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# CURRENT DEVELOPMENTS

VALERIE PEASE\*

## *Commission v. Germany*

### I. Introduction

In the recent judgment in *Commission v. Germany* the European Court of Justice of the European Community (the Court) made significant progress towards the completion of the unified internal market within the European Economic Community (EEC) in the area of insurance services. The requirements of the German domestic law were held to be an unauthorized restriction on the free movement of services within the Community and a violation of Community law. The case does not apply to life insurance or to compulsory insurance (such as for motor vehicles), but does address other commercial risks.

The purpose of this article is to outline briefly the extent and the significance of this holding by the Court in light of the program to remove all internal barriers and restrictions on trade within the Community, and its potential impact in the field of services in general and on insurance services in particular. Theoretically, the EEC is committed to the unification of the internal market by December 31, 1992,<sup>1</sup> and this decision weakens national resistance on legal grounds. Inevitably the Member States will resist in some area, but in the era of the global market, this decision should be welcomed.

The case is also important outside the European Community, especially to the United States, whose economy is increasingly based on the export of services, including insurance, rather than the export of goods. Trade in services and intellectual property now accounts for twenty percent of world trade, and services were on the agenda for the recent GATT negotiations that commenced in September 1986 at Punta del Este, Uruguay. Therefore, when this case is considered in the light of international trade agreements, the potential opportunities for access to the world's largest trading bloc should not be overlooked or underestimated.

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1. This target date was established by the Single European Act, which was signed on February 17 and 28, 1986, by the Member States. Perrott, *Regional Developments—European Communities*, 21 INT'L LAW. 571 (1987).

## II. Significance of the Case

### A. RIGHTS OF ESTABLISHMENT AND FREE PROVISION OF SERVICES

*Commission v. Germany*<sup>2</sup> is one of four cases concerning rights of establishment and freedom of services<sup>3</sup> in the insurance sector decided on December 4, 1986, by the Court of Justice of the European Communities. The other three cases concerned co-insurance and were brought by the European Commission against France,<sup>4</sup> Denmark,<sup>5</sup> and Ireland.<sup>6</sup> In each case the Commission was supported by the United Kingdom and the Netherlands, and the defendant was supported by Belgium, Italy, and the defendants in the other three cases.

The Commission's case against the Federal Republic of Germany (Germany) challenged the German domestic law regarding insurance and co-insurance services, claiming it violated Articles 59 and 60 of the Treaty of Rome.<sup>7</sup> The Court found that rules requiring an undertaking to be established in the Member State where the risk that it insures is located violated Articles 59 and 60. The Court, however, stated that in the absence of harmonized rules at the EEC level, national protective measures are acceptable in order to protect consumer interests. But such measures are only acceptable if they do not discriminate against undertakings from other Member States, do not duplicate requirements already imposed by another Member State, and recognize authorization by another Member State.

The Commission also challenged the German Insurance Supervision law because it required that insurance for a risk situated in Germany be placed with a company established and authorized in Germany. The Commission initially claimed that certain German thresholds were too high.<sup>8</sup> Later, it claimed the thresholds were illegal. The Court refused to consider either of the Commission's claims regarding thresholds.

With regard to the freedom of services, the case was necessary to resolve a political dispute. Certain Member States, such as Germany and Belgium, opposed the liberalization of the insurance markets. Their op-

2. Case 205/84, 49 Comm. Mkt. L.R. 69 (1987).

3. The right to the Free Provision of Services is derived from the Treaty of Rome, March 25, 1957, arts. 59 *et seq.*, 298 U.N.T.S. 3.

4. Case 220/84, *Commission v. France*, 49 Comm. Mkt. L.R. 113 (1987).

5. Case 252/83, *Commission v. Denmark*, 49 Comm. Mkt. L.R. 169 (1987).

6. Case 206/84, *Commission v. Ireland*, 49 Comm. Mkt. L.R. 150 (1987).

7. *See supra* note 3.

8. The Federal Supervision Office (Bundesaufsichtsamt) sets threshold values in respect of co-insurers of certain risks. The relevant figures for this case are DM 125 million for fire insurance, DM 75 million for civil liability aircraft insurance, and DM 500 million for general civil liability.

position had prevented the Council of Ministers' progress toward realizing a proposed second non-life-insurance Directive to facilitate the freedom to provide insurance services. The decision in *Commission v. Germany* clears the way for this Directive and although it does not open the flood-gates, it certainly will liberalize the insurance market in the European Economic Community.

## B. PROVISIONS OF THE TREATY OF ROME

The European Economic Community (EEC) or "Common Market," is a trading bloc of twelve Western European nations<sup>9</sup> with a combined population of 321.1 million and with a labor force of 135.2 million people. Their combined gross domestic product in 1985 was \$2406.4 billion. In 1985 the EEC's ratio of exports to imports was 11.9% (as compared with 5.5% for the U.S.), and its ratio of imports to GDP was 12.8% (as compared with 9.3% for the U.S.). This twelve-nation EEC is the United States' biggest trading partner, accounting for \$53 billion worth of U.S. exports in 1986 (compared to \$45 billion to Canada and \$27 billion to Japan).<sup>10</sup>

In contrast to other organizations such as ASEAN<sup>11</sup> and ANCOM,<sup>12</sup> the EEC is the most developed and effective of the supranational organizations. It is also the most sophisticated and cohesive trading bloc, having its own legislature of directly elected members (the European Parliament), executive (the Council of Ministers and the Commission), and a judiciary (the Court of Justice). The case in question, *Commission v. Germany*, was brought by the Commission against one of the national governments, Germany, in the Court, regarding the interpretation of the EEC's governing document, the Treaty of Rome.<sup>13</sup>

Created by the Treaty of Rome, the EEC arose out of the economic rubble of the Second World War. The Member States formed the EEC to draw the countries of Europe into closer economic unity, reducing, if not eliminating, the possibility of future economic devastation on the scale they had experienced after both the First and Second World Wars. Article 2

9. The bloc includes the six original members of the 1957 Treaty of Rome: France, Federal Republic of Germany, the Netherlands, Belgium, Luxembourg and Italy. In addition, it includes the United Kingdom, Ireland, and Denmark (admitted 1973), Greece (admitted 1981), and Spain and Portugal (admitted 1986).

10. Statistics supplied by the European Community Information Service, Washington, D.C.

11. The Association of South East Asian Nations, comprised of Indonesia, Malaysia, the Philippines, Singapore, and Thailand.

12. The Andean Common Market, comprised of Bolivia, Chile, Colombia, Ecuador, Peru, and Venezuela (membership has fluctuated).

13. See *supra* note 7.

of the Treaty outlines its general aim: the harmonious development of economic activities of Member States. Article 3 outlines the means of achieving that development: the free movement of goods; elimination of tariffs and quotas; the adoption of common agricultural and transport policies; the fostering of a system of undisturbed competition; the harmonization of laws of Member States so far as required for the proper functioning of the Common Market; and the abolition of obstacles to the free movement of persons, services, and capital. Other relevant parts of the Treaty are Article 52, the Right of Establishment, which aids the free movement of self-employed persons and services across national boundaries of Member States, and Articles 59 and 60, which guarantee the freedom to provide services.

Recently the EEC has focused much attention on the free provision of services. It has been attempting to ensure a common market in transport, banking, and securities, in addition to insurance services. In 1986 the European Court of Justice ruled that airfare price-fixing by national governments and airlines in the EEC is illegal, thereby making air transport subject to competition rules.<sup>14</sup> This decision gave the Commission a legal basis to deregulate air transport in the Community.

#### C. PROGRESS TOWARDS UNIFICATION OF THE MARKET IN SERVICES

On December 18, 1961, the Council of Ministers adopted an ambitious plan to abolish restrictions on the establishment of, and the freedom to provide, services.<sup>15</sup> In accordance with this plan, Directive 64/225/EEC (2 February 1964)<sup>16</sup> removed barriers to the establishment and provision of services in reinsurance and retrocession, and Directive 73/240/EEC (24 July 1973) sought to abolish formal restrictions on freedom of establishment. On the same date, Directive 73/239/EEC was adopted to provide for the coordination of laws, regulations, and administration provisions, and Directive 79/267/EEC (5 March 1979) extended these provisions to direct life insurance, which had been excluded under Directive 73/239/EEC.

Based on Articles 57(2) and 66 of the Treaty of Rome, the Council of Ministers first attempted to provide insurance services crossing national

14. Case 209-213/84, *Establishment of Air Fares: Applicability of the Rules of Competition in the EEC Treaty*, Judgment of April 30, 1986, not yet reported.

15. See generally Pool, *Moves towards a Common Market in Insurance*, 21 COMMON MKT. L. REV. 26 (1984).

16. Directives are the legislation of the Community made by both the Council and the Commission. Unlike the Community Regulation, which is self-executing, the Directive is binding on the Member State to which it is addressed, but leaves to the addressee the choice of form and method of implementation.

boundaries through Directive 78/473/EEC (30 May 1978) on the coordination of laws, regulations, and administrative provisions relating to Community co-insurance. It was due to be implemented by mid-1980. This Directive applies to "risks . . . which by reason of their nature and size call for the participation of several insurers for their coverage."<sup>17</sup> It allows a lead insurer, established in the country where the risk is located, to obtain co-insurance from insurers' access to the separate national markets of other insurance providers in other Member States. Many of the Member States had required at least twenty-five percent of the risk to be covered by insurers established in the state where the risk was situated. In the *Van Binsbergen* case,<sup>18</sup> however, the European Court of Justice held that EEC law did not require any proportion of the risk to be retained in the country where the risk was located. It is a basic principle of Community law<sup>19</sup> that national courts must ensure that Community law is applied, even if it means overriding a provision of national law, because Community law takes precedence over any previous or subsequent piece of national legislation that is in conflict with Community law.

Thus, these directives on establishment achieved their primary objective: they increased insurance providers' access to the separate national markets of other insurance providers in other Member States. But, by strengthening the control of the Member State within the national markets, the separation between the various markets was increased and was to exacerbate the lack of progress in the area of freedom of services. The present litigation was an attempt to correct this problem.

The deep division between the European institutions and certain Member States on the question of freedom of insurance services is reflected in the differences between the Court's ruling in these cases and the economic and political structures of those Member States. The United Kingdom and the Netherlands side with the Commission and support the concept of allowing insurers established in Member States to provide insurance throughout the Community without restriction. The United Kingdom is one major exporter on insurance services that does not impose any premium tax or similar fiscal measures on insurance. Its current administration encourages free-market competition, and so its position is not surprising. But other Member States emphasize consumer welfare and place primary importance on the insured, guarding against unfair competition. They also impose premium taxes, which are a source of revenue

17. Directive 78/473/EEC (30 May 1978), Article 1(2).

18. Case 33/74, *Van Binsbergen v. Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid*, 1974 European Court Reports [E.C.R.] 1299.

19. Case 6/64, *Costa v. ENEL*, 1964 E.C.R. 585.

used to support associated social projects.<sup>20</sup> It is within this framework that the Member States became aligned in the current legislation.

After the court decided *Van Binsbergen*,<sup>21</sup> the Commission began to see the objectives of Articles 59 and 60 as the immediate elimination of restrictions on the freedom to provide services. Since the end of the "transitional period," which in the case of Germany as one of the original six Member States was in 1970, private individual rights have vested in accordance with these provisions. Whether these could be limited by Directives, and by 78/473/EEC in particular, became one of the primary issues of the case.

#### D. RULINGS REQUESTED BY THE COMMISSION

The Commission filed this action on August 14, 1984, after it had failed to resolve the issues by direct negotiation with the German Government. The Insurance Supervision Law (*Versicherungsaufsichtsgesetz*) governs German insurance undertakings, including those established in another Member State. Germany amended this law on March 29, 1983, in accordance with Directive 78/473. But Paragraph 105(1) of the Insurance Supervision Law requires that foreign insurers seeking to carry out direct insurance undertakings in Germany be authorized by having a representative, agent, or other intermediary that satisfies German legal requirements to conduct business. Paragraph 106(2) further requires that foreign insurers have an establishment in Germany for all commercial documents and separate accounts. These laws do not apply to transport insurance, or co-insurance. The German Federal Insurance Supervision Office imposed thresholds for fire insurance, civil liability aircraft insurance, and general civil liability.<sup>22</sup> To conclude (or propose to conclude) an insurance contract on behalf of an undertaking without the authorization required to carry out such insurance operations is an offense.

Franz Schleicher was an insurance broker in Bavaria who was prosecuted under that law. He had frequently arranged through a British broker for the insurance of his clients' goods located in the Federal Republic of Germany by a number of London insurers that did not hold the authorization required by German domestic law. The Federal Insurance Supervision Authority sought to impose a fine of DM 18,000 upon Mr. Schleicher

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20. Premium tax in France varies from 4.89% to 30% depending on the class of insurance involved. There is also a 10% levy on all agricultural contracts, which is used to support the National Guarantee Fund for Agricultural Disasters. In Germany there is a 12% levy on all fire insurance to finance fire and rescue services. Figures from Claveloux, *EEC Update—Forward to Freedom*, THE POST MAGAZINE (June 25, 1987).

21. See *supra* note 18.

22. See *supra* note 8.

for arranging this insurance. When Mr. Schleicher appealed, claiming that the domestic law violated Article 59 of the Treaty of Rome, the Kammergericht (a German appeal court) upheld the fine.

Given that EEC law supersedes all domestic law of the Member States, and prevails in the event of a conflict,<sup>23</sup> the issue was whether the requirements of German domestic law could be justified under the Treaty. All national courts of the Member States are under an obligation to observe Community law. When Community law conflicts with domestic law, national courts can apply to the European Court of Justice under Article 177 of the Treaty of Rome for a "preliminary ruling." The German court failed to apply to the European Court of Justice in the *Schleicher* case, stating that such an advisory opinion was unnecessary.<sup>24</sup>

The Commission asked the Court for a Declaration that the German Government had failed to fulfill its obligations under Articles 59 and 60 of the Treaty by restricting the freedom to provide services in the field of insurance, including co-insurance, under Council Directive 78/473/EEC (30 May 1978) on the coordination of laws, regulations, and administrative provisions relating to Community co-insurance. More precisely, it asked for the following rulings:

- That Germany had breached its obligations under Articles 59 and 60 of the Treaty of Rome by enforcing the amended Insurance Supervision Law, which required insurers to be established and authorized in the Federal Republic of Germany.
- That Germany had further breached its obligations under Articles 59 and 60 by enforcing the Insurance Supervision Law because it required the lead insurer to be established in Germany and authorized to cover the entire risk insured.
- That Germany had failed to fulfill its obligations under Articles 59 and 60 of the Treaty of Rome, as well as Articles 1(2) and (8) of Directive 78/473/EEC (30 May 1978) by fixing high thresholds through the Federal Insurance Supervision Office for fire insurance, civil liability aircraft insurance, and general civil liability insurance.

The Commission raised its first point only in its case against Germany. It raised its second and third points also in its cases against France, Denmark, and Ireland. The Commission prevailed on points one and two against Germany, but lost on its third point.<sup>25</sup>

23. See *supra* note 19.

24. Only the highest courts, the Appeal Court and Federal Court, are obliged to send a case to the European Court if a point of European law is raised. The Berlin Court of Appeals (Kammergericht) which ruled on the *Schleicher* case was not under this obligation, but could have applied for a ruling on the point voluntarily.

25. Normally, the losing party must pay costs. Because both sides succeeded in part, the court ordered each side to bear its own costs.



## E. THE ARGUMENTS

First, the Court defined the subject matter of the first claim. The United Kingdom argued, and the Commission agreed, that when brokers or intermediaries advise clients choosing insurance and insurers, they act solely on behalf of their clients. Enacted to protect consumers, the German laws prevent intermediaries in Germany from arranging insurance contracts between German residents and insurers in other Member States. But these laws do not prohibit a German resident seeking insurance from dealing directly with the foreign insurance undertaking. Germany responded that by choosing his own insurer, the German resident would know that he gave up the protection of German law when he chose a foreign insurer.

The Court then defined the provision of "services" in the context of insurance. "Services" within the meaning of the Treaty are normally provided for remuneration, and are not governed by the provisions relating to the freedom of movement for goods, capital, and persons.<sup>26</sup> Article 60 requires the abolition of all restrictions on the freedom to provide services within the Community including those provided by nationals of Member States who are established in a Community state other than that of the person for whom the services are intended.

Next, the Court considered whether national legislation conforms with Articles 59 and 60 of the Treaty. Since Articles 59 and 60 became directly applicable on the expiration of the transitional period, their applicability was not conditional on the harmonization or the coordination of the laws of the Member States. The Articles require the removal of both discrimination against a provider of services based on his nationality, and all restrictions on his freedom to provide services imposed because he is established in a Member State other than that in which the service is to be provided.

Because the freedom to provide services is one of the fundamental principles of the Treaty, the domestic law of a Member State may restrict that freedom only if the law is justified by the general interest<sup>27</sup> and applies equally to all persons and undertakings established and operating within the Member State without discrimination.<sup>28</sup> If a restrictive law is justified and applies indiscriminately, it still fails if the interest it seeks to protect is already protected through legislation of other Member States to which the provider of services is subject. Such requirements must objectively be justified by the need to ensure that professional rules of conduct are

26. Treaty of Rome, *supra* note 7, art. 60, para. 1.

27. This is defined by previous case law for each area of services. See Forward & Clough, *The Single European Act and Free Movement—Legal Implications of the Provisions for Completion of the Internal Market*, 11 EUR. L. REV. 383 (1986).

28. See *supra* note 18.

complied with, and that the interest that such rules are designed to safeguard are protected.

Thus, to comply with Articles 59 and 60 of the Treaty, the requirement of permanent establishment and authorization imposed by the Insurance Supervisory Law must satisfy a four-part test: first, there must be imperative reasons relating to the public interest to justify restriction of the freedom to provide services; second, the public interest must not be protected already by the rules of the state of establishment; third, the same result cannot be achieved through less restrictive means; and fourth, that the rules apply equally to persons established in the Member State and persons not established in the Member State. The Court applied this four-part test to the facts of this case.

Regarding the first part of the test, the imperative public interest, the German Government and the Court agreed that insurance is a very sensitive area. A government must protect the consumer as a policyholder and as an insured person. Some categories of insurance affect whole populations, and therefore need special legislation in the various Member States as to the financial position and permanent supervision of the insurer.

Answering the second part of the test, Germany argued that existing laws of the state on establishment do not adequately protect the consumer. The United Kingdom and the Netherlands disagreed, maintaining that Directives 73/239/EEC and 79/267/EEC protect consumers through the supervision of insurers by the authorities of the state of establishment. These two Directives facilitate the creation of branches or agencies in Member States other than those in which the head office is situated. They do not, however, address the undertaking's activities that are "services" within the meaning of the Treaty. The Directives also include very detailed requirements regarding the free assets<sup>29</sup> of the undertaking, but do not harmonize the national rules concerning technical reserves.<sup>30</sup> That was expressly left to later Directives.

Because of these gaps in the Directives' scope, the Court accepted Germany's argument that the laws existing in other Member States do not adequately accomplish the goals of Germany's insurance legislation. The considerable differences in current national laws concerning technical reserves and the assets that represent such technical reserves justify Germany's laws if they are no more restrictive than is necessary to protect policyholders and insured persons. The Court did not agree, however, that to require authorization and permanent establishment in Germany is

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29. "Free assets" are the undertaking's own capital resources.

30. "Technical reserves" are the financial sources set aside to guarantee liabilities under contract. These are not part of the undertaking's own capital resources.

the least restrictive way to protect policyholders and insured persons. Thus Germany failed to satisfy the third part of the test.

The Member State may exercise certain control over insurance undertakings that provide services within its territory. The German Government argued that authorization was the only procedure that would permit it to investigate, monitor, and remove insurers that infringe the law. The current Directives provide for official authorization of insurers in the state where they are established and supervision by authorities in other Member States where the insurer opens branches and agencies. A proposed Directive anticipates cooperation between the supervising authorities of the state where the insurer is established and authorized, and the states that supervise the insurer's branches. Under this proposal, the authority in the state of establishment could withdraw the insurer's authorization if notified by the supervising authority that the insurer had violated the rules.

To put this dispute in a practical context, the United Kingdom contended that the impact of the free movement of insurance affects commercial insurance, rather than individuals, and avoids the consumer issues upon which the German argument relied. Because the nature of the risks and the parties seeking insurance vary, they do not all need the protection of national law. Because the law did not distinguish between those insured parties that needed and did not need protection, the Court was not willing to uphold Germany's authorization requirement.

Having held that Germany, by requiring authorization, violated the freedom to provide services, the Court also found the necessity of establishment to be "the very negation of that freedom," stripping Article 59 of the Treaty of all effectiveness. To be accepted, therefore, the law must be indispensable in achieving the pursued objective.

Germany argued for establishment stating that the state can verify *in situ* and monitor activities. But administrative considerations cannot justify derogation from Community law.<sup>31</sup> A national law that offends Community law, therefore, fails if any other means exists to achieve the same objective. It is possible under the authorization procedure to subject the undertaking to such conditions of supervision, by means of a provision in the certificate of authorization, and to ensure compliance with these conditions, if necessary, by withdrawing that certificate. Therefore, establishment of the insurer in the territory of the state in which insurance is provided is not indispensable for protecting policyholders and insured persons. Germany, therefore, failed to satisfy the test and breached its obligations under Articles 59 and 60 of the Treaty.

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31. Case 29/82, Van Luipen, 1983 E.C.R. 151.

## F. CO-INSURANCE

The problem of co-insurance stemmed from an ambiguity in Directive 78/473/EEC.<sup>32</sup> The Commission argued that Germany breached its obligations under Articles 59 and 60 when, in transposing 78/473/EEC into national law, it exempted co-insurers, but failed to exempt the lead insurer, from the requirements of authorization and establishment. The Commission conceded that the Directive was ambiguous, but claimed that it must be interpreted consistently with the Treaty.

Germany argued that Article 2(1)(c) of 78/473/EEC allowed the country of risk to require the lead insurer to be established and authorized in its territory before it could cover the whole risk as a sole insurer. The German legislation, therefore, would not encroach upon Articles 59 and 60 and 78/473/EEC. The Court disagreed, stating that under Community law, an insurer authorized and established in one Member State need not be established in another Member State to cover the whole risk situated there.

In *Commission v. Council*<sup>33</sup> the Court held that the language of secondary Community law should be interpreted consistently with the Treaty. Because the Court held the requirement of establishment to be incompatible with Articles 59 and 60 in that the requirement of a permanent establishment is the very negation of free trade in services, Directive 78/473 could not, therefore, require that the lead insurer be established. The requirement of authorization in the state is compatible with the Treaty only if it is justified by protecting the consumer as a policyholder and insured person. Since Directive 78/473/EEC applies only to risks requiring several insurers, and not to life insurance, sickness, or road traffic acts, consumer protection arguments do not have great force. Consequently, a difference between treatment of lead insurers and co-insurers could not be objectively justified.

The Commission's last claim concerned the German thresholds for certain risks that were the subject of Community co-insurance. The Commission changed its position on this issue during the course of the

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32. Article 2, para. 3(a) of the Directive, as finally adopted, states that this Directive shall apply to those Community coinsurance operations which satisfy the following conditions:

(c) for the purpose of covering this risk, the leading insurer is authorised in accordance with the conditions laid down in the First Coordination Directive *i.e.*, he is treated as if he were the insurer covering the whole risk.

It has been read as meaning that the leading insurer must be established in the state where the risk is situated, and also that the leading insurer may be anywhere in the Community, provided that he is authorized in some Member State. *See supra* note 15.

33. Case 218/82, *Commission v. Council*, 1983 E.C.R. 4063.

proceedings. The Court, therefore, found its position untenable, and this claim failed.

### III. Conclusion

Since the decision was announced in December 1986, the reactions to it have been mixed. Predictably, the Commission and the United Kingdom claimed a success, while German authorities announced that it was not so far-reaching. The Commission had originally envisaged the freedom of services applying similar rules to those that exist for the free circulation of goods. But because the Court had distinguished between different types of insurance policies, and said that certain restrictions intended to protect the policyholder were justified, a general principle is not applicable, and the freedom must be more finely drawn. A two-tier system is suggested, dividing the industrial market from the mass market, but where the line is to be drawn or how it is to be classified has yet to be decided.<sup>34</sup>

In view of these problems and other entrenched national interests of Member States, it may be several years before the extent of this freedom is precisely determined. Similarly, although life insurance was not addressed in this case, the willingness of the Court to allow members to legislate for the consumer benefit will affirm the concept of the protection of the individual being given a greater priority than the freedom of services. Nevertheless, the holding in this case is an important step toward unification of the internal market and heralds great commercial opportunities in the next decade.

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34. Claveloux, *supra* note 20.