Apr 2008 (hereinafter

agreement in respect of work done in Sweden infringed the provisions of Article 49 of the EC Treaty. Under Article 49, ‘restrictions on the freedom to provide services’ are prohibited ‘in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended’. The principal party to the original Swedish litigation, Laval un Partneri Ltd, was a Latvian company which posted some of its employees to Sweden on a temporary basis, to carry out work on a building contract there. The strike action began when Laval refused to sign a collective agreement with the unions representing Swedish construction workers, as a preliminary step to negotiating over the rates of pay which would govern the employment of the posted employees. The strike was successful and the contract between Laval’s Swedish subsidiary and the local authority of Vaxholm for the building work was cancelled, after which the subsidiary entered into bankruptcy.

A. What is a ‘restriction’ on the freedom to provide services?

The first issue to examine here is the nature of the ‘restriction’ needed to trigger Article 49. In the course of a lengthy judgment, the Court devoted just a few lines to the discussion of this question. It said:

[I]t must be pointed out that the right of trade unions of a Member State to take collective action by which undertakings established in other Member States may be forced to sign the collective agreement for the building sector—certain terms of which depart from the legislative provisions and establish more favourable terms and

‘Rüffert’).

conditions of employment as regards the matters referred to in Article 3(1) first subparagraph (a) to (g) of Directive 96/71 and others relate to matters not referred to in that provision—is liable to make it less attractive, or more difficult, for such undertakings to carry out construction work in Sweden, and therefore constitutes a restriction on the freedom to provide services under Article 49 EC.⁴

We shall return below to the significance of the Court’s reference to the Directive in this passage. Viewed as a statement on the meaning of Article 49, what does it imply? The Court seems to have thought that it was almost beyond argument that there was a ‘restriction’ here; at any rate, that conclusion was simply asserted, without reasons being given. Advocate General Mengozzi was slightly more expansive. He said:

[I]t is, in my opinion, undeniable that, despite the absence of any contractual link between the defendants in the main proceedings and *Laval* and despite the fact that the collective action (a blockade and solidarity action) *directly* targeted members of the unions which are the defendants in the main proceedings, who had to decline to respond to any offer of recruitment or employment with *Laval*, the collective action taken had the effect of compelling *Laval* to give up the performance of its contract on the Vaxholm site and the posting of Latvian workers to that site ... The taking of such collective action, even if also directed against undertakings established in the territory of the Member State in question, is liable to give rise to significant costs for the foreign service provider, whatever the outcome of such action, so that in my view it constitutes a restriction on the freedom to provide services.⁵

⁴ *Laval*, above n 1, para 99.

⁵ Case C-341/05, *Laval*, Opinion of 23 May 2007, paras 230 and 233.

Commentators have also more or less taken it for granted that Article 49 applied here. According to Norbert Reich, for example, ‘with regard to the applicable Community law since *Rush Portuguesa*,⁶ it is without doubt that the posting of workers of a company established in one EU country is a cross-border service to which Article 49 is applicable’.⁷ Under Article 49, as under other provisions relating to freedom of movement, either a discrimination test or one based on restriction can be applied.⁸ Thus there is no need to show that the service provider is being treated differently from nationals of the host state. In *Laval*, Reich suggests, the action taken by the Swedish unions was ‘the strongest form of restriction; indeed, it made impossible the rendering of services by Laval in Sweden and caused great harm both to Laval and to the Latvian workers it had posted while relying on its freedom to provide services’.⁹

The restriction issue was addressed with equal brevity in the first case to apply *Laval*, *Rüffert*. The issue was whether a German regional law requiring building contractors to observe the minimum terms of a collective agreement governing public works infringed Article 49, in circumstances where the main contractor concerned had employed a Polish subcontractor which was paying its workers wages below the rate set out in the collective agreement. On these facts there was, according to Advocate General Bot, ‘barely any doubt ... that a restriction on the freedom to provide service exists’.¹⁰ The Court did not need to go to a great deal of effort to reach the same conclusion.¹¹

⁶ Case C-113/89, *Rush Portuguesa v Office Nationale d’Immigration* [1990] ECR I-1417.

⁷ Reich, N ‘Free movement versus social rights in an enlarged Union: the *Laval* and *Viking* cases before the European Court of Justice’ (2008) 9 *German Law Journal* 125 available at http://www.germanlawjournal.com/pdf/Vol09No02/PDF_Vol_09_No_02_125-160_Developments_Reich.pdf.

⁸ Barnard, C *The Substantive Law of the EU: The Four Freedoms* 2nd edn (Oxford, OUP, 2007) ch 14.

⁹ *Ibid.*

¹⁰ Case C-346/06, *Rüffert*, Opinion of 20 Sep 2006, para 102.

¹¹ *Rüffert*, above n 2, para 38.

It is perhaps worthwhile examining in a little more detail an issue which, on closer inspection, turns out to be far from doubt-free. In what sense, precisely, did the collective action impose costs which, as the Court put, made it ‘more difficult’ or ‘less attractive’ for Laval to operate in Sweden? More difficult or less attractive than what? There are only three possibilities: (1) more difficult than if the law allowing the industrial action had not existed; (2) more difficult in relation to the situation faced by Swedish firms; and (3) more difficult in relation to the situation which would have prevailed had Latvian law and/or Latvian collective agreements applied.

Let us consider the first possibility. Strikes, if successful, and labour laws, if they allow industrial action, inevitably make it potentially more costly for employers affected by them to do business. Thus labour laws which subject foreign service providers to the possibility of strike action, and such action itself, can be viewed as making it less attractive for them to do business in other Member States. Laval was subject to a restriction simply because Swedish law permitted industrial action to be taken against it, action of the kind allowed was taken, and it was effective; indeed, the more effective the industrial action was, from a trade union perspective, the more likely it was to constitute a restriction.

If this first definition of ‘restriction’ applies, it would amount to saying that a foreign service provider, *simply because it was foreign*, was entitled to have local labour laws disallowed in its favour, unless those laws could be justified by the host state. Evidently, this is an extremely broad test. It would enable any labour law provision which was in any way effective to be subjected to judicial review under Community law. However, if the firm was subject to a *higher* regulatory standard in its home state, it is hard to see how the imposition of the law of the host state could amount to a ‘restriction’ affecting the cross-border flow of

services. Would a Swedish firm providing services in Latvia be entitled to have Latvian labour law disapplied in favour, not of Swedish law, but of a situation in which there was no regulation whatsoever? This possibility cannot be ruled out, given the broad and imprecise formulations used by the Court in *Laval*¹², but if Community law goes this far, it is hard to see where it would stop.

The other two suggested tests are comparative tests in the sense of involving an assessment of the costs imposed upon employers by different regulatory regimes. The second interpretation contrasts the position of Swedish firms with foreign ones. If foreign firms are subjected to a greater burden than those in the host state, there is, in principle, a situation of discrimination, either direct or indirect. This could happen in various ways: the foreign firm could, for example, be subjected to a ‘double burden’ by virtue of the need to comply with two different sets of rules, or to registration requirements which imposed two sets of costs or expenses.¹³ Discrimination is not a necessary condition for the application of Article 49 but it is a sufficient one. However, it does not describe the situation in *Laval*, since in that case the unions were requiring of Laval what they required of Swedish-based employers, namely that it should sign a collective agreement with a view to negotiating over pay and conditions.¹⁴ It

¹² It is also possible to find some support for the proposition in Case C-255/04, *Commission v. France* [2006] ECR-I 5251. In that case the Court struck down legislation establishing a presumption that performing artists had employee status while working in France and were therefore subject to French legislation on social security law and annual paid leave. The Court referred (at para. 48) to the rule of coordination, in Regulation 1408/71, under which self-employed workers working temporarily in a Member State other than their country of origin remained under the social security jurisdiction of the home state. The Court also considered (at para. 50) that it was relevant, in this context, that self-employed workers fell outside the scope of the right to paid leave as set out in the Working Time Directive (which at that point was Council Directive 93/104/EC, OJ 1993 L 307, p. 18). Given the Court’s reliance on these specific arguments, there is a case for saying that *Commission v. France* does not go so far as to establish that there is a restriction simply from the application, without more, of regulatory labour standards which impose costs on either employers or workers from another Member State, although the matter is far from clear.

¹³ As in, for example, Joined Cases C-369 and C-376/96, *Arblade and others* [1999] ECR I-8453.

¹⁴ In addition to its general ruling on Art 49, Court held that the law which was applied by the Swedish courts in *Laval*, the ‘Lex Britannia’, was discriminatory because it permitted collective action to be taken against an overseas collective agreement but not against one made in Sweden. The Court also held that since there was

is possible that a double burden might have arisen in respect of insurance payments which Laval would have been required to make had it signed the proposed agreement. This is one of the reasons given by the Advocate General for his ruling that Article 49 applied to the case.¹⁵ However, both he and the Court thought that there was a potential breach of Article 49 for other reasons, which we will now explore.

These reasons are linked to the third meaning of ‘restriction’ identified above: Laval was subjected to an unduly restrictive regime because of the additional costs it would have incurred if it had had to pay Swedish, as opposed to Latvian, wages. This would have been the likely consequence of signing up to a Swedish collective agreement. As Advocate General Mengozzi put it, Laval was arguing that ‘only Latvian legislation and collective agreements are applicable to the posting so that, as a result, the Swedish trade unions are deprived of the possibility of seeking to compel Laval, through collective action, to sign the [relevant] collective agreement’.¹⁶

The point comes out more starkly in *Rüffert*. According to the referring court, the issue was whether service providers in the position of the Polish subcontractor should ‘lose the competitive advantage which they enjoy by reason of their lower wage costs’;¹⁷ as far as the workers were concerned. The national court also thought that ‘the obligation to pay the collective agreed wage does not bring about actual equality with German workers but instead

discrimination on grounds of nationality in this case, it could only be justified if it fell within one of the grounds of public policy, public security or public health, and that none of these was relevant to *Laval*. This ruling was separate from the Court’s decision on the first (and main) question put to it, which was whether strike action taken with the aim of persuading a foreign service provider to sign a collective agreement in the host state was compatible with Art 49 of the Treaty and the Posting of Workers Directive. In the context of this question, there was no discrimination, only a ‘restriction’ under Art 49 in the sense discussed in the text.

¹⁵ See his Opinion, above n 4, paras 279 *et seq* (where he discusses whether the provisions of the relevant collective agreement concerning insurance payments and a contribution towards the unions’ costs of monitoring observance of wage rates were proportionate under the justification test in Art 49).

¹⁶ *Laval* Opinion, *ibid*, para 133.

¹⁷ *Rüffert* Opinion, above n 9, para 41.

prevents them from being employed in Germany because their employer is unable to exploit his advantage in terms of labour costs'.¹⁸ In the words of Advocate General Bot, Article 49 was relevant here because the German law in question imposed 'on service providers established in another Member State *where minimum rates of pay are lower* an additional economic burden that may prohibit, impede or render less attractive the provision of their services in the host state' (emphasis added).¹⁹ The Court agreed with this, but did not agree with the Advocate General's argument that the application of the German law was justifiable in the circumstances.

Laval and *Rüffert* between them establish a presumption of 'regime portability': Article 49 protects the right of the foreign service provider to apply the law and/or agreements of its country of origin, that is to say, the law of the home state, in preference to that of the host state, where the latter imposes a higher regulatory burden, unless those laws can pass a justification test. The concept of regime portability is closely related to the 'country of origin principle' which originally formed part of the Services Directive.²⁰ The Services Directive was amended in its final draft stages in order to remove reference to the country of origin principle and to ensure that none of the provisions of the Directive would undermine the territorial application of labour law rules and provisions collective agreements.²¹ The effect of *Laval* and *Rüffert* is, in effect, to circumvent this derogation and to revive the country of origin principle in relation to labour law, but now with the added force of a Treaty provision

¹⁸ *Ibid*, para 44.

¹⁹ *Ibid*, para 103.

²⁰ Directive 2006/123 OJ [2006] L376/26.

²¹ See Barnard, C 'Employment rights, free movement under the EC Treaty and the Services Directive' in Rönngmar, M (ed) *EU Industrial Relations and National Industrial Relations: Comparative and Interdisciplinary Perspectives* (Deventer, Kluwer, 2008).

(Article 49) which is capable of having horizontal direct effect at least against private regulatory bodies including trade unions.²²

B. The scope of regime portability: the need for a transnational dimension

If a principle of regime portability is the effect of *Laval*, the next critical issue is to determine the scope of that principle. As we have seen, the free movement provisions of the Treaty can only be invoked to challenge a rule or practice where the restriction to which it gives rise has a transnational or cross-border element.²³ But what exactly does a transnational element mean in practice?

A good place to start in answering this question is the dispute in *Laval* itself. Who precisely was providing services to whom? The contract for the building work was between Laval's subsidiary, a company called L&P Baltic Bygg AB (hereinafter 'Baltic'), and the town of Vaxholm. Baltic seems, on the face of it, to have been an undertaking established under Swedish law. Whichever one of the possible tests for determining the domicile of a corporation is used—the test of incorporation, or that of the main site of the undertaking's operations or head office (the so-called 'real seat')²⁴—Baltic must have been a Swedish company, albeit one whose share capital was entirely held by its foreign parent, Laval. *Laval*

²² *Laval*, above n 1, para 98; see the contribution of Dashwood, A 'Viking and *Laval*. Issues of horizontal direct effect', forthcoming, *Cambridge Yearbook of European Legal Studies* (2008).

²³ Article 49, for example, refers to the freedom to provide services being protected 'in respect of nationals of Member States who are established in a State of the Community other than that of the person for whom the services are intended'. As the Court said in an early case, 'the provisions of the Treaty on freedom to provide services cannot apply to activities whose relevant elements are confined within a single Member State': Case 52/79 *Procureur du Roi v. Debauve* [1980] ECR 833, para. 9.

²⁴ Either test is possible under the national laws of different member states; the judgment of the Court in Case C-212/97, *Centros Ltd v Erhvervs-og Selkabsstyrelsen* [1999] ECR I-1459 places limits on the capacity of Member States to apply the so-called 'real seat' principle which insists on the need for a physical link between the company's operations and its applicable law. See the discussion in the text, below.

looks very much like a case in which the service provider (Baltic) was not established in a Member State other than the one in which the services in question were being supplied.

Was the parent company Laval un Partneri Ltd, which was established in Latvia, providing services to the town of Vaxholm? No: this can only have been the case if the parent and subsidiary are to be treated as the same undertaking for this purpose. Such a view is not by any means implausible; they were part of the same corporate ‘group’, if that term is understood to include companies linked by a common ownership or in a parent-subsidiary relationship, as these two were. But if the veil of corporate personality is to be lifted in this way, it does not necessarily aid Laval, for the reason that any such ‘group undertaking’ could just as plausibly be treated as an undertaking established in Sweden, through the subsidiary, as in Latvia, through the parent.

This last point was argued by the Swedish trade unions, as part of their claim that the reference for a preliminary ruling was inadmissible. Their argument was rejected by the Court on the grounds that the ‘factual context’ of the case was such that it was not ‘artificial’ to see the dispute as giving rise to the questions, involving the interpretation of Article 49 of the Treaty and of the Posting of Workers Directive, which the national court had referred to it.²⁵ The relevant elements of the ‘factual context’ were three-fold: the dispute turned on the terms and conditions ‘applicable to Latvian workers posted by Laval to a building site in Sweden’; the work was ‘carried out by an undertaking belonging to the Laval group’; and, following the collective action mounted by the unions, ‘the posted workers returned to Latvia’.²⁶ In referring to Baltic as an ‘undertaking belonging to the Laval group’ the Court seems to have taken the view that the Swedish subsidiary was a *separate* undertaking from its

²⁵ See *Laval*, above n 1, paras 42–50.

²⁶ *Ibid*, para 49.

parent. What it did not do was clearly indicate what it thought the nationality of Baltic's establishment was.

It is perhaps not surprising that the Court rejected the argument on the admissibility of the preliminary reference. The questions set by the national court were, clearly, of importance in the context of the wider question of the posting of workers. The problem comes in trying to understand exactly what dispute the Court thought it was dealing with. Was Baltic established under Latvian law and, if not, in what sense was Laval, which clearly was a Latvian company, providing services on a cross-national basis? This is not an issue which goes to the question of the admissibility of a preliminary reference under Article 234, but to the substance of Articles 49 and 50.

Perhaps Laval was providing services, not to the town of Vaxholm, but to its own subsidiary. This is possible, but the point is not clear. Under Article 50, 'services shall be considered to be "services" within the meaning of the Treaty where they are normally provided for remuneration'. There is no evidence of there being a contract between Laval and Baltic under which it undertook to hire out its own employees to its subsidiary, or of it receiving remuneration from Baltic for doing so.

We must assume that the Court did not think it was deciding a hypothetical case. If that is so, a number of possibilities arise. One is that the Court tacitly lifted the veil of corporate personality, discovered that Laval and Baltic were part of the same corporate group, and (tacitly again) assigned Latvian nationality to them both. A second possibility is that Laval's involvement in the process as Baltic's parent company—even though Laval itself was not the provider—was sufficient to confer upon the dispute a transnational element within Article 49. A third possibility is that the events of the Vaxholm case might deter Laval, and

similar overseas companies, from operating in Sweden in future (even though in this case, Laval chose to act through a Swedish subsidiary and might have done so again).

A fourth possibility is that the Court was applying a special rule in the context of the posting of workers. This possibility is not apparent from the Court's judgment, but the issue was discussed by Advocate General Mengozzi. The Advocate General pointed out that that Article 1(3)(b) of the Posting of Workers Directive includes within the scope of that measure a situation in which 'the business of an undertaking established in a Member State ... posts a worker to the territory of another Member State, to an establishment or to an undertaking owned by the group, provided that there is an employment relationship between the undertaking making the posting and the worker during the period of posting'.²⁷ Later in his Opinion the Advocate General advanced the view that the Directive 'represents a specific interpretation of Article 49 EC in the light of the case law of the Court',²⁸ so that, as a result, 'a measure that is incompatible with Directive 96/71 will, a fortiori, be contrary to Article 49 EC'.²⁹ On this basis, the Directive clarifies the scope of the Article, with the result that the facts of *Laval* fall under them both.

It is relevant to consider which of these four interpretations might be the correct one. If it is the fourth, the scope of the *Laval* judgment can be narrowly confined to the context provided by the Directive. If it is one of the first three, the Court is giving Article 49 a very broad reading, as covering several situations which do not self-evidently fall within the express words of the article: situations where there is no contractual nexus between the foreign provider and the person for whom the services are intended; where the foreign

²⁷ *Laval* Opinion, above n 4, para 107.

²⁸ *Ibid*, para 145.

²⁹ *Ibid*, para 149.

provider acts through a local subsidiary which it controls; and where foreign service provision might be deterred by a given law or practice on future hypothetical facts.

Let us assume that the Court was correct, for whatever precise reason, in treating the parent company Laval as the relevant service provider for the purposes of Article 49. In what way did it suffer a competitive disadvantage by virtue of its Latvian establishment? As we have seen, the Court took the view that Laval's freedom to provide services was being infringed by the action taken by the Swedish unions because, as a Latvian firm, it employed Latvian workers and was subject to Latvian labour law and collective agreements. However, this point is by no means as obvious as the Court seems to have thought. A company's establishment has no intrinsic connection with whom it employs, the labour laws it is subject to, or the collective agreements which it observes. Both under the practice of individual states and under Community law (in the form, here, of the Rome Convention on the law applicable to contractual obligations),³⁰ labour laws are generally applied on a territorial basis; in other words, they operate by reference to the normal or habitual place of work of the worker (which will override any agreement to the contrary, at least as far as mandatory rules are concerned). By contrast, the tests for determining an undertaking's establishment are not territorial. Under the rules of the conflict of laws in force in various Member States, the establishment of an undertaking depends either on the site of its head office or on its jurisdiction of incorporation, that is to say, the jurisdiction under which its members have chosen to incorporate it. It is not dependent on where it carries out most of its activities (this may or may not be the same place as the location of its head office). Under Community law, a slightly more expansive test of 'establishment' applies; this refers to 'the actual pursuit of an

³⁰ Art 6(2); see further, below.

economic activity through a fixed establishment in another Member State for an indefinite period'.³¹ But again, a company's physical presence on a given territory is not a necessary condition for being established there. Thanks to *Centros* and related judgments,³² an undertaking may now choose to incorporate in a state entirely separate from that in which it does business; attempts to constrain this right of free incorporation, such as the 'real seat' principle which applies in a number of civil law systems, are subject to strict controls in the sense that they must pass a high justification threshold. *Centros* concerned the right of a company which operated (or proposed to operate) on Danish territory to incorporate itself under English law. As a consequence of that ruling, there are now several thousand firms which operate on the territory of continental European jurisdictions, employing workers under the terms of labour legislation in force in those countries, but which are incorporated under English law.³³

Laval's supposed disadvantage in being subject to Swedish law and to industrial action aimed at getting it to sign a collective agreement was only in the most tenuous sense the result of its Latvian *establishment*. It was principally the result of its decision to employ Latvian workers on the Vaxholm contract. This was a decision it presumably took in the light of an assessment of its business interests, but it in no sense followed from it being a Latvian company. There is no principle of either national law or Community law which states that an undertaking established in a particular Member State must employ only nationals of that state when posting them overseas, or otherwise; nor *may* it decide to do so to the exclusion of

³¹ *Viking*, above n 2, para 70 (referring to Case C-211/89, *Factortame and Others* [1991] ECR I- 3905, paras 20-2).

³² *Centros*, above n 22; Case C-208/00, *Überseering v Construction Company Baumanagement GmbH (NCC)* [2002] ECR I-9919; Case C-167/01, *Kamer van Koophandel en Fabrieken voor Amsterdam v Inspire Art Ltd* [2003] ECR I-10115; Case C-411/03, *SEVIC Systems AG* [2005] ECR I-10805.

workers from other Member States, as this would amount to discrimination on the grounds of nationality, (probably) under Article 39. The same point applies to Laval's signature of a Latvian collective agreement: its Latvian establishment imposes no obligation upon it to sign such an agreement. Its decision to do so was entirely voluntary (and was taken only when its negotiations with the Swedish unions had broken down).

Laval extends the scope of Article 49 and, by extension, Article 43, which uses the same formula of 'restriction', to cases where the transnational element is marginal or tangential to the dispute at issue. In *Laval* the party to the dispute, although a foreign company, was not contracted to supply the service in question (Baltic was the service supplier); as we have seen, this did not make any difference to the Court's ruling. Thus service providers from low-cost states can access the territory of other states via subsidiaries incorporated in those states, while still retaining the benefit of the laws of their country of origin. In *Rüffert*, where the foreign provider was contracted to supply the services concerned, it was not a party to the dispute before the court. *Rüffert* therefore shows that an employer established in the host state can invoke Article 49 to disapply labour laws which indirectly affect its profitability by virtue of their impact on a foreign service provider upstream in the chain of supply.

But *Laval* goes beyond cases involving (even tangentially) foreign service provision. This is because of the way Articles 49 and 43 interact. Under Article 43, thanks to *Centros*, an undertaking has a very wide freedom of choice over the nationality of its establishment; companies can be incorporated under the legal regime which their members consider most amenable, with other Member States being required to pass a high threshold of justification if

³³ See Becht, M, Mayer, C and Wagner, H 'Where do Firms Incorporate? Deregulation and the Cost of Entry' ECGI-Law Working Paper No 70/2006.

they wish to deny this choice. Moreover, the test of what counts as a ‘restriction’ on freedom of establishment under Article 43, as both *Centros* and *Viking* make clear, is similar to that which applies to freedom to supply services under Article 49. *Laval*, *Viking* and *Centros* together open up new possibilities of employers accessing low-cost labour law regimes. Consider the following examples:

(1) A Latvian company is considering investing in a new manufacturing site in Sweden. It proposes to rely on Latvian labour law and collective agreements in its relations with Swedish unions and the workers they represent. It argues that Swedish law should be disapplied in order to prevent it being deterred from making the investment.

(2) A British company wants to supply consulting services to firms in Germany. It employs workers in Germany through a German subsidiary but with contracts of employment governed by UK law. When the subsidiary dismisses the workers on the grounds of redundancy, it seeks to have German labour legislation disapplied in favour of UK law, on the grounds that the latter is less ‘restrictive’ of the employer’s power to make redundancies.

(3) The same facts as (2), but the parent company this time is a German one which wants to supply consulting services to firms based in the UK.

In each of the above examples, there is, conceivably, a *Laval*-style ‘restriction’ on freedom of movement which arises from the variations in labour costs imposed by different regulatory regimes, and there is also a transnational element to the dispute. Would it be necessary, in each case, for the application of the domestic labour laws in question to be justified by the host Member State (bearing in mind that the conditions of justification, if the example of *Laval* is followed, are likely to be very strict)? Such possibilities seem incompatible with the protection previously afforded to the principle of the territorial effect of labour legislation by the Rome Convention on the laws applicable to contractual obligations, which is due to become the Rome I Regulation shortly.³⁴ However, the relationship between the Convention, or the soon-to-be Regulation, and Article 49 is yet another of the issues which *Laval* poses without clearly answering. To consider some possible answers it is necessary to look in more detail at the Court’s interpretation of the Posting of Workers Directive and to consider how far temporary postings may constitute a special case in the context both of Article 49 and of the Rome Convention.

III. TOWARDS PRE-EMPTION? THE COURT’S INTERPRETATION OF THE POSTING OF WORKERS DIRECTIVE

Most labour law jurisdictions give effect to the ‘principle of territoriality’ through tests which refer to the ‘habitual’ or ‘normal’ place of work of the employee or worker.³⁵ In *Laval*, the Court claimed to recognise the principle of the territorial application of labour laws, or, at

³⁴ See section III, below.

³⁵ See eg Deakin, S and Morris, G *Labour Law* 4th edn (Oxford, Hart, 2005) 111–13.

least, to recognize that this had provided the basis for a defence of justification in earlier cases:

Community law does not preclude Member States from applying their legislation, or collective labour agreements entered into by management and labour relating to minimum wages, to any person who is employed, even temporarily within their territory, no matter in which country the employer is established.³⁶

In practice, its ruling puts the principle of territoriality in doubt in the one case where it really matters, namely where an employer seeks to have domestic labour laws set aside in order to access a less restrictive regime under the law of another Member State. How could it reach this conclusion?

The Rome Convention, in Article 6(1), states that ‘in a contract of employment a choice of law made by the parties shall not have the result of depriving the employee of the protection afforded to him by the mandatory rules of the law which would be applicable ... in the absence of choice’. Article 6(2) indicates that, in the absence of choice, a contract of employment should be governed ‘by the law of the country in which the employee habitually carries out his work, even if he is temporarily employed in another country’. Thus the Convention cements into place the territorial application of mandatory labour law rules, requiring its signatories (all the current Member States) to observe the ‘habitual work’ test. As mentioned above, the Rome Convention is in the course of being converted into a Community regulation.³⁷ The draft, known as the Rome I Regulation, restates the rule in Article 6, with two modifications. It is now stated that the mandatory rules of law of the country ‘in *or from* which’ (emphasis added) the employee habitually works are to apply, a

³⁶ *Laval*, above n 1, para 57.

change made in order to bring the employment contracts of certain airline and other transport workers within the Regulation. In addition, draft Regulation 6(2)(a) spells out in more detail the rules relating to temporary work. This provision says that, in the case of a temporary posting, ‘the place of performance shall not be deemed to have changed if [the employee] is temporarily employed in another country’, and goes on to give the following definition of temporary work:

Work carried out in another country shall be regarded as temporary if the employee is expected to resume working in the country of origin after carrying out his tasks abroad. The conclusion of a new contract of employment with the original employer belonging to the same group of companies as the original employer does not preclude the employee from being regarded as carrying out his work in another country temporarily.

The basic rule, then, is that labour laws generally have a territorial effect, but that in the case of temporary postings, the law of the country of origin applies. The temporary posting of workers is, in that sense, a special situation outside the normal case of the territorial application of labour laws.

The Posting of Workers Directive,³⁸ in its turn, carves out an exception to the rules contained in the Convention/Regulation, restoring the territorial effect of the labour laws of the host state in so far as they apply to posted workers within the terms of that Directive. The Directive requires Member States to apply certain mandatory rules of labour law and, in the case of the building industry, the terms of certain collective agreements, to workers on

³⁷ See Commission, *Proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I)*, COM(2005)650 final, 15 Dec 2005.

³⁸ European Parliament and Council Directive 96/71/EC concerning the posting of workers in the framework of the provision of services.

temporary postings; in other words, the law of the *host* state must be applied, in preference to the law of the *home* state as specified by the Convention. The mandatory rules of law which must be applied under Article 3(1)(a)–(g) are listed as those relating to working hours, holidays, minimum wages, the conditions of agency-supplied labour, health and safety, the protection of pregnancy and maternity, and anti-discrimination law.³⁹ The collective agreements which may be applied in the building trades are those which ‘have been declared universally applicable’ in the sense of being required to be observed by ‘all undertakings in the geographical area and in the profession or industry concerned’. In the absence of a power to make collective agreements universally applicable, a Member State may instead adopt under Article 3(8) agreements or awards which are ‘generally applicable’ to all similar undertakings in the industry or geographical area concerned, or, agreements made by the ‘most representative’ employers’ associations and trade unions at national level and which are effective throughout the national territory concerned. Finally, Article 3(10) states that a Member State may add to the list of mandatory rules of law which must be observed under Article 3(1)(a)–(g) (unfair dismissal laws, laws governing employee representation and those relating to industrial action, for example, could come into this category).

³⁹ In this regard, the United Kingdom’s approach to the implementation of the Directive is noteworthy: there is no legislation specifically referring to the Directive, merely a series of provisions setting out the scope of particular employment statutes. The National Minimum Wage Act 1998, for example, applies where a person ‘is working, or ordinarily works, in the United Kingdom under his contract’ (s. 1(2)(b)), and the Working Time Regulations are stated ‘to apply to Great Britain only’ (SI 1998/1833, reg. 1(2)). In the case of rights to employment protection contained in the Employment Rights Act 1996, Parliament simply repealed a provision which had formerly excluded from the scope of the Act situations where the employee ‘ordinarily worked outside Great Britain’ (Employment Relations Act 1999, s. 32(3)), the implication being that the statute would be construed, implicitly, as having a territorial reach (which would bring workers temporarily posted to the United Kingdom from other Member States within its scope) but no further. This was result duly arrived at by the House of Lords in *Lawson v. Serco Ltd.* [2006] ICR 250, although the principle of territoriality was applied flexibly in that case to cover employment in overseas military bases. The anti-discrimination statutes apply to employment ‘at an establishment in Great Britain’ but they have on occasion been given a limited extra-territorial effect under Article 39 EC, as in *Bossa v. Nordstress Ltd.* [1998] IRLR 284. See generally Deakin and Morris, above n. 35, at 111-12.

In both *Laval* and *Rüffert*, the Court focused its attention on the Directive, to an even greater extent than on Article 49. It is not at first sight clear why it did this. If Article 49 applied to these cases, and brought with it its own case law on the issue of justification, why was it necessary to consider the Directive at all? The provisions of the Directive were not capable, in themselves, of having direct effect in a case involving private parties, such as *Laval*⁴⁰ (*Rüffert* is different, in principle, as the defendant was the regional government, although nothing seems to have turned on this, for reasons which will shortly become clear). In *Laval* the Court itself simply stated that the Directive had to be taken into account when giving a ruling on the meaning of Article 49 in a posting case, without saying precisely why, except to refer back to its own earlier case law (which is no more informative).⁴¹ The Opinion of Advocate General Mengozzi goes into more detail. As we have already seen, he took the view that the Directive is a ‘specific interpretation’ of the Article in the light of the case law of the Court, and that it is ‘intended ... to implement’ the Article.⁴² In other words, the Directive gives concrete expression to Article 49. The Directive can accordingly be read as clarifying both the ambit of Article 49 (so as to bring within it the facts of *Laval*, as we saw earlier) and the content of the justification defence under that article. In its turn, Article 49 can be read as throwing light on the interpretation of the Directive, as we shall now see.

Article 49, in particular, helps to explain the decision of the Court to give the Directive pre-emptive effect,⁴³ that is to say, an interpretation which rules out Member State legislation setting standards above those provided for in the Directive. On the face of it, the

⁴⁰ See the Opinion of Advocate General Mengozzi, above n 4, paras 135–6. See Dashwood, *op. cit.*, n 22 above.

⁴¹ *Laval*, above n 1, para 61, referring to Case C–60/03, *Wolff and Müller* [2004] ECR I–9553.

⁴² *Laval* Opinion, above n 4, paras 145 and 149.

⁴³ On the analogy between the doctrine of pre-emption in American constitutional law and the interpretation of directives in European Union law, see Deakin, S ‘Two types of regulatory competition: competitive federalism versus reflexive harmonisation. A law and economics perspective on *Centros*’ 2 (1998–1999) *CYELS* 231.

Directive requires Member States to apply certain core labour law rules and, in the case of the building trades, certain collective agreements (in principle those having *erga omnes* effect, that is to say, binding all employers in a given trade and/or geographical region) to the employment of posted workers. A Member State is not obliged, for example, to have laws on minimum rates of pay or to make provision for collective agreements to have an *erga omnes* effect, but if it does, it *must* extend them to postings coming under the scope of the Directive otherwise they cannot be applied to posted workers. The Directive also appears, quite explicitly, to say that a Member State is allowed to go beyond this core obligation: Article 3(7) of the Directive states that the earlier paragraphs of that Article ‘shall not prevent application of terms and conditions which are more favourable to workers’ and recital 17 of the Directive says the same thing. Other recitals make it clear that the Directive fully recognises the principle of territoriality and the right of collective action ‘to defend the interests of trades and professions’.⁴⁴

Despite all this, on several occasions in *Laval* and *Rüffert* the Court states that the Directive merely empowers Member States to act: ‘[A]s regards the matters referred to in Article 3(1), first subparagraph (a) to (g), Directive 96/71 expressly lays down the degree of protection for workers of undertakings established in other Member States who are posted to the territory of the host Member State which the latter State is *entitled* to require those undertakings to observe’⁴⁵ (emphasis added). To say that the Member State is entitled to act is a strange way to refer to the effect of a Directive which is intended to create binding standards. Member States, the Court says, can go this far and no further, notwithstanding Article 3(7) and recital 17. These provisions ‘cannot be interpreted as allowing the host

⁴⁴ The twelfth and twenty-second recitals, respectively.

⁴⁵ *Laval*, above n 1, para 80.

Member State to make the provision of services in its territory conditional upon the observance of terms and conditions of employment which go beyond the mandatory rules for minimum protection’ since this ‘would amount to depriving the directive of its effectiveness’.⁴⁶ In other words, the Directive has the ‘pre-emptive’ effect of ruling out all state action which departs from its provisions.

The Posting of Workers Directive could reasonably have been interpreted, prior to *Laval*, as allowing variation of state practice above the floor of mandatory terms and conditions. That is not just what the Directive, in so many words, clearly indicates; it is an interpretation consistent with the widely accepted understanding of other social policy directives and regulations, which do not seek to set out either uniform laws or even a level playing field, but to establish a floor of rights above which regulatory competition is possible.⁴⁷ Given the clear wording of the Directive and the wider institutional context of social policy in which it is set, how can the Court’s view in *Laval* be explained? What the Court appears to be saying is that action taken by a Member State in compliance with the Directive is permitted in the sense of being justified within Article 49. The Directive spells out what amounts to justification in both a positive and a negative sense—it tells us what is possible, but also what the limits of state action are.

What is the purpose which the Court sees as being frustrated if a Member State goes beyond what the Directive requires? Presumably (although yet again this is not made clear) the Court takes the view, notwithstanding passing references to other objectives,⁴⁸ that the principal purpose of the Directive is to protect the rights of service providers. In *Laval* it

⁴⁶ *Ibid.* See also *Riiffert*, above n 2, para 33.

⁴⁷ Deakin, S and Wilkinson, F ‘Rights versus efficiency? The economic case for transnational labour standards’ (1994) 23 *ILJ* 289.

⁴⁸ See, for example, *Laval*, above n 1, paras 74-77.

referred to the Directive serving ‘the interests of the employers and their personnel’.⁴⁹ The Court’s interpretation of the Directive can be seen as protecting employers in two ways: by ensuring that their labour law obligations beyond the core of protective rights identified in the Directive are minimised; and/or by making more certain and consistent the content of the laws applying to posted workers across the different Member States.

The first of these interpretations implies that the Directive had, as one of its goals, the exemption of foreign service providers from those rules and standards, beyond the core, which apply to home-state employers. It is by no means clear that the Court did not regard this as a legitimate role for the Directive, but if that is the case, its implications for regulatory competition are far-reaching: the Directive is to be read as requiring, in the context of foreign service provision, the labour standards of low-cost home states to be directly translated on to the territory of host states, a form of legally mandated social arbitrage in which labour law regimes are placed in direct competition with each other. It is one thing to allow such arbitrage, another to mandate it.

If the second of these objectives was the Court’s objective, it is aiming at an illusory target: uniformity of laws can never be achieved through the Directive. Diversity will inevitably remain even under *Laval*, since the Directive does not require Member States to adopt laws on each one of the matters listed in Article 3(1), and several of them do not have, for example, statutory minimum wages; nor does it require the level of the substantive standards to be harmonised. The Directive cannot sensibly be said to be aiming at either a single legal regime for posting across the Union, or a level playing field in terms of costs.

⁴⁹ *Laval*, above n 1, para 58.

How can the Court's interpretation be seen as protecting the interests of 'personnel'?'⁵⁰

The immediate effect of its ruling is that posted workers may not benefit any longer from protections beyond the core laid down in the Directive, even if other employees working on the territory of the home state do so.⁵¹ Perhaps the Court thought that it was protecting their interests, in the sense that they would more easily find work if they were exempted from the labour laws of the host state; or perhaps it took the line that they would benefit from there being greater certainty over the terms which applied to their work. A more conventional understanding of the Directive, and one which was widely believed to be correct prior to *Laval*, is that it was intended to confer labour law rights and the benefit of collective agreements on posted workers, not to remove such protections from them on the grounds that this would enhance their employability.⁵²

In favour of the Court's interpretation in *Laval*, the Directive's Treaty base is to be found in the free movement provisions of the Treaty,⁵³ not its social policy provisions. But

⁵⁰ *Laval*, above n 1, para 58; see above.

⁵¹ It may be asked why posted workers do not benefit from the protection of Arts 12 and 39 EC on non-discrimination and equal treatment for workers in the context of free movement, respectively. In this regard, Reich suggests the following rationale: '[T]he workers employed by *Laval* are not seeking access to the Swedish labour market but will be removed once the construction work as contracted is finished. In principle, they remain under Latvian jurisdiction. Therefore, the provisions concerning free movement of workers (article 39) and non-discrimination (article 12 EC) can be disregarded in this context' (above n 7, 133–4). In essence, there is a conflict between the Art 49 rights of the service providers and the Art 39 rights of their workers. Reich's solution is one in which Community law is seen as inherently more protective of the free movement rights of the employers.

⁵² Davies, P 'Posted workers: single market or protection of national labour law systems?' (1997) 43 *CML Rev* 571; Deakin and Morris, above n 35, 116. The Court's pre-*Laval* case law had been concerned not simply with protecting the interests of employers but also in articulating the rights of posted workers to the core of protections the Directive accorded them, as in *Wolff and Müller*, above n 38. The Court had also taken the view that the goal of protecting workers could be pursued concurrently with that of ensuring equality of treatment between domestic and foreign undertaking operating on the territory of the member states concerned (Case C-164/99, *Portugaia Construções* [2002] ECR I-787), and had ruled that, while purely 'economic' objectives such as the protection of domestic businesses could not amount to justifying factors, Member States were entitled to take steps to prevent unfair competition on the part of employers paying workers below the minimum wage (*Wolff and Müller*, above n 38). See also Advocate General Mengozzi's reference to 'the aim of protecting posted workers laid down in Art. 3 of Directive 96/71' at para 187 of his Opinion (above n 4).

⁵³ Art 55 EC (ex-Art 66). According to the Court in *Rüffert*, above n 2, the Directive 'seeks in particular to bring about the freedom to provide services' (para 36).

this in itself need not require a conclusion that the Directive's principal purpose is to protect service providers rather than their workers. It is possible to see the Directive as striking a balance between the interests of employers, posted workers and host-state employees in a way which serves to legitimise the posting of workers and thereby facilitating the cross-border supply of services in a broad sense.⁵⁴ Nor does the Directive's Treaty base justify giving the Directive a pre-emptive effect. Although recent social policy directives have been adopted under the powers put in place for this purpose under the Maastricht and Amsterdam Treaties, earlier directives on equal pay and employment protection were adopted under general powers for the internal market powers, without being interpreted as setting maximum standards.⁵⁵ The Court's interpretation of the Directive is supported not so much by the specific argument concerning its Treaty base but, more generally, by the claim that it is a 'specific interpretation'⁵⁶ of Article 49; on that basis, its interpretation should be informed by Article 49's purpose of protecting freedom of movement. We saw earlier that the Directive was needed in order to bring *Laval* within Article 49 in the first place;⁵⁷ Article 49, in its turn, supplied the context for the Court's pre-emptive reading of the Directive.

Can the existence of provisions in the Directive itself spelling out certain specific circumstances under which a Member State may go beyond the core be read as preventing other more favourable measures? Article 3(8) allows a Member State, where it does not have a mechanism for giving collective agreements universal effect, to extend to posted workers the terms of collective agreements which are 'generally applicable' or which are agreed by the

⁵⁴ Davies, above n 52, 600.

⁵⁵ On this see generally Lord Wedderburn *The Social Charter, European Company and Employment Rights: An Outline Agenda* (London, Institute of Employment Rights, 1990); Deakin, S 'Labour law as market regulation: the economic foundations of European social policy' in Davies, P, Lyon-Caen, A, Sciarra, S and Simitis, S (eds) *Principles and Perspectives on EC Labour Law: Liber Amicorum for Lord Wedderburn* (Oxford, OUP, 1996) 63.

⁵⁶ To refer, again, to Advocate General Mengozzi's formulation (at para 145 of his Opinion, above n 4).

most representative employers associations and trade unions and are applied throughout the national territory. Sweden did not take advantage of this provision for the reason that it does not have a procedure for doing either of these two things; therefore it took the view that to make their application mandatory for posted workers would be to impose an unequal burden on them by comparison to domestic employers.⁵⁸ Article 3(10) allows a Member State to add to the ‘core’ matters not listed in Article 3(1) which fall under the definition of ‘public policy provisions’. According to the Court, however, the insurance payments which Laval would have been required to make if it had signed the building sector collective agreement could not be defended under this provision because that agreement was made by private parties who were not ‘bodies governed by public law’ and so could not, for that reason, cite ‘grounds of public policy’ to bring themselves under Article 3(10). Thus under both Article 3(8) and Article 3(10), the Court gave the Directive both a highly prescriptive and a very narrow interpretation, one which requires a Member State to go down a legislative route and which rules out implementation through collective bargaining even where that approach is consistent with the practice of the State concerned.⁵⁹

In *Rüffert* the Court held that a law (the *Landesvergabegesetz*) which allowed the Land of Lower Saxony to give mandatory effect to a sectoral collective agreement governing public sector employment (but not the private sector) could not be read as a measure implementing the Directive since it ‘[did] not fix a minimum rate of pay according to the procedures laid

⁵⁷ Section II.B, above.

⁵⁸ See *Laval* Opinion, above n 4, para 190. The Court had previously decided that where the law of a Member State allowed a domestic employer to obtain an exemption from a sector-level collective agreement by making a company or plant-level agreement, in circumstances where a foreign service provider did not have such flexibility, there was a breach of Art 49: *Portugaia Construções*, above n 52.

⁵⁹ Here, the Court clearly departed from the approach taken by Advocate General Mengozzi, who had concluded that ‘the right to take collective action granted by Swedish law to trade unions to enable them to impose the wage conditions laid down or governed by Swedish collective agreements provides a suitable means of attaining

down in the first and second indents of the first subparagraph of Article 3(1) and in the second subparagraph of Article 3(8)'. In other words, a law which did not fall precisely within the terms of Article 3, even though it had the aim of protecting both domestic and posted workers and ensuring fair competition between undertakings, could not be regarded as an implementing measure.⁶⁰ The Court then went on to find that the *Landesvergabegesetz* failed under Article 49, since it imposed an additional economic burden 'on service providers established in another Member State where minimum rates of pay are lower'⁶¹ which could not be justified because there was 'no evidence to support the conclusion that the protection resulting from such a rate of pay ... is necessary for a construction worker only when he is employed in the context of a public works contract but not when he is employed in the context of a private contract'.⁶² In *Rüffert*, there were none of the factors which could possibly be seen as persuading the Court to take a strict narrow of the justification defence in *Laval*. There was no strike action and no uncertainty over the rate of pay which employers (foreign or domestic) were being expected to observe. There was, straightforwardly enough, a law which extended a collective agreement with a specific sectoral and regional reach and which went above the lower minimum level of pay set out in the national collective agreement for the construction industry as a whole. The Court deemed this protection to be unjustified on the basis that it went beyond the bare minimum set out in the national agreement. In effect, the Court was saying, protection is 'unnecessary' wherever it goes beyond the *lowest* level provided by law in the host state.

the aim of protecting posted workers laid down in Art. 3 of Directive 96/71' (at para 187 of his Opinion, above n 4).

⁶⁰ *Rüffert*, above n 2, para 30.

⁶¹ *Ibid*, para 37.

⁶² *Ibid*, para 40.

The Court's pre-emptive interpretation of the Directive may have little impact outside posting cases. Most other social policy directives are not affected by the context provided by Article 49 in *Laval*. They have Treaty-bases in the Social Policy Title and they cannot in any sense be said to be interpretations or expressions of Article 49 or any of the other free movement provisions of the Treaty.

It is also possible that the principle of regime portability which emerges from *Laval* only applies in posting cases. In *Laval* the Court interpreted the Posting Directive as allowing the host state to apply the principle of territoriality only up to the point strictly required by that Directive. This was compatible with the Rome Convention since, under that measure (and under the draft Rome I Regulation), the applicable law of the contract of employment of a posted worker will normally be that of the home state. However, as we have seen, in other cases the principle of territoriality applies—the rule set out in the Rome Convention (and retained in the draft Regulation) is that the choice of law made in the employment contract may not deprive the employee of the protection of the mandatory rules of law of the state in which the employee habitually works. How does this fit with the broad notion of 'restriction' in Article 49 (and, by extension, Article 43)? One possibility is that the Rome I Regulation will be read, as the Posting Directive was in *Laval*, as providing a specific answer to the question of what a Member State is allowed to do by way of the justification defence under Articles 43 and 49: it *may* do what the Rome Regulation (when it is adopted) *requires* it to do, and no more. If it goes further, it risks infringing freedom of movement rights.

This may offer a resolution to the issues raised by the hypothetical cases considered at the end of section II, above: in each case, the principle of territoriality would prevail. But this is far from clear. The conflict rules set out in the Rome Convention (and draft Regulation) are

stated to be without prejudice to the application or adoption of rules designed to promote the operation of the internal market,⁶³ and they could in any event be disapplied if they were found to be contravention of a Treaty provision protecting a fundamental right, as is the case with the free movement provisions. It is too early to rule out the wider application, beyond posting cases, of the principle of regime portability.

IV. THE WIDER INSTITUTIONAL CONTEXT: STATE POWERS, FEDERAL CONTROLS, AND SOCIAL POLICY

If *Laval*'s broad reading of the test of 'restriction' in the law on free movement, coupled with its rigid interpretation of the Posting Directive, is followed in future cases, it will turn out to have marked a fundamental shift in the nature of the relationship between Community law and the law of the Member States. Up to this point, there has been an uneasy compromise between federal tendencies and state rights in the labour law field: the principal responsibility for making labour law rules has remained with the states, with only limited harmonization through directives and regulations, and a narrowly framed role for free movement and competition law in ensuring that state initiatives did not obstruct the operation of the internal market. This compromise originated in the preparatory documents for the Treaty of Rome, including the Spaak Report, which rejected arguments for a European-wide labour code as misconceived. Differences in labour regulation across the Member States would not, in and of themselves, give rise to a distortion of the common market, nor should they be regarded

⁶³ See Art. 22(c) of the draft Rome I Regulation in Commission, *Proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I)*, n. 37 above.

without more as partitioning or segmenting the market on national lines.⁶⁴ Variations in nominal wage costs and in social and fiscal charges largely reflected differences in productivity and could be accommodated by national exchange rate fluctuations. A ‘distortion’ only arose in cases where particular industries *within* a given Member State were able to tap into a pool of low-cost labour which was not open to firms based elsewhere. Within-country variations of this sort would not be eliminated by differences in national exchange rates.⁶⁵ Where cheap labour became available to producers by virtue of the absence of regulation in a given Member State, a harmonizing measure might be justified. This was the (rather tenuous) market-related justification given⁶⁶ for the adoption of the principle of equal pay between women and men which became Article 119 of the Rome Treaty (now Article 141 EC).

In the mid-1950s, all of the Member States were committed to the maintenance of strong welfare states and the use of legal means to underpin collective bargaining. Most of them had adopted post-war constitutions which recognized the existence of fundamental social rights on a par with (or at least broadly equivalent to) civil and political rights. Cost levels in the national economies of the original six Member States were also broadly aligned. Under these conditions, it was plausible for the Spaak Report to believe that a leveling-up of wage and social standards would follow from the operation of the common market, without the need for labour law harmonization. Competition between the Member States to attract and retain skilled labour and productive capital would ensure a ‘race to the top’. This position was not greatly altered by the later adoption, from the 1970s onwards, of directives and regulations in the labour law field. These measures only touched on a small part of the range

⁶⁴ Spaak Report, op. cit. n. 1, ch. 2.

⁶⁵ Ibid., 61-63.

of topics covered by labour legislation at state level and the standards they set out were, in any event, expressed as ‘floors’ not ‘ceilings’, so no issue of pre-emption arose.⁶⁷ The Member States were free to engage in regulatory competition above the ‘floor’ and, to the extent that they did so, experimentation was encouraged.⁶⁸ From the mid-1990s onwards most labour law directives were flexible or ‘reflexive’ in form, allowing Member States considerable leeway in adjusting Community law norms to national conditions and opening up a space for implementation through collective bargaining, while the changes made by the Maastricht and Amsterdam Treaties fostered the emergence of transnational social dialogue as a new source of labour law rules.⁶⁹ In these various ways, developments in labour law anticipated the emphasis on experimentalism⁷⁰ and ‘learning through difference’⁷¹ which has more recently been associated with the ‘soft law’ approach of the open method of coordination in its various forms.

Spaak’s specific arguments against harmonization in the labour law field no longer hold; the arrival of the euro has meant the end of exchange rate flexibility for a majority of the Member States, with most of the rest heading in the same direction, while the enlargement of the Union has meant that nominal cost levels are no longer closely aligned across national borders. But Spaak’s wider approach to the question of how Community law should define the contours of the common (now single) market is still defensible. Few now argue for the use of harmonizing measures to put in place a comprehensive European labour code; the

⁶⁶ Ibid, 66.

⁶⁷ See Deakin, ‘Labour law as market regulation’, op. cit., n. 55, above.

⁶⁸ Deakin, S. ‘Regulatory competition and legal diversity: which model for Europe?’ (2006) 12 *European Law Journal* 440.

⁶⁹ See generally Kenner, J. *EU Employment Law: From Rome to Amsterdam and Beyond* (Oxford, Hart Publishing, 2003).

⁷⁰ Cohen, J. and Sabel, C. ‘Directly-deliberative polyarchy’ (1997) 3 *European Law Journal* 313.

⁷¹ Sabel, C. and Zeitlin, J. ‘Learning from difference: the new architecture of experimentalist governance in the European Union’ (2008) 14 *ELJ* 271.

argument for diversity and experimentation has become widely accepted. But Spaak also concluded that there was no compelling case for uniform labour laws on what would now be called single market grounds. *Laval* gives the impression that these debates had never happened. In his Opinion, Advocate General Mengozzi rather grudgingly recommended that Sweden be allowed to retain a system based on collective bargaining rather than direct legislative control for the reason that it was too late to do anything about it: ‘I do not think that, at its present stage of development, Community law can encroach upon that approach to employment relationships through the application of one of the fundamental freedoms of movement provided for in the Treaty’.⁷² Given the way in which it was expressed, it is perhaps not surprising that this less than ringing endorsement of state autonomy failed to convince the Court.

Laval’s approach to pre-emption, if more widely followed, would put an end to regulatory competition ‘above the floor’ and institute a regime of uniform laws in the areas where directives set mandatory standards: Member States would not be allowed to depart at all from the content of the Community law standard. Outside the areas where directive or regulations were already in place, *Laval* would have a strongly deregulatory effect: regime portability, if it extended beyond the posting issue, would allow firms to access low-cost labour law systems even on the territory of other states. This would directly undermine the functioning of labour law rules designed to set in place a floor of rights at national level. As we have seen, regime portability *Laval*-style is not confined to foreign employers; domestic employers can invoke it as well to have national laws disapplied wherever there is a transnational dimension to a dispute, which there will be if, at some (possibly distant) point, a

⁷² *Laval* Opinion, above n 4, para 260.

foreign provider is involved in the chain of production or supply. In any case, thanks to *Centros*⁷³ and related case law, there is considerable leeway for companies to change their seat of incorporation or take other steps to access the company law regimes of other Member States through subsidiaries, thereby gaining a foreign establishment which will enable them to trigger Articles 43 and 49. More generally, the combined effect of widening the basis of judicial review of national-level laws and practices while at the same time limiting the grounds of justification and restricting the margin of appreciation available to Member States in the labour law field would most likely be to undermine the effectiveness with which labour standards, whether originating in law or in collective agreements, can be applied at national level. *Laval* and *Rüffert* have already led to questions being raised about the legality of ‘living wage’ laws which seek to guarantee wages which are consistent with the local cost of living for workers employed on large construction projects, such as those relating to the 2012 Olympic Games in London.⁷⁴ High-cost states will find themselves not simply undercut by lower standards in other countries, but unable even to apply their own legislation on their national territory. For these various reasons, in areas where there is no Community-level labour law standard and Member States possess, in principle, full autonomy of action, *Laval* seems liable to induce, in practice, ‘defensive regulatory competition’, or a ‘race to the bottom’.

Such an outcome had been carefully avoided in previous decisions on the interface between labour law and free movement, largely through the use of the justification defence and the associated proportionality test.⁷⁵ After *Laval*, that option no longer seems an effective way of protecting state autonomy. Too much turns on the application of a proportionality test

⁷³ Case C-212/97, *Centros Ltd v Erhvervs-og Selskabsstyrelsen* [1999] ECR I-1459; n. 24, above.

⁷⁴ Unite Press Release, <http://www.amicustheunion.org/Default.aspx?page=8247> (last checked July 2008).

which invites the courts to engage in ad hoc, subjective judgments on the appropriateness of regulatory action.⁷⁶ This raises the question of whether a more fundamental reappraisal of the scope of free movement law is required.

The central issue here is the meaning of the term ‘restriction’ in Article 49 (and, by extension, Article 43). One plausible line of attack on *Laval* is that the test of restriction which it adopts is over-inclusive. This is particularly so if a restriction is simply taken to be the presence of any regulatory law, whether or not it is equally applicable to home-state and host-state providers; but even if a more narrow definition is used, which refers to differences in regulation between the home and host states, the test is too broad. As we have seen, the law of the internal market, from its very early beginnings in the Spaak Report, took the view that uniform laws were not needed for a transnational market to function. The Court has accepted this point in other areas of internal market law.⁷⁷ In *Weigel*⁷⁸ it held that Article 39 could not be invoked to strike down a fuel consumption tax chargeable at the point when a vehicle was first registered in a Member State. It was claimed that the tax amounted to a restriction on freedom of movement, and the Court held that it was indeed ‘likely to have a negative bearing on the decision of migrant workers to exercise their right to freedom of movement’;⁷⁹ however it went on to hold that such a ‘disadvantage, by comparison with the situation in which the worker pursued his activities prior to the transfer, is not contrary to Art. 39 EC if that legislation does not place that worker at a disadvantage as compared with those

⁷⁵ See the judgments in the posting cases referred to above, n. 52.

⁷⁶ See further Barnard, C. ‘*Viking and Laval: an introduction*’, forthcoming, *Cambridge Yearbook of European Legal Studies* (2008).

⁷⁷ Most importantly, in the context of free movement of goods, in Joined Cases C-267 and 268/91 *Keck and Mithouard* [1993] ECR-I 1697.

⁷⁸ Case C-387/01 *Weigel v. Finanzlandesdirektion für Vorarlberg* [2004] ECR-I 4981; see also Case C-365/02 *Lindfors* [2004] ECR I-7183.

⁷⁹ *Ibid*, para. 54.

who were already subject to it'.⁸⁰ In *Graf*⁸¹ the Court rejected a claim that Article 39 entitled a worker migrating from one Member State to another to receive severance pay which he would have received at the end of his employment had he not voluntarily left to take up employment in the other Member State, Advocate General Fennelly commenting that 'the migrant worker must take the national employment market as he finds it'.⁸²

Thus there is no basis in Community law for a principle of regime portability in favour of workers – in other words, a worker moving from a more to a less regulative member state cannot insist on taking the protection of the labour law of the state of origin with them. This is precisely the converse of *Laval*, where an employer moving from a less regulative state to a more regulative one *was* entitled to the protection (from its point of view) of the (weak) labour law of the country of origin. It is not at all surprising that the claims in *Weigel* and *Graf* were rejected; the Court's decisions in these cases were consistent with the philosophy which has informed internal market law since the Spaak report. What is surprising, in the context of such decisions, is that *Laval* was decided the way it was. Narrowing the definition of 'restriction', as in *Graf*, would provide one possible escape route for the Court in future should the full consequences of *Laval* turn out to be hard to swallow.⁸³

Another route for the Court is to develop a more nuanced account of the circumstances under which regulatory diversity poses an obstacle to market integration. This is a more difficult step to take as it requires the Court to articulate a theory of how regulatory competition works and under what circumstances Community-law intervention is necessary in

⁸⁰ *Ibid.*, para. 55.

⁸¹ Case C-190/98 *Volker Graf v. Filzmoser Maschinenbau GmbH* [2000] ECR-I 493.

⁸² *Graf*, Opinion, para. 32.

⁸³ *Graf* also points to the possible relevance of a shift in the prevailing 'market access' test in free movement cases, from one which accepts a material barrier to exit or access as sufficient to trigger Community law, to one which requires a *formal* barrier to access or one which is equivalent to it: Barnard, C. and Deakin, S. 'Market

order to avoid a destructive breakdown of cooperation between the Member States. Clearly, one instance in which intervention is needed is where there is discrimination, against goods, services, persons and so on, on the grounds of nationality, but it is not the only one. Market partitioning is another case and a third could be the idea of ‘cost externalization’, or measures taken by one Member State which have the effect of displacing costs on to another and which thereby give rise to the risk of retaliatory action. These are concepts familiar from American case-law and doctrinal writing on the interpretation of the dormant Commerce Clause⁸⁴ (the equivalent, in this context to free movement rules) but they have so far made little impact on the discussion in Community law.⁸⁵

Doctrinal flexibility can also be achieved on the question of the interpretation of directives. In its rigid analysis of the Posting Directive, *Laval* is reminiscent of late-nineteenth and early twentieth-century pre-emption decisions of the United State Supreme Court, which ruled that state autonomy was displaced across large areas of regulatory activity by the presence of federal laws even in cases where there was no clear conflict between them.⁸⁶ From the 1930s onwards, the Supreme Court shifted its position as part of the wider realignment of constitutional law which took place as a result of the acceptance of the legality of the regulatory legislation of the New Deal. It took the view that the issue of pre-emption was essentially one of Congressional intent, and that federal statutes should be carefully construed in the context of a presumption against pre-emption.⁸⁷ Had this approach been

access and regulatory competition’, in Barnard, C. and Scott, J. (eds.) *The Law of the Single Market: Unpacking the Premises* (Oxford, Hart Publishing, 2002).

⁸⁴ See Epstein, R. and Greve, M. ‘Conclusion: Preemption doctrine and its limits’, in Epstein, R. and Greve, M. (eds.) *Federal Preemption. States’ Powers, National Interests* (Washington DC, AEI Press, 2008), 318-323.

⁸⁵ A rare discussion is that of Poiares Maduro AG in his Opinion in *Viking*, at para. 63 et seq., discussing partitioning alongside discrimination, although the issue of cost externalization is not addressed.

⁸⁶ S. Gardbaum, ‘The breadth vs. the depth of Congress’s Commerce Power: the curious history of preemption during the Lochner era’, in Epstein, R. and Greve, M. (eds.) *Federal Preemption*, op. cit. n. 84.

⁸⁷ *Rice v. Santa Fe Elevator*, 331 US 218, 230 (Douglas J).

taken in *Laval* it is likely that a different result would have been reached, given the clear expression, at several points in that Directive, of an anti- pre-emptive intent.⁸⁸ This is an issue which will recur if other social policy directives come to be interpreted against the backdrop of the Court's free movement jurisprudence.

V. CONCLUSION

This paper has considered the implications of *Laval* for regulatory competition in the European Union. Prior to *Laval*, the Member States could engage regulatory competition in the labour law field above a floor of rights set by Community law mainly via directives. *Laval* gives the Posting of Workers Directive a 'pre-emptive' effect, reading it, contrary to its own clearly expressed intent, as if it were a ceiling not a floor. The justification for doing this is that the Directive gives expression to Article 49 EC, and, therefore, protects above all the interests of service providers, rather than those of workers, either their own employees or those employed elsewhere. Article 49, in turn, was given an exceptionally broad scope in *Laval*, as applying to all cases of restriction on freedom of movement which stem from laws which, on what is perhaps the most plausible interpretation, give rise to differences in regulatory standards across Member States. *Laval* therefore points towards a principle of regime portability, which would enable service providers and other employers to access the least regulative regime of the Member States with which they had a connection. In effect, this is a country of origin principle discovered not within the Service Directive but in the core of

⁸⁸ See above, section III. By analogy, the US Fair Labor Standards Act 1938, a federal measure, explicitly indicates that the states may set higher minimum wages and stricter limits to working hours than those set out in the Act. In some states, legislature have sought to pre-empt 'living wage laws' set at local level through state-level legislation which aims to set a ceiling as opposed to a floor. Pre-emption has become an enormously complex and controversial issue in this and other contexts in the USA, giving rise to a 'prominent and often

Article 49 itself. It is not clear how far this logic extends beyond posting cases or how far regime portability, in the sense just described, is compatible with the rules of the Rome Convention (soon to be the Rome I Regulation) on the applicable law of contracts of employment. However, it is clear from *Laval* that the courts now have a greatly extended power to review state-level regulations (and, by extension, collective agreements and other private arrangements with regulatory effect) and to subject them to a strict justification test. *Laval* displaces a framework of rules which had a clear upward bias in favour of regulation, in the sense that member states could go above the floor set by a directive but not below it and were otherwise more or less free to adopt whatever labour law they liked, with one which has a clearly deregulatory tendency.

Laval is not simply inconsistent with the recent move towards the encouragement of experimentalist approaches to governance in the European Union, through such techniques as ‘reflexive harmonisation’ and the open method of coordination; in its over-inclusive definition of what amounts to a ‘restriction’ on or ‘distortion’ of the internal market it ignores carefully drawn distinctions which go back to the Spaak Report itself. European law urgently needs to develop a more nuanced theory of regulatory competition, one which is capable of identifying more precisely the grounds (which could include not just discrimination but also partitioning and cost-externalisation) on which courts can review national laws and practices on the grounds of their incompatibility with the operation of the internal market.

polemical debate’: Epstein, R. and Greve, M., ‘Introduction: preemption in context’, in Epstein, R. and Greve, M. (eds). *Federal Preemption*, op. cit. n. 84, at 1.