EU enlargement: enforcement and compliance challenges

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BACKGROUND TO THE ACCESSION PROCESS

On 1 May 2004, ten new countries joined the European Union (EU), creating an internal market of 25 countries with a population of 450 million. Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia joined the existing 15 EU member states to increase the size of the single market by some 40% and create one of the world's largest trading blocks.

The celebrations have barely died down but already the EU institutions are focusing on the next wave of accession. Bulgaria and Romania are currently scheduled to join the EU in three years and Croatia's EU candidate status was confirmed by the European Council (Council) on 18 June 2004 with membership negotiations expected to start early 2005. A similar decision is pending with regard to launching accession talks with Turkey. In the meantime, the Former Yugoslav Republic of Macedonia (FYROM) has also applied to join the EU.

Institutional changes

Before jumping ahead to assess further expansion, there is still an uphill task ahead in managing the recent accession of ten new member states. The effectiveness of the new institutional changes designed to give a voice to all 25 EU member states will be tested in the coming months. The institutional changes consist of:

- A new 25-member Commission of the European Communities (Commission).
- Changes in the representation and voting rights at the Council.
- An imminent increase in members of the European Parliament.

This heavier institutional framework will not be fully functioning until 1 November 2004 when the new college of EU commissioners will take up office and the voting structures in the Council will change.

Also, the effective implementation and enforcement of all EC laws in accession countries will remain a challenge over the coming months and possibly years. The Commission assumes new responsibilities for enforcement in the new member states, such as in the competition area, where it will have jurisdiction to engage in investigations and direct enforcement. National authorities in accession states can also expect increased activity as their role converges more with similar authorities in the "old member states" and with increased interaction with Brussels and their national counterparts throughout the EU. The old member states are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Ireland, Luxembourg, The Netherlands, Portugal, Spain, Sweden and the UK.

The lead up to accession

Over the past few years, the ten new member states have been progressively adapting their laws and policies in preparation for joining the EU. Over ten years ago, the Council meeting in Copenhagen fixed the following criteria for EU membership:

- Democracy, the rule of law, human rights and respect for minorities.
- A functioning market economy and the capacity to cope with competitive pressures.
- The ability to take on the obligations of membership (that is, to apply effectively EC rules and policies).

This latter requirement implied that accession countries must adopt into their legal systems the vast body of EC law including the EC Treaties, secondary legislation set out in numerous regulations and directives, and decisions of the European courts, covering a broad range of areas from competition law to food safety and environmental laws (known as the *acquis communautaire*) (the *acquis*). Accession countries were also required to set up mechanisms for effective enforcement of those laws.

The Commission has been monitoring closely the progressive implementation of the *acquis* in recent years and right up to the date of accession. However, this task was not complete by 1 May 2004 and the Commission's role in ensuring all member states' compliance with EC law continues with the possibility, following accession, to challenge new EU member states before the European courts in the event of failure to implement or incorrect implementation of EC law.

In their accession negotiations with the EU, some countries have agreed transitional arrangements that will allow them to postpone implementation of certain legislation. These transitional arrangements are included in the Accession Treaty that was signed by the EU member states and the accession countries in April 2003. However, the transitional arrangements are limited and the vast bulk of EC law has already been adopted by the new member states.

IMPLICATIONS FOR BUSINESSES OPERATING IN THE NEW MEMBER STATES

The enlargement of the EU represents the largest expansion in its history. It presents both enormous opportunities and challenges for companies. An enlarged EU market functioning on the basis of a common set of rules and standards with free movement of goods, services, capital and people across 25 countries should facilitate trade and create increased investment opportunities. At the same time, one of the main challenges for companies already established in the accession countries or planning to invest there, is compliance with the rapidly changing legal and enforcement regimes. New rules on public procurement, state aid, product standards, employment, environment, health and safety issues, customs, value added tax (VAT), among others, all necessitate changes to business practices and procedures for companies operating in those countries.

Ongoing compliance and training programmes for businesses in the accession countries will be important in educating people on the ground on the substance and significance of the new laws and regulations, and in minimising the risks of enforcement actions.

The following are among the key areas where counsel can expect to find significant changes and potential compliance issues:

- General competition law.
- State aid.
- Public procurement
- Environmental law.
- Employment law.

General competition law

Most of the EC competition rules, which were required to be implemented by accession countries, were implemented before 1 May 2004. Many of the detailed competition rules as they apply, for example to vertical agreements, licensing arrangements, R&D and specialisation agreements, are contained in regulations that are directly applicable in the accession countries, without the need for specific reference to these provisions in national law. However, there have already been some problems with implementation of certain rules. For example, implementation of the EC Modernisation Regulation (*Regulation 1/2003*) which, unlike many regulations, requires changes to be made to national law since it increases the power of national courts and authorities in applying EC competition rules, was delayed in the Czech Republic when the Czech Senate rejected the necessary draft amendment to the Czech Competition Act (*see Country Q&A: Czech Republic in this Handbook for more information on Czech competition law*).

Accession countries have also established national agencies who have the power to enforce both EC and national competition rules. However, as contact with the Commission and between the various EU national authorities increases, not least in the context of participation in the newly-formed European Competition Network, companies can expect to see an increase in national enforcement actions in the new EU member states. In addition, competition enforcement in the new member states is no longer the prerogative of the national agencies alone since the Commission now has the same powers it enjoyed in relation to the old

member states in enforcement of competition rules, including powers to:

- Dawn raid companies for suspected infringements.
- Initiate investigations.
- Order repayment of illegal state aid.
- Levy fines of up to 10% of group turnover for competition infringements.

Compliance with general competition rules. While the accession countries have put in place EC and national competition rules regulating anti-competitive agreements and arrangements and abuse of dominance, there has been little evidence of strict enforcement of such rules across the board. The Commission has, in the past, expressed its concerns in relation to this and has stressed the importance of effective application and enforcement of the new rules (*"Towards the Enlarged Union, Strategy paper and Report of the European Commission on the progress towards accession by each of the candidate countries" (COM(2002) 700 Final)*). In Poland, for example, dawn raids, large fines and divestment orders were unheard of until recently (*see Country Q&A: Poland in this Handbook for more information on Polish competition law*). This was mainly due to a lack of funds necessary to carry out investigations and a shortfall in sufficiently qualified staff. However, in recent months, the Polish competition authority has been more active and there has been:

- A dawn raid on a mobile phone operator.
- A divestment order for a newspaper publisher.
- An anti-trust investigation against suppliers of medical devices.

Another recent example of a new member state enforcing competition rules is that of the Czech Anti-monopoly Office (UOHS) imposing a fine of CZK6.5 million (about US$240,000) on Cesky Mobil, operator of the Oskar mobile phone network, for an illegal pricing arrangement. However, while there are definitely changes afoot, many of the new member states do not yet have a strong track record in competition enforcement.

In addition, there is a perceived gap between the existence of the rules and awareness of those rules among the players in the market. Provisions in contracts or practices that would normally come under scrutiny by counsel in the old EU member states, may not be reviewed in some of the new member states.

There are no transition periods for new member states to apply and enforce competition rules and companies can expect that their agreements and practices will face greater scrutiny following accession. Typical potential issues to be reviewed in contracts and practices in these countries include:

- Long-term exclusivity provisions in purchase and supply arrangements.
- Post-term non-compete obligations.
- Restrictions in distribution contracts on unsolicited sales to customers outside the allotted territory.
- Any actions to encourage distributors to apply recommended resale prices.
- Information exchanges between competitors.
- Rules for participation in trade association meetings.
- Cross-licensing of competing technologies combined with restriction of field of use to separate product markets.
- Exclusion of customers of parallel importers from the benefit of guarantees or after sales services.

In addition, companies need to assess whether they may be considered dominant in the relevant markets in which they operate. If they have high market shares in the markets concerned, they also need to assess practices such as:

- Product tying.
- Discounts awarded on the basis of exclusive purchase commitments.
- Refusals to supply certain customers.
- Refusal to license intellectual property rights.
- Refusal to grant access to an essential facility.

State aid

State aid deserves specific mention in the accession context since traditionally many of the accession

countries did not regulate the granting of such aid and did not view state aid as unlawful. State aid control in the EU is centered on the principle that aid granted to enterprises via state resources is, by definition, incompatible with the Common Market, although some types of aid can be justified in exceptional circumstances. The reason behind this prohibition is that state aid is often (mis)used to keep some companies or sectors, although in desperate need of restructuring, on life-support, while unsubsidised firms ultimately run into difficulties as they cannot compete "on a level playing field" with those receiving governmental support. If the Commission finds an aid incompatible with the Common Market, it can require the aid (with interest) to be repaid by the beneficiaries. Under certain circumstances, illegal state aid may also be recoverable from the successors or purchasers of assets of the entity that received the aid.

Although beneficiaries of state aid are not obliged or even entitled to notify the Commission about a member state's plans to grant aid, they have a clear interest in verifying whether the member state has complied with all obligations under EC state aid rules, before accepting the aid in question. This is particularly relevant in the context of accession where aid that was considered lawful under the "old regime" may now come up for review by the Commission.

As of 1 May 2004, the EU regime for state aid control became directly applicable in the new member states, and enforcement of the state aid rules passed exclusively to the Commission. Aid schemes are classified into two main categories: existing aid or new aid. Aid schemes that were put in place in a new member state before the date of accession and were still applicable after that date, will be regarded as existing aid, provided that:

- The aid was put into effect before 10 December 1994;
- The aid is explicitly listed in the accession documents; or
- The aid was assessed by the relevant national state aid monitoring body and found to be compatible with the *aquis*, and the Commission has raised no objection against the aid (on the ground of serious doubts as to its compatibility with the Common Market).

The Commission has the power to monitor and periodically review existing aid, but it can only restrict or prohibit it as for the future, without the possibility of recovery.

State aid measures that do not meet the conditions above will be regarded as "new aid", which will need to be notified to the Commission. In addition, new aid falls under the "standstill" provision, as a result of which the new member state would have to cease granting the aid pending review by the Commission, until the latter has authorised it. State aid measures that are put into effect in a member state in contravention of the notification and standstill obligations will be regarded as "unlawful aid". In one of its first state aid investigations following accession, on 19 May 2004, the Commission announced that it had launched an investigation into the restructuring of the Polish Steel producer, Huta Czestochowa SA.

In spite of this general approach, the Accession Treaty contains specific transitional state aid arrangements that enable certain new member states to continue specified aid for a limited period following accession, even though that aid is not compatible with the Common Market. Therefore, special transitional arrangements have been set up for fiscal aid schemes and/or restructuring aid to sensitive industries (for example shipbuilding) in Cyprus, Hungary, Malta, Poland and Slovakia. In addition, state aid to transport and agricultural sectors are subject to a different regime, as the majority of accession candidates have no experience in monitoring public aid to those sectors.

Public procurement

The EC public procurement rules require competitive tendering for public contracts, transparency and equal treatment for all EU tenderers, with the aim of ensuring that the contract is awarded to the tenderer offering best value for money. Two new directives designed to simplify and modernise the rules on public procurement and to bring them more up to date with modern procurement methodology were recently published. (*The old directives governing work (93/37/EEC), service (92/50/EEC) and supply (93/36/EEC) contracts awarded by public bodies have been replaced by a consolidated text, Directive 2004/18/EC. Directive 2004/17/EC on procurement rules for utilities in the water, energy, transport and postal service sectors replaces Directive 93/38/EEC (Official Journal on 30 April 2004).*) Public contracts with a value above certain thresholds are subject to common EC rules regulating:

- Advertising of procurement contracts.
- Invitations to tender.
- The award of contracts.

Public contracts and contracts for purchases of goods and services by public authorities and public utilities accounted for around 14% of the EU's GDP, before the recent expansion, with a value of around EUR1,000 billion (about US$1,198 billion). As the new countries' authorities are now subject to the same rules, this market will also expand. Like state aid, some new member states have not traditionally regulated the award of public contracts and the adoption and implementation of these rules was one of the sticking points in the preparation for accession.

Companies who have been battling against discriminatory practices in the award of such contracts should now find it easier to penetrate these markets following accession. Conversely, companies who may have benefited from preferred supplier relationships with public authorities and utilities in accession countries should be ready to face tougher competition and comply with strict award criteria.

Environmental law

Enlargement of the EU is also an enlargement of environmental protection as the new member states have to apply the environmental *acquis*. Some countries have agreed transition periods for implementation of certain legislation, for example the Czech Republic can postpone full compliance with legislation on waste management (2005) and water quality (2010). For the new member states, improving administrative capacity to enable effective implementation of the new laws will be one of the greatest challenges.

By the end of April 2004, almost 100% of the environmental *acquis* had been transposed into national law in the new member states although implementation in certain areas, in particular nature protection, waste and industrial pollution, was still not considered satisfactory. The new standards must be respected not only by national authorities but also by industries affected by the legislation.

Upon accession, the level of EU cash for environmental projects rose three-fold as the new states became eligible for cohesion and structural funds. However, this still falls well short of the total needed, which the Commission puts at 2% to 3% of the accession countries' GDP.

Companies doing business in the new member states may face significant changes in environmental protection legislation and enforcement which, depending on the nature of their business, may require significant investment. If a company does not comply, for example with licensing, waste management and safety requirements, it may find itself penalised by new environmental supervising bodies.

Employment law

Employment issues and worker protection are a priority for the EU, and new member states have seen wide-ranging changes in their employment laws and practices as a result of implementation of EC rules in this area. Employers in the new member states will have to spend more time and resources on systems, training and organisation to meet these obligations. The EU also requires member states to introduce penalties for employers who breach the rules.

The major changes brought about by accession include:

- Elimination of discrimination on the basis of gender, age, disability, race/ethnicity, nationality, religion or belief, and sexual orientation.
- Prohibition of sexual harassment.
- The introduction of the 40-hour working week (although there are exceptions for each new member state regarding, for example, shift workers performing special activities) and precise limits on overtime.
- Changes to the information to be included in an employment contract.
- Delimitation of conditions for dismissal.
- Increased protection for pregnant workers and those under 18 years of age.
- Maternity and paternity leave.
- The right for employees to be consulted on key issues affecting their employment, sometimes through work councils.

In addition, a large number of EC directives addressing health and safety protection have also been implemented in accession countries.

EC law aims to allow free movement of workers within the EU, and so arrangements for workers to be able to move around between existing and new member states, for example by co-ordinating different national

social security schemes, is also required. However, the EU has agreed on a flexible transition period of up to seven years for limiting the influx of workers from new member states to the existing member states.

Although studies suggest that the arguments for denying the EU's new citizens full access to labour markets are exaggerated, the only country that has not imposed restrictions on the free movement of workers from the accession states is Sweden. The UK and Ireland have decided to allow workers free access to their job markets, but will limit access to social security. All other EU countries, fearing a sudden surge of immigrants from the new member states, have put in place transitional arrangements to restrict those that can seek work within their borders.

The overall impact of EC law on workplace discrimination is that employers must now provide equal pay and working conditions as well as equal access to training and promotion. EC law requires member states to place the burden of proof on the employer in cases where the employee is claiming sex discrimination, to prove that there has been no discrimination. These changes imply that employers need to review their payment systems to ensure that men and women are paid equally for like work and to consider funding maternity and paternity leave. These changes also require appropriate training for managerial staff.

CHALLENGES AHEAD

For companies doing business in the new member states many of these changes are now a reality. However, while the laws have changed, there is still the question as to how these requirements are being enforced at national level, or indeed by the EU, and perhaps consequently, the level of awareness of local staff in complying with the new measures. In the coming months and years, companies can expect increased enforcement at national level. In areas such as competition where the Commission has jurisdiction, there may well be some high profile investigations of practices in the new member states. Organising compliance across 25 member states will be challenging. Companies will need to take into account different cultural backgrounds, different languages, and in some cases, specific transitional arrangements and variations in national implementing measures. Ongoing monitoring of national and EU developments, and education and training of staff, will be an important element in this continuing compliance exercise.

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