THE COSTS OF COMMUNITY ENFORCEMENT OF WTO LAW*

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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 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 European Court of Justice (ECJ).[1] 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' rulings.' By this notion we mean the possibility for private parties to use these acts as parameter of the legality of a Community measure that the DSB has declared in breach of WTO law or to declare the Community liable, under art. 288 par. 2 of the TCE, for the damages arising out of the Institutions' failure to respect the decisions of the WTO Tribunals.

The Court's approach, refusing to act as enforcer of DSB's decisions, has been criticized. Three arguments have been made in support of Community enforcement of DSB rulings. The first is that enabling private parties to use the DSB's decisions before the European Courts favours compliance with WTO law and hence it should be encouraged. 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. The third is an *a contrario* argument: the rulings of the WTO Tribunals should be made enforceable before

[1] 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 consider domestic and Community enforcement of WTO law as two separate issues. 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.

the CFI and the ECJ, since the cost of non-compliance with these decisions are particularly high for the Community.[2]

The contention of this article is that the Community enforcement of DSB's decisions bears costs that outweigh the benefits. In the first part of this study we examine the case-law of the ECJ to show that the enforcement of those acts is not in the Community's interest; in the second part, we argue that the alleged beneficial effects on WTO compliance are merely apparent. Central in our study is the FIAMM and Fedon[3] case. Here, the ECJ appears to have consolidated an approach that facially precludes any possibility of directly resorting to WTO law, when it dismissed an appeal lodged by two Italian companies, claiming compensation for damages suffered because of the retaliatory measures ('suspension of concessions') imposed by the US.[4] The damages allegedly suffered by specific companies and the related jurisprudence of the Luxemburg Courts have made more visible the fact that international law may have serious and tangible consequences for private parties. This turns the seemingly highly theoretical question of the WTO law status in the Community legal order into a politically sensitive issue, calling for more scrutiny on the potential consequences of different scenarios. Is it desirable to grant unilateral direct effect to WTO law and to DSB rulings? Should collateral victims of trade wars, such as FIAMM and Fedon, be compensated? What are the costs and benefits of different rules in this area? And lastly, is it beneficial to enhance WTO compliance by introducing a form of Community enforcement?

This Article originally contributes to the existing scholarship on this subject in two ways: firstly, beyond a legal analysis of the reasons excluding the desirability of Community enforcement of DSB's rulings, it develops a theoretical framework, drawing from Law and Economics, to analyze this question. It is worth noting that while the economic analysis of law has been long employed to shed light on the functioning of many areas of law, the field of international law remains highly understudied. This research is the first

[2] COTTIER, 'Dispute settlement in the World Trade organization: characteristics and structural implications for the European Union,' *CMLRev*., 1998, p. 365.

[3] Fabbrica italiana accumulatori motocarri Montecchio SpA and Fabbrica italiana accumulatori motocarri Montecchio Technologies LLC (together referred to as 'FIAMM') and Giorgio Fedon & Figli SpA and Fedon America, Inc. (together referred to as 'Fedon').

[4] Joined Cases C-120/06 P and C-121/06 P *FIAMM and Giorgio Fedon & Figli v Council and Commissio*n, nyr.

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. Secondly, taking both perspectives, this article offers comments to the recently decided *FIAMM* and Fedon appeal, with special emphasis on a new point of law raised by the appellants: this is the principle of the 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 in ten sections. In sections 2, we chart the current status of WTO law in the EC legal order. A concise overview is given of the case-law, denying direct effect to the provisions of this Treaty, both for the purpose of reviewing the legality of a Community measure and for establishing the Community's non-contractual liability, under art. 288, par. 2 of the TCE. Section 3 summarizes the AG's conclusions and the Court's position in the appeal against the CFI's ruling in FIAMM and Fedon. Section n. 4 offers an in-depth analysis of the judicature's position, siding overall with the ECJ for excluding that DSB decisions may be invoked for the purpose of an action in damages, irrespective of the lawfulness or unlawfulness of the EU Institutions' behavior. In this section the reasons that in our opinion justify the ECJ's refusal to let private parties become enforcer of DSB's rulings will be spelled out, without sparing criticism to certain aspects of the ECJ's ruling. The consequences of this judgment will also be illustrated.

In section 5, 6 and 7, drawing from 'Law and Economics', we articulate different theoretical frameworks, within which to assess the desirability of enforcement of WTO law by European Courts. Section 8 offers an economic analysis of non-contractual liability for lawful acts, an issue central to the *FIAMM* case. In section 10, we consider the shortcomings in terms of equity of the Court's ruling and we highlight possible alternative avenues to address the inconveniences caused by private parties' impossibility to enforce DSB's decisions before the ECJ. Section 10 will draw the overall conclusions of our study.

2. The status of WTO law in the Community legal order: an overview of the case-law

2.1 The lack of direct effect

Although article 300 par. 7 of the TEC states that both the EC institutions and Member States are bound by an agreement concluded under this provision, this does not mean that such an act can be invoked before the Community courts to have rights and obligations arising from it, enforced at EC level.[5] 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,[6] and also on whether its provisions contained a clear and precise obligation. Although recent cases, such as *Pokrzeptowicz*[7] and *Simutenkov*,[8] could be read as meaning that the ECJ has started to neglect the first limb of the direct effect test, by confining itself to examine the substantive provisions of the concerned agreement,[9] the *Intertanko*[10] case bears witness of the vitality of both criteria.[11]

The application of the 'direct effect' test to the GATT[12] first, and then, to the WTO agreements,[13] has led the ECJ to consistently deny that the *Member States* can rely on the

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5 *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).

6 Case 104/81, *Kupferberg*, [1982] ECR 3641, par. 20-22.

7 Case C-162/00, *Land Nordrhein-Westfalen v Beata Pokrzeptowicz-Meyer*, ECR [2002] p. I-01049.

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

9 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

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

11 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 its nature and the broad logic of UNCLOS that 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.

12 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.

13 See decision n. 94/800/CE, in GUCE [1994], L 336/1.

latter to contest the legality of an EC measure conflicting with the WTO rules.[14] The Court has also rejected *private parties*' requests to use the latter as the standard of review of the EC legislation.[15]

In principle, art. 230, 234 and 241 of the TEC do not require the direct effect of the legal parameter against which the legality of an EC measure is appreciated.[16] However, the Community judicature has convincingly set out special exceptions for international agreements and in particular for those founding the WTO.

The rationale for denying direct effect to the provisions of this Treaty was identified in *Portugal v. Council.*[17] First of all, they leave the Parties free to negotiate the settling of disputes.[18] 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 any party, having invoked the WTO dispute settlement procedures,[19] with a view to finding a mutually acceptable compensation.[20] Indeed, even if the DSB declared the EC legislation in breach

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14 Case C-149/96 *Portugal v Council*, [1999] ECR I-8395.

15 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," in *CMLRev.,* 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. 9, p. 32. Along these lines see CREMONA, 'Competence, mixed agreements, international responsibility, and effects of international law,' *EUI Working paper,* 2006/22, p. 30. This trend contrasts with the case law related to the GATT and WTO agreements. However, the latter are not any longer isolated example. The case law denying direct effect to international agreements has been extended to the UNCLOS. Case C-308/06, cit.

16 For a criticism of the case-law requiring that WTO has direct effect in order to form the yardstick against which the EC secondary legislation is reviewed see HACHEZ, Case C-308/06, International association of the independent tanker owners and the others: the requirement of direct effect in the judicial review of EU law against international law, *Columbia Journal of European Law*, 2008, 143.

17 C-149/96, cit.

18 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 can be interpreted as leaving them an unfettered discretion.

19 This is regulated by the Understanding on Rules and Procedure Governing the Settlement of Disputes (DSU).

20 Art. 22, par. 2 of the DSU provides that if a WTO member fails to fulfil its obligation to implement the DSB's recommendations and rulings, settling a dispute, within a reasonable period of time, it is, if so requested, and on the expiry of a reasonable period at the latest, to enter into negotiations with any party having invoked the dispute settlement procedures, with a view to finding mutually acceptable compensation. See par. 40 of C-149/96, cit. The preservation of the political margin of manovre for the

of WTO law, the Community may still not follow the recommendations of this body.[21] In this case[22] the DSU makes possible for the successful complainant to ask for compensation or the suspension of concessions.[23]

The second reason supporting the denial of direct effect is related to the principle of reciprocity. The Court considered that the EC major trading partners (the United States and Japan) did not provide for direct effect of the WTO provisions in their domestic legal orders.[24] The assumption was that the lack of reciprocity, in an agreement which is based on the principle of "reciprocal and mutual advantageous arrangements[25]"—as opposed to those that were based on "asymmetric obligations of the Parties"[26] — would have been detrimental for the Community interests.[27] 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.[28] Here, the Court ties up the reciprocity argument with that on the 'margin of manoeuvre.' However, this does not mean that the former is less important than the latter.[29] It is submitted that the Court

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negotiating of a solution to a WTO dispute has often been considered the most important argument for refusing direct effect to WTO law.

21 Art. 19 par. 1 of the DSU. On the legal effects of the DSB's recommendations see section n. £.

22 The non-compliance with DSB's decisions is not encouraged by the DSU which considers preferable that a loosing Party bring its legislation in conformity with the recommendations issued by the DSB. Art. 22, par. 1 of the DSU.

23 Art. 22 , par. 2, cit.

24 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.

25 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. 12, p. 259.

26 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.

27 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).

28 Par. 45-46.

29 The importance of the 'reciprocity argument' has been downgraded on several occasions by different Advocate generals. AG Alber argues that 'reciprocity is really a commercial policy issue, decked

attaches equal weight to the two justifications. Indeed, in the post *Portugal v. Council*, the Community judge has consistently used the reciprocity argument as a ground to deny direct effect in all cases in which this legal issue was raised.[30] However, it should be noted that the weight attached to the principle of reciprocity to deny the direct effect of GATT/WTO law is unique in the context of the ECJ case-law since in no other agreement it has represented an obstacle to the direct effect.[31] A partial justification of the special treatment reserved to the WTO Treaty is that this is like no other agreement.

The case-law on WTO just sketched, justified by some[32] and criticised by others,[33] was

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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.' 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. On the importance of the principle of reciprocity to justify the denial of direct effect to WTO law see DE ANGELIS, *The effects of WTO law and rulings on the EC domestic legal order: a critical review of the most recent developments of the ECJ case law (Part 1)*, in *International trade law & regulation*, 2009, p. 92. *Contra* see 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.

[30] Alemanno notes that the reciprocity argument was not invoked by the ECJ in *Biret*, cit. It is submitted that this is due to the fact that in the case at hand the ECJ did not touch upon the issue of direct effect altogether and it concentrates on the legal effects of the DSB's recommendations, as if these concepts were separate. See ALEMANNO, 'Judicial enforcement of the WTO hormones ruling within the European Community: toward EC liability for the non-implementation of the WTO dispute settlement decisions?,' *Harvard Int'l. Law J.*, 2004, p. 559.

[31] In *Kupferberg*, above n. 6, the Court held that '[…] The fact that the courts of one of the parties consider that certain of the stipulations in the agreement are of direct application whereas the courts of the other party do not recognize such direct application is not in itself such as to constitute a lack of reciprocity in the implementation of the agreement.' Par. 18. For a criticism of the Court's interpretation of the principle of reciprocity see MARESCEAU, above n. 12. p. 294.

[32] Amongst others see MARESCEAU, above n. 12, 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.

[33] 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 WTO for more than 25 years. See 'Application of GATT by the Court of Justice of the European Communities,' *CMLRev*., 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. Other commentators are: HAHN, SCHUSTER, Les droits des Etats membres de se prévaloir en justice d'un accord liant la Communauté, *RGDIP*, 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. See also LAVRANOS who argues that the consequences of the case-law on WTO essentially revolve around fundamental aspects of (Community) law, namely, access to justice, the possibility of judicial review of Community acts, pacta sunt servanda and ultimately about the rule of law. LAVRANOS, 'The Chiquita and Van Parys judgments: an exception to the rule of law,' in Legal Issues of Economic integration, 2005, p. 456.

shaped not only in annulment actions and preliminary ruling procedures[34] but also in actions for non-contractual liability against the Community,[35] under art. 288, par. 2 of the TEC.[36] Indeed, companies suffering financial damages, as a result of the infringement of GATT/WTO by the EC institutions, asked the Court to condemn the Community to pay for the damages. However, they have never succeeded in fulfilling the very strict conditions of this action. Curiously, the grounds for rejecting the Community 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 it could not be invoked for the purpose of an action in damages.[37] In a recent case, the Court has rejected a request under art. 288, par. 2 of the TEC, on the ground that WTO lacked direct effect 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.[38]

With respect to the action in damages, it should be noted that legal commentators have argued that it should not be subject to the proof that WTO law has direct effect;[39] it has also been claimed that in *Biret* the ECJ left this issue open.[40] However, as it has been

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[34] See in particular preliminary rulings concerning the TRIP 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.

[35] Case T-18/99, Cordis, cit., Case T-30/99, Bocchi Food Trade, cit., Case T-52/99, T-Port, cit.

[36] 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).

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

[38] See the CFI's ruling in *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. Counciland Commission*, in [2005] ECR II 5393. This ruling was appealed by FIAMM and Fedon. See above n. **Error! Bookmark not defined.**.

[39] WIERS, 'One Day, You're Gonna Pay: The European Court of Justice in Biret', *LIEI*, 2004, p. 148. The reason for de-linking the action in damages from direct effect is to provide for 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. As we will see in the next paragraphs the authors do not share this view. £

[40] DI GIANNI, ANTONINI, "DSB decisions and direct effect of WTO law: should the EC courts be more flexile when the flexibility of the WTO system has come to an end?", *Journal of World Trade*, 2006, p. 784.

noted, this is not the most important obstacle preventing the success of such an action: it would be difficult to prove that WTO confers rights to individuals. This difficulty remains even if it can be showed that the EU institutions have committed a breach, by failing to adopt any measure to comply with a DSB's decision, finding an EC measure inconsistent with WTO law, upon the expiry of the reasonable time limit, given to the defaulting party to comply with this act.[41]

2.2 The difficult position of private parties

A distinctive feature of the case-law on WTO "post *Portugal v. Council*" concerns the quality of the applicants. Whereas privileged applicants, such as the Member States, quite early resigned to the ECJ's position refusing to review the EC legislation in the light of this agreement,[42] private parties did not. This is not surprising since they directly suffer the consequences of the misapplication of WTO law. Sometimes the preservation of EC legislation infringing WTO law provoked indirect damages to companies selling goods which had nothing to do with those that were the object of disputes between the EC and its trading partners. This was the case of FIAMM and Fedon.[43]

Having good financial reasons to challenge the EC measures before the Court, private parties attempted to circumvent the straitjacket of the case-law on the lack of direct effect of WTO law on the basis of a two edged-strategy: on the one hand, in order to have a Community measure annulled or to claim for damages caused by such a measure, they placed emphasis on the fact that the Community contested legislation had been declared unlawful by a DSB's decision.[44] However, both the CFI and the ECJ have never

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41 GATTINARA, above n. 15, p. 158.

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

43 See infra £.

44 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 *Fruchthandelsgesellschaft 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 recommendations within the prescribed time-limit.

considered this factor decisive[45]. On the other, as the *Chiquita*[46] case shows, they tried to induce the Court to be more generous in applying the exceptions made by the Court to the lack of direct effect.[47] As we see in the next paragraph, this attempt fell on the CFI and the ECJ's deaf ears. The former in *Chiquita* and the latter in *Van Parys*[48] refused to relax the conditions under WTO law was taken into consideration in reviewing EC law.

2.3. The parsimonious application of the exceptions

Before the WTO was created, the ECJ had devised exceptions to the impossibility to use GATT as a yardstick for the lawfulness of the EC measures. These were laid down by the Nakajima/Fediol cases.[49] As we learn from case C-149/96, they are also available in relation to the WTO law. On the basis of these exceptions, "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 Court can review the legality of the conduct of the defendant institutions in the light of the WTO rules.[50] The possibility of relying on WTO law in the Nakajima/Fediol circumstances can be explained in the following manner: the EU institutions, by incorporating WTO law or referring to it, signal their intention to apply it.[51] Consequently, the Court could abandon its attitude of judicial restraint in applying WTO law.

Whereas the Fediol exception has been applied in connection with the agreement of Technical Barrier to Trade and is very much limited in its scope, the Nakajima exception was successfully invoked in a few cases dealing with the EC legislation on anti-

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45 See section n. £

46 T-19/01, *Chiquita c. Commission*, cit.

47 See section n. 2.3.

48 C-377/02, *Léon Van Parys NV*. cit.

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

50 C-149/96, cit, par. 49.

51 For a more comprehensive examination of other theoretical justifications see EECKHOUT, *External relations of the European Union – Legal and constitutional foundations,* Oxford, p. 319-320.

dumping.[52] In principle, this is not the only area in which this exception may find application.[53]

However, so far the Community judicature has been very parsimonious in applying the Nakajima/Fediol exceptions,[54] rejecting the applicants' actions invoking them in the context of the common agricultural policy[55] and in the framework of different judicial remedies.[56] The *Ikea* case,[57] decided recently, can be interpreted as a further narrowing down of the scope of this exception.[58]

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52 Case C-76/00 P *Petrotub and Republica v Council*, [2003] ECR I-79 and Case T-256/97 *BEUC v Commission*, [2000] ECR II-101. 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 agreements (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.

53 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.

54 The CFI has, by its motion, excluded the application of the implementation exceptions in Bocchi, cit. Cordis, cit. and T-Port, cit. The CFI held that neither the reports of the WTO Panel of 22 May 1997 which was adopted by the DSB on 25 September 1997 included any special obligations which the Commission intended to implement, within the meaning of Nakajima, 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 body. Therefore, this was considered an ideal situation for the application of the implementation exception. PEERS, "WTO dispute settlement and Community law"*, ELR,* 2001, p. 610-612 and EECKHOUT, *External relations of the European Union – Legal and constitutional foundations,* Oxford, p. 321-322. The case in which the scope of the Nakajima exception has been most extensively discussed at the request of the applicant is Case T-19/01 cit.

55 The banana and hormones in beef WTO disputes, which are at the roots of many private parties' actions, concern agriculture.

56 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 *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, (action in damages).

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

58 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*, CLMRev, 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.

2.4 On the specific legal effects of the decisions of the Dispute Settlement Body (DSB) within the EC legal order: on overview of case-law before the ECJ's ruling in the FIAMM and Fedon case

2.4.1 The DSB' s recommendations in the DSU and the legal nature of DSB

Under the DSU, the DSB may approve the reports of the Panel or the Appellate Body adjudicating a dispute arisen between its WTO members.[59] These bodies identify possible breaches of WTO provisions in their reports; however, the DSU imposes that by so doing, they cannot 'add to or diminish the rights and the obligations of the WTO members.'[60] The DSB's recommendations, issued on the basis of the adopted reports, are binding on the parties,[61] which must accept them 'unconditionally.'[62] They do apply prospectively. 'Prompt' compliance with DSB decisions is deemed to be 'essential' in order to ensure effective resolution of disputes.[63] Compliance with them may be delayed until a reasonable period of time[64] expires. Full implementation of the recommendations is the favoured option under DSU.[65] However, the latter also envisages the possibility that the Parties fail to bring 'the measure found to be inconsistent with a covered agreement into compliance therewith or otherwise comply with the recommendations and rulings'[66] within the prescribed time limit. It is not clear how these determinations will be made.[67] By contrast, it is certain that the Parties enjoy maximum autonomy in ensuring conformity to WTO law obligations[68] and also that the Parties may agree on 'alternative remedies,' with the view to reach a 'mutually acceptable compensation.' This may consist

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59 Art. 16, par. 4 and 17, par. 14 of the DSU.

60 Art. 3.2 and art. 19.2.

61 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.

62 Article 17, par. 14.

63 Art. 21, par. 1.

64 Art. 21, par. 3.

65 Art. 19, par. 1.

66 Art. 22, par. 2.

67 PALMETER, MAVRODIS, Dispute settlement in the World Trade Organization, 2004, Cambridge University Press, p. 279.

68 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.

in a compensation or in the suspension of concessions.[69] 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.[70] This 'last available option,' is not very often resorted to[71] but reliance on it is on the increase.[72] 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 is debated.[73] A further unsettled issue is whether the DSU allows the Parties of a dispute to exceptionally depart from the DSB's recommendations or whether such a possibility is only available for a limited period of time, in order to enable the defaulting Member State to make the necessary internal adjustments to give full implementation to the DSB's decisions.[74] We are convinced that, although under the DSU neither compensation, nor the suspension of concessions is preferable to full implementation,[75] the first solution is to be favoured.[76]

Commentators are also divided as to the legal nature of the DSB (whether it is a judicial body or an organ of political nature) and on the effects of its decisions within the EC legal order.[77] The qualification of the DSB is also crucial within the EC legal system.

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69 Art. 22 par. 1.

70 Art. 22, par. 2.

71 Retaliation was requested and authorised in only six out of over one hundred cases. PETERSMANN, above n. 37, p. 13

72 On 14th January 2009, the USA decided to impose sanctions on European products on the basis of the so-called carousel legislation of 2000. 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).

73 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 favoring 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,' 37 *JWT*, 2003, 139.

74 See Griller, above n. 29, p. 453.

75 Art. 22, par. 1.

76 See infra section n. £.

77 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?,' AJIL, 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,' *JWT*, 2000, p. 102-103; COTTIER, 'Dispute settlement in the World Trade organization: characteristics and structural implications for the European Union,' *CMLRev*., 1998, p. 340). *Contra* see BELLO, The WTO dispute settlement understanding: less is more, *AJIL*, 1996, p. 416.

Should this body be considered as a "court", then, the ECJ's opinion n. 1/91 on the European Economic Agreement (EEA)[78] would apply and the DSB's decisions should be considered legally binding for the Court. However, this equation is highly problematic: the DSB is a quasi-judicial organ but not a tribunal in the sense of the EEA Court. As to the second problem, regardless of the nature of this body, the Community judicature seems unwilling to consider the DSB's decisions as binding.[79] The CFI clearly took this position in *Chiquita*;[80] Advocate general Lèger followed the CFI in *Ikea.* The justification put forward by the latter to deny that a report of the DSB can bind the Courts is to preserve the autonomy of the Community legal order. [81] The ECJ has not yet taken a clear stance on this issue.[82] It may be observed that the Court of Justice follows the DSB's recommendations when the interpretation of the EC legislation in the light of these acts is possible under EC law, under the principle of 'consistent interpretation.' The present state of affairs, which is inspired by pragmatism, may be considered satisfactory and hence there may be no need to formalize the relations between the two Courts.

2.4.2. 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 the DSB's recommendations, holding the EC legislation incompatible with WTO law, are capable of being directly invoked by applicants seeking to challenge the EC's disregard of WTO law. In particular, the purpose of such action is to review the legality of an EC measure

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[78] Opinion n. 1/91, [1991] ECR I-6102, par. 39. In this opinion the Court considered itself bound by the rulings of the court set up by the EEA.

[79] 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*, cit., p. 248. *Contra*, MCNELIS, *What obligations ere created by World Trade Organization dispute settlement Reports?, JWR,* 2003, p. 670; KUIJPER, BRONKERS, "WTO law in the European Court of Justice", *CMLRev*., 2005, p. 1328.

[80] Cit, par. 162.

[81] Cit., par. 79.

[82] 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, cit., par. 129).

declared unlawful by the DSB or to establish the non-contractual liability of the Community for failure to bring the EC legislation in 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 or not. Some commentators, including Jackson,[83] do not consider the two issues as separate.[84] Others take the opposite view and have reckoned that this distinction was possible and have contended that when a violation of WTO law is established by a DSB's decision, the binding character of the agreement and the principle of legality should trump any lack of direct effect.[85] On the same line, another author has advocated that DSB's recommendations should have direct effect since the implementation of DSB's recommendations affects the individuals, although they are addressed to WTO members.[86] A third scholar has emphasised that the direct effect of DSB's rulings is unlikely; however, he considers that the provision of the WTO Treaty, whose violation has been identified by a DSB's ruling, may, instead, be directly invoked.[87]

Eeckhout's position introduces a temporal distinction that deserves a 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 also argues that applicants should be able to rely on DSB's decisions in an action for damages, if they prove that the condition of the 'sufficiently serious breach' is fulfilled.[88] However, it has been noted that the first limb of Eeckhout's proposal could not lead to the annulment of Community past measures (adopted *prior* to the DSB's ruling). Therefore, it would be of no use to rely on

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[83] 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.

[84] See for example ANTONIADIS, *The Chiquita and Van Parys judgments: rules, exceptions and the law*, in *Legal Issues of Economic integration*, 2005, p. £.

[85] EECKHOUT, 'The domestic legal status of the WTO Agreement: interconnecting legal Systems,' *CML Rev.*, 1997, p. 53. Cottier also supports this position. See above n. 68., p. 371. See also ZONNEKEYN, above n. 68, p. 93

[86] THIES, above n. 88., p. 1162.

[87] GATTINARA, *La responsabilità extracontrattuale della Comunità europea per violazione delle norme OMC*, in *Diritto dell'Unione europea,* 2005, p. 143, 145. This solution has been suggested by AG Alber in Biret, above n. 29, paras. 94-96 and is also supported by Tizzano, in Van Parys, above n. 29, par. 73.

[88] 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. 98.

DSB's rulings in these circumstances. Certainly, the fact that DSB's decisions apply *ex nunc* would not represent an obstacle for an action for damages.[89] Leaving aside that it is very difficult to fulfil the strict conditions of a liability action, especially when the supposed breach concerns a DSB's ruling,[90] we wonder whether it be appropriate to make possible for private parties to rely on these acts for the purpose of an action in damages. Comments on this issue will be made in the context of the analysis of the ECJ ruling in FIAMM, which addresses this problem.

At this juncture, it is appropriate to provide a short account of the Community judicature's position on the decisions of the DSB. Notoriously, Advocate generals Alber in Biret[91] and Tizzano in *Van Parys*[92] 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 *Comafrica*.[93] However, in more recent cases, the CFI's attitude was more ambiguous. For example, in *Biret*[94] that 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.[95] In *Fiamm and others*[96] the CFI did not straightforwardly address the direct effect of DSB's recommendations; rather, it excluded the application of the Nakajima/Fediol exception. Turning to the ECJ, the latter had had the chance of addressing this issue in

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89 Ibidem, p. 99.

90 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 invokability of WTO law in the EC: a wave of mutilation,' EFAR, 2006, p. 75.

91 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. **Error! Bookmark not defined.**, par. 91. For a criticism of AG Alber's reasoning and for 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,' *JWT,* 2005, p. 49-59.

92 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. n. **Error! Bookmark not defined.**, paras 76-78.

93 T-225/99 *Comafrica 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 could be taken to imply that the Court considered these rulings as lacking direct effect.

94 T-174/00, *Biret International v. Council*, cit., par. 61.

95 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.

96 T-69/00, cit.

Atlanta where it had linked up direct effect of DSB's decisions to that of general WTO provisions, thus implicitly excluding it[97]. However, in *Biret* the Court seemed to have taken the opposite view;[98] eventually, the possibility of relying on DSB's decisions was denied in *Van Parys*[99] and even more explicitly in *FIAMM and Fedon.*[100]

The latter is the most recent case on the effects of WTO law within the EC legal order and it is interesting under two respects. On the one hand, the Court, following the AG,[101] eliminated the ambiguity of *Biret* by setting in stone that even if the deadline of the DSB's recommendations has expired, they cannot be directly invoked by the applicants for the purpose of an action in damages. On the other, the Luxembourg judges were confronted for the first time with the admissibility of the Community non-contractual liability in the absence of unlawful acts. The two courts reached very different conclusions on this issue: the CFI considered the action admissible but rejected it on the substance.[102] In the appeal before the ECJ, AG Maduro went even further than the CFI by upholding the applicant's claim that the EC was liable. By contrast, the ECJ distanced itself from both the CFI and Maduro: it posited that the principle of non-contractual liability in the absence of unlawful behaviour could not be established in the circumstances of the case.[103]

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97 '[…] 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*, cit., par. 20.

98 By holding that a review of the Community legislation at stake, in the framework of an action in damages, in the light of DSB's decisions, was not possible before the expiry of the reasonable period for compliance (par. 62), commentators were induced to believe that private parties could invoke those decisions in the context of an action under art. 288, par. 2, after the expiry of the mentioned time-limit.

99 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.' Such a conclusion is not very convincing: the only reason of the EU institution to modify a piece of legislation is that a DSB's decision has declared it incompatible with WTO law. Therefore, by so doing they do specifically implement the obligations stemming from WTO agreement to bring its legislative and administrative measures in line with the law of the WTO.

100 C-120/06 and 121/06, cit. See section n. ?

101 See section n. £?

102 See section n. £

103 See infra section n. £

3. The FIAMM case

3.1 The factual and legal context

Between 1999 and 2001 FIAMM and Fedon's products (stationary batteries and spectacle cases) were hit, amongst those of other companies,[104] by a heavy increase in custom duties[105] enacted by the United States, 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 import of bananas. The EC legislation on the import of bananas have been found in breach of WTO rules on several occasions[106] but the EC's inadequate efforts to bring its legislation in line with WTO law had spurred the United States's application of the described retaliatory measures. This legal context had induced the applicants, often referred to as 'innocent victims,'[107] 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 damages incurred by them as a result of the retaliatory measures adopted by the United States. The Court had rejected the applicant's 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,'[108] within the meaning of *Nakajima*.[109]

The applicants' second argument was that the EC was liable in the absence of unlawful

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104 See above n. 38.

105 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.

106 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.

107 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.

108 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.

109 The CFI had also excluded the application of the Fediol exception.

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 United State' suspension of concessions were not of an unusual nature for business operators such as FIAMM and Fedon.[110]

The latter 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,' one of the conditions to establish the Community's liability. 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 on the applicants a right to claim for damages.

Finally, FIAMM and Fedon consider that the CFI has not correctly evaluated the conditions of the Community's liability in the absence of unlawful behaviour, in particular, the risks of collateral damages would not be inherent to operators in the sector concerned. In the next sections we will examine the ECJ's ruling as well as AG's opinion[111] and then, an analysis of the judicature's position will follow. We will explain why we share the Court's position denying direct effect to the DSB's decisions. In the subsequent section, we will criticise the AG's arguments in favour of the Community

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110 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 the 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 unfilled condition of the Community's liability is the absence of causal link between the Community's activity and the damage susffered 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, in Revista española de derecho europeo, 2005, p. 374.

111 See opinion of AG Maduro of 20 February 2008 in Joined Cases C 120/06 P, C 121/06 P above n. £. For a comment see ALEMANNO, *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, (2008) 'From "direct effect" to "muted dialogue"-Recent Developments in the European Courts' Case Law on the WTO and Beyond,' in 11(4) *Journal of International Economic Law*, 885-898.

extra-contractual liability for lawful activity and we will single out the reasons to support the Court's denial of the existence of this action in the Community system of remedies.

3.2 The Community non-contractual liability for unlawful acts

The position of the AG and of the ECJ

AG Maduro points out that the crucial question in the case at hand 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 that the finding of a solution, 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 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 prefer an alternative to implementation of the decision)*, 'it still constitutes freedom of choice*.'[112]

Secondly, Maduro shows that the EU institutions' margin of manoeuvre *vis-à-vis* the complaining Party is jeopardised by an action in damage 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.*'[113]

Since the prospect of actions in damages forces the political organs of the Community to eliminate the Community measure held incompatible with the WTO rules, it also restricts the freedom of conduct they are permitted by the legal order of the WTO.[114]

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.

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112 Par. 47.
113 Par. 49.
114 Par. 50.

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*.'[115]

On appeal, the Court confirms that the Community cannot be held liable insofar as it cannot be attributed the breach of the DSB's rulings. In substance, the latter's inability to be directly invoked, make it impossible for an applicant to establish that the Community has committed a 'breach,' one of the conditions of an action under art. 288, par. 2.

Taking up the Maduro's suggestion, the Court posits that the CFI had, albeit implicitly, ruled on direct effect of DSB's decisions for the purpose of an action for damages. And 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 of all, by undertaking 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; secondly, in the resolutions of disputes, options other than the withdrawal of the unlawful measure are possible. The adoption of a DSB's decision finding 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.[116] 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 for compensation.[117]

The second interesting part of the ruling concerns the distinction between the direct effect of the DSB's decisions and that of the WTO substantive provisions, a point which was not touched upon in detail by Maduro. In the present case the ECJ openly confirms the lack of direct effect of the former since they cannot be distinguished from the latter. The flexible nature of the WTO agreements makes necessary for the political bodies to maintain an element of discretion and scope for negotiation *vis-à-vis* their trading partners as far as the adoption of measures intended to respond to the ruling or

[115] Par. 51.

[116] C-120/06 and C-121/06, cit, par. 119.

[117] In particular cfr. Par. 124.

recommendation are concerned.

The Court puts forward a second argument against direct effect of DSB's rulings: "*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.*"[118]

Although we will comment and overall support the Court's ruling later, it is necessary to clarify that this second argument is not at all convincing. Art. 3(2) was inserted in the DSU to constrain the techniques of interpretation that the DSB could use and, more broadly, to avoid 'judicial activism' of the WTO Tribunals.[119] The fact that the DSB's decisions interpret WTO law and do not confer additional rights or obligations on WTO members seems to us totally un-related to the internal effects of the DSB's ruling within the EC legal order.[120] Hence, it cannot lead to exclude the possibility for private parties to rely on those decisions before the ECJ. However, as we will see, the first justification put forward by the Court to deny that private parties may rely on DSB's decisions, before the ECJ, may be considered in itself sufficient.

3.3 The Community non-contractual liability for lawful activity

The position of AG Maduro

In his conclusions, Advocate general Maduro argues in favour of the non-contractual liability of the Community in the absence of an unlawful conduct or 'non-fault based liability.'[121] Moreover, it considers the conditions to establish such an action fulfilled.

Very powerfully, he states: "*Enshrining in Community law a principle of no-fault Community liability would advance the case-law from potential to settled, from the era of*

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[118] Par. 131.

[119] JACKSON, Sovereignty, the WTO, and the changing fundamentals of International law, Cambridge University Press, 2006, p. 183.

[120] *Contra*, see ANTONIADIS, *The Chiquita and Van Parys judgments: rules, exceptions and the law*, in *Legal Issues of Economic integration*, 2005, p. 471.

[121] This is the expression used by AG Maduro, in par. 17.

uncertainties to that of solutions."[122]

First of all, 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. Secondly, Maduro 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 the balance in the burdens suffered by citizens. Indeed, all citizens should bear equal burdens from public activity. Where the latter fall more on a close circle of citizens, compensation should be awarded to 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.*"[123] 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.[124]

The fact that only two Member States recognised such a principle, thus engendering doubts as to its being 'common to national legal orders of the Member States,' as required by art. 288, par. 2, is not obstacle, if it can be shown that the acknowledgment of such a principle is in the interest of the Community. In fact, Maduro finds 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*[125] and sets out the criterion to channel liability;[126] furthermore, a wide scope

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[122] Par. 61.
[123] Par. 63.
[124] See section n. ?
[125] Par. 68.
[126] Par. 65.

ratione materiae[127] and restrictive substantive conditions of application are devised.

We will confine ourselves to highlight 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 incurring of fault-based Community liability.*"[128]

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.*"[129]

The third reason making the recognition of a principle of no-fault liability appropriate for Maduro 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*.'[130]

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 the non-contractual liability in the absence of unlawful conduct. On the contrary, it had left this issue open[131] and had even engendered confusion in defining the conditions of such a liability in *Dorsch Consult.*[132]

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127 Par. 66-67.

128 Par. 57.

129 Par. 59.

130 Par. 60.

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

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

Departing from the opening of the CFI and the AG's conclusions, the ECJ excluded that such a principle existed.[133] However, it did not eliminate the fundamental state of uncertainty on this issue.[134] 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 the hypothetical case that this principle was recognised[135]. This is not a good justification since the Court should have never defined the conditions of a principle before recognising its existence.

Be as it may, 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 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,[136] in particular where it is of a legislative nature.[137] Hence, the ECJ feels unable to apply art. 288, par. 2 of the TEC anchoring the Community non–contractual liability to the general principle familiar to the legal systems of the Member States.

However, the Court 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 latter are specifically caused by a Community infringement of WTO law or 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

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133 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".

134 See section n. "£.

135 Par. 148.

136 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).

137 Par. 175.

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 looks 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 leaving aside this specific situation, this remedy may be available to private parties. The Court will have the chance of clarifying this point in future cases.

Having excluded that the appellants could rely on the Community non-contractual liability for lawful behaviour, the consequence is that FIAMM and Fedon are left without a remedy, as Maduro rightly emphasises.[138] As we know that the Court is always very keen on showing that the Community system of remedies is complete, it is not surprising that the Court makes two closing remarks to show that private parties enjoy a special position within the Community legal order. However, the judicature points out to innocent victims of trade wars a judicial avenue that is not very promising. This is 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 which must be fulfilled for such an action to succeed. Finally, the Court's emphasis on the fact that an economic operator, carrying out its activity in other Member States, must put up with the possibility of being subject to suspension of concessions must have sounded as mockery to the applicants. Admittedly, the Court sets a very high standard for an extra-contractual liability action to succeed, thus it may be doubted that the present and future applicants will benefit from the Court's suggestion; but what counts more is that the façade of a Community complete system of remedies is preserved.

The Luxembourg judges raise a further point whose implications will be discussed in section n. £.[139] 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

138 Par. 58.

139 Par. 181.

damages than the first one. The Court also emphasizes that there are precedents of legislative measures of this kind. For example, the regulation whose validity was indirectly challenged in *Booker Aquaculture*[140] 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 decisions: justifications and consequences

In the FIAMM appeal the Court excludes the possibility of distinguishing between direct effect of 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 times these decisions are complied with[141] and this very same fact ensures the success of the DSU. However, these rules leaves room for considering compliance with the DSB's a choice.[142] Indeed, regarding the WTO Tribunals' rulings as an 'absolute parameter' in the settlement of a trade dispute belies an underestimation of the importance that diplomacy maintains in the DSU, even if the WTO is an overall rule-oriented system. There may be cases in which the Parties of a dispute may find more convenient to agree upon a solution that departs from the DSB's recommendations. For example, the loosing Party may consider preferable to avoid compliance and accept that its traders will be subject to retaliatory measures. These alternatives are temporary under the DSU; but this does not mean that ultimately the DSB's decisions will be implemented. The best illustration of this is the recent temporary agreement between the

140 C-64/00 *Booker Aquaculture and Hydro Seafood* [2003] ECR I-7411.

141 *Contra*, JACKSON, Sovereignty, the WTO, and the changing fundamentals of International law, Cambridge University Press, 2006, p. 159.

142 Ibidem., p. 159.

Community and the USA on the hormone-in-beef dispute (May 2009). The two Parties found a temporary 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 continue to apply, although its application is subject to review.[143] These facts show that it is preferable that the Parties to a trade dispute depart from the DSB' 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 two Parties to the dispute, the traders of beef and European consumers. These three categories would have been worse-off, had the EC implemented the DSB's recommendations by changing its legislation on the levels of hormones in beef.

What is the impact that the ECJ's refusal to enforce the DSB's rulings may have on WTO law? 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, in turn, may reduce the level of security and predictability of the multilateral trading system, principles which are at the heart of the DSU. It is submitted that the importance of these inconveniences is largely overestimated; at the moment, these problems have not materialised. Indeed, we have already highlighted that compliance record with WTO reports is good. This means that the authority of the DSB has thus far been unaffected by the few cases, i.e. for example in the banana dispute, in which the Parties opted to depart from the recommendations of this body. Moreover, should the Parties be forced to stick at the DSB's settlement findings at all costs, this may inject in the DSU's rules a rigidity that eventually may turn to be detrimental to the current satisfactory observance of these rules by the WTO members and even nurtures hesitations on their side in submitting a dispute to the DSB. In other words, WTO members may loose faith in the DSB if they were asked to strictly respect its findings in highly sensitive disputes.

Let us know turn to the justifications adduced by the Court to exclude that private parties

[143] Press release, MEMO/09/239, of 13/05/2009.

may use 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 damage with respect to that seeking the annulment of a Community act. 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 that the two categories of actions have overlapping negative consequences which need 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-a-vis* the measure causing damages exactly as it does an action reviewing the legality of EC measures. This is because the inner logic of the EC remedies implies that art. 233, imposing to remove 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 implementation time limit, for the purpose of an action in damages would be technically feasible,[144] giving private parties the possibility to sue the Community for its non compliant behaviour with WTO law, is not opportune.

As a closing remark, it may be added that ECJ's ruling in FIAMM enhances the degree of coherence of the ECJ case-law on the effects of WTO law within the EC legal order by refusing to private parties as well as to privileged applicants the possibility to enforce DSB's decisions before the Community courts.

The broader implication of this ruling 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 agreed by WTO members.

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144 See the discussion under section n. £.

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

Turning to the principle of Community's non-contractual liability in the absence of fault, we consider the Court's refusal to recognise such a principle. Conversely, none of the reasons put forward by Maduro in favour of its acknowledgement seem to us persuasive. It must be admitted that the AG's solution looks attractive, given that private parties' rights (to carry out their business activity and also their right to property) receive full protection. However, on closer scrutiny, under the current Treaty framework, it does not appear possible to expand the area of Community remedies to 'rectify' the inequities of the global trade system.

Let us start from the AG's arguments.

The first one, turning 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, does not have any legal basis in Community law; neither there are precedents in the case-law that could support such a judicial approach. On the contrary, it is necessary that the Court adopts the opposite solution in order to avoid accusations of incoherence. For example, the case-law denying legal standing to individuals, in the framework of an action for annulment against general Community measures, shows that the Court has never accepted to manipulate the wording of art. 230, par. 4 in order to make easier for natural and legal persons to challenge these measures.[145] Secondly, upholding an action for damages, would be inconsistent with the case-law denying to privileged applicants any possibility of invoking DSB to review the legality of the Community measures. It would be paradoxical to enable private parties to rely on DSB decisions when privileged applicants do not have the same possibility. In addition, should the grant of a remedy to innocent victims be in the Community interest (and we believe it is not[146]), a relaxation of the conditions of the non-contractual liability for unlawful conduct would be sufficient. There is no need to create new remedies.

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

146 See section n. ?

The 'good governance' argument, which is 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 6; for now, let us anticipate that we do not find this reasoning convincing.

The third argument in favour of the extra-contractual liability is that the Community institutions would enjoy enhanced discretion in deciding how to distribute the costs of retaliatory measures, since they could decide whether private parties should suffer the consequences of these measures or whether the European citizens as a whole share the burden. In the current system, they do not have this choice and therefore they have to 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 it by using the Community budget to set up a fund reserved to by-standers of collateral damages.[147] The creation of a new remedy is unnecessary and we agree with the Court's position whereby the proposal to embed the Community extra-contractual liability, in the absence of unlawful behaviour, within art. 288, par. 2, is contrary to the Treaty. The Court's exclusion that the principle of fault liability in the absence of unlawful behaviour has a legal basis in the Treaty is convincing, since only two Member States out of 27 provide for a principle along the lines of extra-contractual liability in the absence of lawful conduct and in very special circumstances, as well illustrated by the Commission.[148] Such being the situation of national legal orders, it is more than doubtful that that principle is '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 to decide on the Community non-contractual liability on the basis of 'common principles' of the national legal orders. It is true that this Treaty provision does not prescribe that the principle is common to *all* Member States. However, two of them are not enough to make this principle of general application, considering its broad

147 See section n. £.

148 Above n. £

financial, redistributive and constitutional implications. In view of its 'nuclear weapon' nature, it is not sufficient that art. 288, par. 2 does not rule out its existence for it to be provided for as a Community remedy. Had the Member States wanted to include it in the Treaty, they would have done so in the numerous cases in which The Treaty was revised.

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

After having shown that the ECJ denies direct effect to WTO law, including the DSB decisions, both for the purposes of an annulment action and of the Community non-contractual liability, we now turn to 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 (form of private enforcement), brought by private parties against the non-compliant Community.[149] In general, having in mind the overall welfare of the WTO membership, it may be tempting to judge community enforcement positively because of its likely effects of increasing compliance with WTO law.[150] However, following a Law and Economics logic, compliance should be assessed in terms of its costs and benefits. Normatively what should be achieved is the optimal level of

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149 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 obligations under WTO rules […]. " Alemanno, above n. 172, 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 N., (2005) "The Chiquita and Van Parys judgments: an exception to the rule of law", in 32(4) *Legal Issues of Economic Integration*, pp. 449-460 at p. 459. More generally, see Petersmann, E.U. 'Judging Judges: From "Principal-Agent Theory" to "Constitutional Justice" in Multilevel "Judicial governance" of Economic Cooperation among Citizens', 11(4) *Journal of International Economic Law*, 827–884.

150 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, P. 'Chapter 15 - Remedies and Compliance', in D. Bethlehem, D. McRae, R. Neufeld and I. Van Damme (eds), *The Oxford Handbook of International Trade Law*, Oxford University Press 2009, pp. 438-459, at p. 455.

compliance rather than full compliance.[151] This means that, even when having the welfare effects of the WTO membership in mind, the efficiency of community enforcement needs to be rigorously assessed before reaching any conclusion; increasing compliance per se does not tell us much in relation to efficiency.

The efficiency analysis is what we set to do in the next sub-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 less conventional for the Law and Economics scholarship but more specific to the realm of WTO law and politics.

After having concluded this analysis, in section 8, we turn to investigate a specific case of private enforcement: the non-contractual liability for lawful acts, which has been raised in *FIAMM*. As we will show, the effects on compliance of this rule 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 framework to study the functioning of alternative legal remedies (hereinafter the Cathedral).[152] 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.[153] In the

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[151] For a general Law and Economics framework of compliance in International Law see Guzman, A. T. (2002), 'A Compliance-Based Theory of International Law,' *California Law Review*, 90, 1823–1887.

[152] Calabresi, G. and Melamed, D. (1972) 'Property Rules, Liability Rules and Inalienability: One View of the Cathedral,' 85 *Harvard Law Review*, 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.

[153] 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

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,[154] 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.[155] Such a divide is likely to stem from the complex and unique structure of the WTO remedies.[156] 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 of achieving full compliance, at least in the long run. In other words, non-compliance and authorized-retaliatory measures are meant to be *transitory*

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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 (1972), pp. 1111-1115.

[154] 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, Matteo (2008), 'The Cathedral: An Economic Survey of Legal Remedies'. Available at SSRN: http://ssrn.com/abstract=1092144

[155] Defending the view that the DSU embodies a property rule see Jackson, J (2004), 'International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to "Buy Out"', 98(1) *The American Journal of International Law*, 109-25, Pauwelyn, J. (2008), *Optimal Protection of International Law: Navigating between European Absolutism and American Voluntarism*, Cambridge, Rizzoli (2008), op. cit. and Nzelibe, J. (2005), 'The Credibility Imperative: The Political Dynamics of Retaliation in the World Trade Organization's Dispute Resolution Mechanism' in 6(1) *Theoretical Inquiries in Law*, 215-54. Defending the opposite thesis see Schwartz, Warren F. and Sykes, Alan O. (2002) 'The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization,' 31 *Journal of Legal Studies* 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 Robert Z. Lawrence (2003), *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 N. D. and Alexandrov, S. (2002) '"Inducing Compliance" with WTO Dispute Settlement,' in Kennedy and Southwick (eds.) *The political economy of international trade law: essays in honour of Robert E. Hudec*, Cambridge University Press, at pp. 646-666.

[156] For a critique of the remedies provided by WTO law see: Charnovitz, S. (2001), 'Rethinking WTO Trade Sanctions' 95(4) *The American Journal of International Law*, 792-832.

provisions only.[157] Looking at the system from this perspective, WTO remedies are best reflected by a property rule. This brief overview of the remedies provided by WTO leaves us with the question: Are the WTO remedies property or liability rules and what does it 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 Reports is well enshrined in the DSU.[158] Several authors have thereafter followed this interpretation and have characterized the WTO dispute settlement system chiefly as a property rule.[159] 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.[160] 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).[161]

We believe that, as a matter of legal doctrine, Jackson has made a convincing case, detailing eleven provisions part of a coherent legal framework establishing a legally binding obligation of compliance on WTO Members.[162] However, if we want to apply the Cathedral, for the sake of accuracy, we need to include the specific features of the

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[157] 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).

[158] Jackson, J (2004), 'International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to "Buy Out"', 98 *The American Journal of International Law*, 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.

[159] Pauwelyn (2008), op. cit., pp. 138-39. Rizzolli (2008), op. cit. and Nzelibe (2005), op. cit.

[160] Schwartz and Sykes (2002) op. cit.

[161] Trachtman, Joel P. (2007), 'The WTO Cathedral' 43 *Stanford Journal of International Law* 127, at p. 146. It should be noted that, while Tracthman, 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.

[162] Jackson, J. (1997), 'The WTO Dispute Settlement Understanding--Misunderstandings on the Nature of Legal Obligation' in 91(1) *The American Journal of International Law,* 60-64, at p. 63.

remedies envisaged by the WTO, which is better captured by the S&S framework and by the subsequent Trachtman analysis. While these visions seem contrasting, we argue that they can be reconciled.

A way to pay due respect to the legal text and at the same time to provide an appropriate characterization of the rules at hand is to slightly refine Calabresi and Melamed original theoretical framework by introducing the *temporal dimension*. As is well-known, C&M article was meant to be 'only one of Monet's painting of the Cathedral of Rouen. To understand the Cathedral one must see all of them.'[163] Adding a temporal dimension to their framework is a way to capture 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 'aspirational property rule operating through a temporary liability rule.'[164]

The aspirational property rule, coupled with a temporary liability rule, signifies that there is a legal obligation to fully comply; however, the legal obligation leaves a margin of time during which compliance has to be realized.[165] In this period, non-compliance is tolerated under an evolving sanction; more precisely, the costs of the sanction increase over time, as we will detail 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 is, is best interpreted as a mixed rule. How would the mixed property/liability rule change if we would add a rule, according to which WTO DSB recommendations 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, in order to test the efficiency of community enforcement, we need to compare the efficiency of a mixed rule to the one of a pure property rule.

We divide the following analysis in three subsections, where we show that: neither a pure property rule a pure liability rule are efficient solutions, whereas the mixed rule, here

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[163] Calabresi and Melamed, op. cit. at p. 1090 in ft 2.

[164] An analysis of other forms of mixed rules has been previously performed Bell, Abraham and Parchomovsky, Gideon, Pliability Rules (October 12, 2003). 101(1) *Michigan Law Review*, 2002. Available at SSRN: http://ssrn.com/abstract=1282862

[165] 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.

suggested, is likely to provide a framework conducive to efficiency.

6.1 Pure Property Rules

Under a pure property rule, Members would have to fully comply immediately with the DSB rulings. If it is difficult to conceive of a pure property rule in international law, allowing direct effect is surely one of the scenarios that would best approximate such a rule. There are few problems with this scenario, however. First, as observed by S&S, renegotiation in cases of inefficient compliance is likely to be extremely costly due to strategic behavior of other Members (in particular holdout problems).[166] 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 behavior necessary to achieve compliance. Generally, a recommendation of 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 all, which leaves the property right not clearly specified. Under unclear property rights, transaction costs are likely to be high,[167] a scenario that makes renegotiation even more costly. Thus, *a fortiori*, property rules do not work efficiently.

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 surely 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 remind that the WTO package-deal concluded in 1994 consists of more than 30.000 pages of documents, covering wide 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:

166 Schwartz and Sykes (2002) op. cit., at p. S187.

167 Coase, R. (1960) 'The Problem of Social Cost', 3 *Journal of Law and Economics* 1–44.

> '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.'[168]

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 let Members to remain *indefinitely* in a state of non-compliance. Not only we disagree as a matter of legal interpretation, but we will also show that pure liability rules are equally problematic from an economic standpoint.

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 of all, when we look at positive law, we know that the most commonly used compensatory mechanism, widely referred to as retaliation, does not correspond to the damage suffered by the victims because retaliation (technically 'suspension of concessions') is temporary 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 perceived to be entitled to buy-out rights, reputation will not be affected by non-compliance because Members by suffering retaliation will be perceived as complying with the system. The effects of framing liability as a pure liability rule

[168] Schwartz and Sykes (2002), op. cit., pp. S191-92.

would thus undermine the incentives to comply provided by reputational losses. This phenomenon can be compared to the so-called crowing-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 people that were blood-donors are crowded out. Studies in experimental economics have shown that the crowing-out effect is a significant phenomenon.[169] Likewise, it is plausible to assume that in a legal system, the formulation of the law has an influence on behavior; in our case, if the law is written as a permit to pay and buy-out the right, there may be an influence on behavior that stimulates defection rather than compliance.[170] 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 and developing countries will not always be able to retaliate, which makes the system asymmetric and skewed against poorest countries.[171] While several suggestions have been advanced to improve the liability rule,[172] 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 to

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[169] For a general overview of the phenomenon see Frey, B.S. (1997), *Not Just for The Money. An Economic Theory of Personal Motivation*, Cheltenham: Edward Elgar and Frey, B. S., Oberholzer-Gee, F. and Eichenberger R. (1996), "The Old Lady Visits Your Backyard: A Tale of Morals and Markets" in 104 *The Journal of Political Economy*, 1297-1313; for a survey of empirical studies showing the wide spread existence of crowding effects see Frey, B. S. and J. Reto, (2000) 'Motivation Crowding Theory: A Survey of Empirical Evidence', *Zurich IEER Working Paper No. 26; CESifo Working Paper Series No. 245*. Available at SSRN: http://ssrn.com/abstract=203330 (last visited June 16, 2009).

[170] Expressive function of the law # add bibliography (check Cass Sunstein, *Law, Economics & Norms, on the Expressive Function of the Law,* 144 U. PA. L. REV. 2021, 2045 (1996).

[171] 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, F. M. (2009),'Cross-Retaliation in TRIPS: Options for Developing Countries', *ICTSD Programme on Dispute Settlement and Legal Aspects of 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, C. and Hoekman, B. (2005) 'WTO Dispute Settlement and the Missing Developing Country Cases: Engaging the Private Sector' 8(4) *Journal of International Economic Law*, 861.

[172] For a comparative analysis of different means to improve the enforcement mechanism at the WTO, see Trachtman (2007), op. cit.; also, Charnovitz, (2001) op. cit.; contra, arguing that the retaliatory system is efficient see Nzelibe (2005), op. cit.

provide 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 for renegotiation. DSB recommendation set the boundaries of the renegotiation space, by indicating the behavior 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 behaviors of Members that would arise under a pure property rule.[173]

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, we are in presence of a light sanction. 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 by, 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 reputation in international law works, to certain extents, as a mechanism to induce compliance.[174] The reputational losses increase because the status

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[173] Some authors have further shown that liability rules may work in the sense of facilitating trade Ayres, I. and Eric T. (1995a), 'Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade' *Yale Law Journal*, 104(5), 1027-117 and Ayres, Ian, and Eric Talley. (1995b) 'Distinguishing Between Consensual and Nonconsensual Advantages of Liability Rules' *Yale Law Journal*, 105(1), 235-53. Add Kaplow L. and Shavell, S. (1996), 'Property rules liability rules: an economic analysis' 109(4) *Harvard Law Review*, pp. 713-

[174] Guzman, A. (2008), *How International Law Works: A Rational Choice Theory*, Oxford University Press: Oxford, chapter 3 and quoted literature; see also Guzman, A. T. (2002), "A Compliance-Based Theory of International Law," *California Law Review*, 90, 1823–1887. For a discussion of the role of multiple reputations see Downs, G. W., and M. A. Jones (2002), "Reputation, Compliance, and International Law," 31 *Journal of Legal Studies*, 95–114. More skeptical of the role of reputation Goldsmith, Jack L. and

of the scofflaw as violator will become 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 owner's consent.'[175] (emphasis added and internal citation omitted). Our framework, by including time, renders the kicker an evolving variable that increases over time, mediating the problems created by strategic behavior in the renegotiation phase with the needs of moving towards increased compliance in the long run.

This system proves superior because is based on a 'guidance norm' of compliance leaving a space for limited defection.[176] The flexibility of this mixed rule sets favorable 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 we showed, 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

Eric A. Posner, *The limits of international law*, Oxford University Press US, 2005, pp. 100-104.

[175] Rizzolli (2008), op. cit., at p. 8

[176] The concept of guidance rules as opposed to enforcement rules, has been articulated by Nance; cfr. Nance, D. A. (1997), 'Guidance Rules and Enforcement Rules: A Better View of the Cathedral,' 83(5) *Virginia Law Review*, 837-937.

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.[177] In this framework, originally devised by economist Albert Hirschman, the decline and/or successfulness of an organization depends on the balance of the 'exit and voice options.'[178] 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 that, 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 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.[179] 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.'[180] The schism 'economics-politics' introduced by Hirschman is thus turned into the schism 'law-politics' by Pauwelyn. In this framework, lower degrees of legalization correspond to high-exit and higher degree of legalization to low-exit. Put it differently, increased legalizion entails the closure of exit options. The inverse relation between exit and voice, which is a necessary condition for the successfulness of an organization holds also in the context of international organizations. Employing Pauwelyn analytical grid, we can thus easily conclude that high levels of legalization should correspond to high levels of

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177 Pauwelyn, J. (2005) 'The Transformation of World Trade' 104(1) *Michigan Law Review*, 1-65. In a similar fashion, the exit and voice theoretical framework was earlier applied by Joseph Weiler to study the evolution of the European Community (EC). Weiler, J.J. (1991), 'The Transformation of Europe,' 100 *Yale Law Journal*, 2403

178 Hirschman, A. O. (1970), *Exit, Voice, and Loyalty: Responses to Decline in Firms*, *Organizations, and States*, Harvard University Press, Cambridge, Mass..

179 Hirschman (1970), at p. 15.

180 Pauwelyn (2005), at p. 5.

participation or politics.

Let us now briefly describe the evolution of the WTO dispute settlement system in the light of the exit/voice framework. In the transition from the GATT 1947 regime to the WTO, the dispute settlement system has undergone one of the major 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 increase in voice, where consensus has been adopted as the dominant rule in the decision-making process.[181]

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 compensate or that the other Members are allowed to impose retaliatory measures against them ('suspension of concession'). Granting direct effect to WTO DSB recommendations for the purpose of the annulment or non-contractual liability actions would increase compliance by taking away 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.'[182] In our view, the thesis of Pauwelyn well reflects the state of

[181] Pauwelyn, (2005), op. cit. pp. 20-24 and pp. 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.

[182] Pauwelyn (2005), cit. p. 34.

affairs at the WTO, where the stalling negotiations of the Doha Round can be seen as an 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 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. In order to promote trade, Members have to 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 difficult to concede more 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 past history, protection of intellectual property, etc.), leaving to the Members a safety valve for non-compliance for cases that are politically sensitive appears to be a 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.'[183] Paradoxically, allowing a margin of non-compliance appears, at this point in time, the only viable route for a system that overall aims at increasing 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 to the dialogue on further liberalization, Members could also fall back on a disproportionate use of facially licit behaviors, such as the imposition of anti-dumping measures, that however offers *de facto* other exit options and overall increase protectionism. We thus believe that the decline of the organization could manifest by a

[183] Trachtman, J. (1999), 'Bananas, Direct Effects and Compliance,' 10 *European Journal of International Law*, 655-678, p. 660.

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 us an extreme scenario.[184]

If our characterization of the current state of the art about the 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. If we stretch for a moment the scope of compliance beyond isolated legal rules and we think 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.[185]

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 ratio exit-voice were different, with for instance higher levels of politics and participation than we have today, a marginal increase in compliance may turn out to be efficient.[186] This also means that in the future, if the scenario will change, 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 will move towards a more complete contract, a pure property rule may become more attractive from an economic standpoint and so would be community enforcement.

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184 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.

185 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 Ivan Illich, *Medical Nemesis*: *The Expropriation of Health*. ##

186 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.' Pauwelyn (2005), op. cit. p. 57.

8. Non-contractual liability for lawful acts and good governance: friends 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 will focus on the efficiency dimension only.

Non-contractual liability for 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 of all, 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 more interesting to look at the arguments articulated by AG Maduro in favor of no-fault liability in his opinion in *FIAMM* and to verify whether they are tenable. In particular, we will focus on the hypothesis that introducing a system of no-fault liability could enhance good governance. As recalled 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 & Economics logic: allowing a no-fault liability rule can be understood as a way to force public authorieties to take the opportunity costs of non-compliance into account.

While interesting, we do not find the 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.[187] 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.[188] Moreover, if the idea is the one of stimulating the use of CBA, it is questionable whether endorsing no-fault liability is the best route.[189] In fact, there are strong reasons to believe it is not.

First of all, the Court by engaging in a process of calculating damages could at best help the political institutions to assess some of the costs stemming from the Community illegal measures. The Court does not perform any assessment of the 'advantages' (or benefits) of the violation. Thus, we would be in presence of a biased analysis, focusing only on costs. Think of the hypothetical case of a health regulation, found in violation of WTO law, which entails substantial benefits for European citizens, 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 among 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; 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 liabilty would be introduced, symmetrically some form of charges should be introduced anytime a gain falls on private parties because of

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[187] 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, M. J. (1987), "Market-Inalienability" in 100 *Harvard Law Review*, 1849-1937 and Sagoff, M. (1981), "Economic Theory and Environmental Law" in 79 *Michigan Law Review*, 1393-1419, at 1410-1418. For a critique of the use of CBA in the context of environmental regulation see Ackerman, F. Heinzerling L. and Massey, R. "Applying Cost-Benefit to Past Decisions: Was Ever Environmental Protection *Ever* a Good Idea?," *Administrative Law Review* 57, (2005), pp. 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 Lisa Heinzerling, "Regulatory Costs of Mythic Proportions," *Yale Law Journal* 107, (1998) pp. 1981-2070.

[188] For an overview of the way RIAs have been implemented in the EU see Renda, A. (2006) *Impact Assessment in the EU – The State of the Art and the Art of the State*, CEPS, Brussels. See also Meuwese, A.C.M. (2008), *Impact Assessment in EU Lawmaking*, E.M. Maijers Institute of Legal Studies, Leiden University.

[189] 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, S. (1992) *Rethinking the Progressive Agenda, The Reform of the American Regulatory State*, Free Press pp.135-140. #

WTO related measures. This symmetry has indeed been considered by AG Maduro in his opinion. The difference of our reasoning with AG Maduro 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 certain individuals and to them alone … must give rise to compensation' (emphasis added).[190] However, in most instances, specific government acts benefit specific groups. In relation to trade, for instance, after a Round is concluded, some groups receive benefits and others are likely to 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 subjects 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 exemplifies the sort of issues that would have to be dealt with. The administrative costs of a system of damages and charges are likely to be so high to offset any remaining benefits.

These considerations notwithstanding, it may still be claimed that granting damages has positive sides and that eventually it enhances good governance. This could be argued from a public choice perspective, according to which public institutions maximize their own, rather than the collective interest.[191] 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

190 AG Maduro, cit. ; Par 62.#

191 Public choice ..

WTO context, retaliation is usually targeted at strategic industries, as the goal of the retaliating Members is to put pressure on the violator. As it has been noted in relation to a US legislation concerning retaliatory schemes, '[t]he legislation attempts to put pressure on the foreign goverments, through their domestic exporters, to bring their measures into conformity with the WTO Agreements.'[192] Thus, it is plausible to assume that in most cases, the victims of retaliatory measures will be powerful groups capable to exert pressure on the government, and accordingly, even from a public choice perspective, awarding damages is not necessary as a tool to align the agent's to the principal's interest. This reasoning further supports our conclusion that no-fault liability is not likely to enhance good governance.

At a first sight the case of awarding damages to collateral victims may appear a compelling one; at a second look, however, it becomes less so as it is in the nature of trade policies to unevenly impose costs and benefits on society. While we agree that check 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 FIAMM case

Having explained in the previous sections that we agree on the Court's position in *FIAMM* 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.[193] The widely-used expression 'collateral victims of trade wars' evidences a shared perception that the applicants of these cases bear iniquities. This feeling of uneasiness appears well-founded,

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192 Alemanno, A. 259

193 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 […].' (para. 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' (para. 58).

especially if one considers that the financial consequences suffered as a result of the banana war came unexpected 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 on the one hand 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 also known as optimism bias.[194] It appears then plausible the conclusion that, in the circumstance of *FIAMM,* the costs of the (Community) non-compliance with WTO rules are unfairly borne by private parties.[195]

Secondly, the innocent victims at stake are left without a remedy against the Community since they cannot use any of the actions provided for by the Treaty. In this situation, it is therefore important to identify what other avenues are open to companies unjustly hit by trade sanctions, if the Community decides to retain a WTO-incompatible legislation.

While it is beyond the scope of this Article to study the articulate detailed solutions, it is submitted that the there are at least two different options whose feasibility could be further explored. The first is that all those operators, feeling threatened by increases in custom duties due to suspension of concessions, get an insurance against these risks. The weakness of this solution is that it is not sure whether this economic instrument is available, especially in the light of cognitive biases towards risks.[196] Probably market-based insurance would have 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.

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[194] See generally Jolls, C. and Sunstein, C. R. (2006) 'Debiasing through law', *Journal of Legal Studies*, 199-241 and Sunstein, C. R. (ed.) (2000) *Behavioral Law and Economics*, Cambridge, Cambridge: Mass. at p.291.

[195] This argument has been put forward by ALEMANNO, "Private parties and WTO Dispute settlement system, in CHAISSE, BALMELLI, Essays on the future of the World Trade Organization", volume II, 2008, p. 249.

[196] See Jolls and Sustein (2006), op. cit.

The second possibility 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,[197] would be sustainable only if the financial pocket was 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.[198] 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 self-empowerment 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 and 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.[199].

10. Concluding Remarks

With the *FIAMM*'s ruling the denial of direct effect of DSB's decisions has become truly 'absolute'[200] since the Court's findings in *Van Parys* (preliminary ruling) are extended to an action for damages. Unlike many legal commentators who have criticized the European Courts, we conclude that the approach of the Courts, refusing to enforce the WTO DSB Reports 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

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197 See infra, £.

198 Moreover, if it would keep the group of compensable victims limited as we suggest, it would also meet economic criteria; on this point see the reasoning in footnote 162##.

199 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 proporionality: equivalence and appropriateness*, *Harvard International Law Journal*, 2007, p. 364-370.

200 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.

the Court to rectify the effects of trade sanctions imposed by a WTO member. If private parties suffer as a result of WTO incompliance, 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 the WTO legal system endorses a mixed property/liability rules, 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 *FIAMM*, is unlikely to be desirable from an economic perspective.

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 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.