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BUSINESS DISPUTE MEDIATION AGREEMENTS

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Abstract

Purpose – to analyze agreements to mediate existing and future business disputes, their legal regulation, validity, forms, and objectives

Methodology – in this research paper, theoretical and empirical methods (the linguistic method, the document analysis method, and the systematic analysis method) are applied

Findings – business dispute mediation agreements are like other agreements, but with a specific subject matter (i.e., the parties involved in a business dispute mutually agree on a dispute resolution procedure rather than on the substantive issues of law). There are two types of mediation agreements: those which are concluded before the dispute arises and those which are concluded after the dispute between the parties has arisen. A mediation clause is a separate provision which is included in the main business contract. By including a mediation clause, both parties express their will to settle their future disputes which arise out of or in connection with the present business contract through mediation. A concluded mediation agreement does not prevent parties from initiating judicial proceedings or arbitration

Research limitations – the author of this research paper analyzes business dispute mediation agreements and their legal regulations. She limited her research to the legal provisions which regulate mediation agreement in Lithuania as well as the legal provisions of other civil law countries (e.g., Estonia, Latvia and Poland). The author also analyzes the legal practices of agreements to mediate business disputes in the United States and in the English Courts

Practical implications – this article can be useful for those studying Lithuanian mediation doctrine because there is currently a lack of legal literature on the subject. The findings can be applied in practice by the parties involved in a business dispute, by the contracting business parties if a dispute does not exist, as well as by mediation providers

Originality – this is the first time that an in depth study of business dispute mediation agreements was carried out in Lithuania

Keywords: business dispute mediation agreements, mediation clause, business contracts, business disputes

Research type: research paper

Introduction

Business dispute mediation is a flexible, voluntary and, most importantly, a non-judgmental method to resolve business disputes. It is oriented in an amicable dispute resolution, controlled by the parties to the mediation. Experienced participants of legal business relationships already recognize the benefits of the mediation process (e.g., its confidentiality, the free choice it affords to the mediator and the mediation procedure itself). Although the legislative basis to practice mediation in Lithuania has been created nearly a decade ago and despite its key advantages, it is rarely used to solve
business disputes here. Before using business dispute mediation, it is important for all parties involved to understand that the mediation agreement predetermines that they must attempt to mediate before filing suit.

In the legal literature and in practice, the term "mediation agreement" is an ambiguous notion and appears to have two different meanings. First, "mediation agreement" can be used as a term signifying an agreement which resulted from a business dispute mediation in which parties agreed on the dispute merits. Such an agreement is a result of an amicable business dispute settlement and is intrinsic to the final stage of a mediation process. Thus, to avoid confusion, it would be more precise to entitle such mediation agreements as "mediated business dispute settlements" or "business dispute settlement agreements". Second, "mediation agreement" can be used as a term signifying the possible method of initiating a business dispute mediation in the future. The latter definition refers to an agreement to resolve business disputes via mediation. This second meaning is the object of the present research paper.

In the most general sense, business dispute mediation agreements are understood as the consent of the parties to resolve their business disputes through mediation. They are unique agreements wherein parties to a business dispute mutually agree to attempt mediation. However, an agreement to mediate business disputes has not been integrally analysed in Lithuanian jurisprudence.

This article is mostly based on the most recent works of Neil Andrews (2016, 2013), who performed a broad analysis of the content of mediation agreements and on Manon and Fred Schonewille (2014), who examined the legal regulation of mediation clauses and their consequences in multiple jurisdictions.

The analysis of various national legal acts shows that the legal regulations governing mediation agreements differ from country to country. In some countries (including Lithuania), mediation agreements are binding agreements which create legal consequences such as a parties must attempt mediation before filing suit or arbitration. In other countries (e.g. Poland and Estonia), mediation agreements do not create imperative consequences. Thus, an agreement to mediate has no effect on the admissibility of the case in court.

Another debated issue is whether mediation clauses should be considered as separable and autonomous provisions of the main contract. According to Jennifer Ralph (2005) and Gary Poon (2010), mediation agreements are considered to be contracts. The assumptions of the latter authors are used as a starting point for our insights that the validity of mediation clauses are not necessarily affected by the validity of the main business contract.

The aim of the present article is to analyze business dispute mediation agreements, their legal regulations, validity, forms, and objectives. Traditional jurisprudence methods, namely the linguistic method, the method of document analysis and the systematic analysis method, were applied in order to achieve the purpose of this research.

The Concept of Agreements to Mediate Business Disputes

Mediation is a voluntary process initiated by an advance mutual agreement of the parties involved in a dispute. Occasionally, the agreement to start the mediation process may not exist in cases of mandatory mediation. Therefore, agreements to
mediate are more relevant when the mediation process is initiated voluntarily. It is worthwhile mentioning that a general principal declares that business dispute mediation is a non-mandatory process. Therefore, if the disputants wish to resolve their business disputes through mediation then first they have to agree on this.

Neither Lithuanian doctrine nor case law indicate a particular definition of business dispute mediation agreements. On the other hand, the Law on Conciliatory Mediation in Civil Disputes of the Republic of Lithuania adopted on 15 July 2008 (hereinafter the Mediation Law)\(^1\) can help us understand the meaning of mediation agreements. At present, it is the only national legal act which regulates its concept in general. According to Paragraph 1 of Article 3 of the Mediation Law, mediation is applied with a written agreement by the parties to a dispute. The Mediation Law does not provide the definition of the mediation agreement. Nevertheless, we may conclude that according to the this legislation, mediation agreements must meet the following criteria. They:

- shall be formed between the parties to a dispute;
- shall be in writing;
- and shall cause the mediation application to be a legal consequence.

The Draft Law on Mediation\(^2\) proposes to amend Paragraph 1 of Article 3 of Mediation Law by adding that parties may agree to enter a mediation process only in disputes that legally can be solved through an amicable settlement. The general criteria of cases which cannot be referred to mediation are currently spelled out in Paragraph 2 of Article 1 of Mediation Law, which restricts mediation to certain cases.

In considering the form of mediation agreements, it should be emphasized that the Directive on Certain Aspects of Mediation in Civil and Commercial Matters adopted in 2008\(^3\) (hereinafter the Directive) regulates, that:

"in the absence of a written agreement, the parties should be deemed to agree to use mediation at the point in time when they take specific action to start the mediation process"

Specifically, a created mediation agreement means that the parties involved in a dispute have an obligation to resolve their dispute through mediation. This obligation is clearly regulated in Paragraph 2 of Article 3 of the Mediation Law: "when the parties agree to settle their dispute through mediation, before applying to court or arbitration, they have to try to attempt mediation".

If the parties are willing to resolve their disputes with the help of neutral third party (the mediator) and they both have agreed on this, then a valid agreement to mediate gives the parties the right to settle their disputes through mediation. When creating a mediation agreement, parties design a dispute settlement procedure which will be applied to their disputes. One of the key advantages of such a procedure is that the entire control of the dispute resolution process relies on the parties themselves rather than on mediator. Intriguingly, forms of business dispute resolution other than mediation are be even considered by some experts to be inherently unjust (Richbel, 2008).

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Business dispute mediation agreements can be understood similarly as indicated above. They have the same mediation agreement with the same legal outcome. However, the parties of such an agreement will be specifically the participants of a business relationship.

Mediation agreements can be enacted only if all the parties to a business dispute agree to settle their dispute through mediation. It is important to note that the parties' agreement should be expressed independently, avoiding the factors that can create a defect of their consent. The main feature of business dispute mediation is voluntariness. It is clearly stipulated in the Directive that parties to a dispute should attempt mediation on a voluntary basis. Thus, a refusal to mediate made by one of the parties to a dispute may cause inability to apply mediation procedure.

A free-will mediation agreement is absent only when a judge or legislation makes mediation compulsory. In mandatory mediation cases, however, the mediation agreements does not have high practical value for several reasons. First, an obligation to enter into a mandatory mediation process may arise to the parties de jure, regardless of whether or not they have signed an agreement to mediate (e.g., when the duty to use mediation before applying a lawsuit is indicated in a court order or in legal acts (Kaminskiénė, 2013)). Second, when participation in mediation is encouraged by a number of procedural penalties this creates what we call "the defect of the consent to mediate". Even though mediation agreements in latter cases are usually signed, such agreements may be considered to be with defective consent because the parties' free will is violated. According to Kaminskiénė (2013), despite the fact that mediation initiation remains within the parties' discretion, the promotion with various procedural sanctions is rather a compulsion to participate in mediation and is considered to be the feature of a mandatory mediation.

In contrast, business dispute mediations in Lithuania are non-mandatory and agreements to initiate such processes are strictly autonomic and voluntary. Mediation is possible only if parties to a business dispute are willing to examine their issues in good faith (Andrews, 2012). Hence, legal agreements to mediate business disputes should be determined both mutually and autonomously.

Returning to the main legal consequences of business dispute mediation agreements it should be stressed that in Lithuania, it is a general principle that case is not admissible in court with an unattempted mediation clause. This is not the general principal in every country.

In contrast to Lithuanian national legal regulation, the Conciliation Act of Estonia adopted on 18 November 2009 stipulates that a mediation clause in a binding contract does not create an imperative to solve the dispute through mediation. Similar legal regulations are valid in Poland, where a case is also admissible in court with mediation clause (Schonewille, 2014).

In Latvia, the parties who signed a mediation clause must implement their contractual agreement to refer future disputes to mediation. An exception is if the parties themselves both mutually refuse to comply with an agreement to resolve their dispute through mediation. Similarly in France, a dispute can be referred to mediation only with the prior consent of the parties. If parties have concluded a

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1 The Section 10 of the preambles of the Directive.
3 The Decree on The Development of Conciliatory Mediation System and Endorsement of its Conception authorized by the Minister of Justice of the Republic of Lithuania. *Official Gazette*. 2015, 1R-268.
mediation clause, they must attempt mediation before initiating court proceedings\(^1\). In Austria, there are no legal consequences for noncompliance with a mediation clause. Parties are required to determine the consent and willingness to mediate at the point in time when they are willing to start mediation process (Roth and Stenger, 2013).

In such United States of America’s\(^2\) (hereinafter US) jurisdictions as, for example, California, Florida, and New York, the courts require the parties to mediate before pursuing a court action (Schonewille, 2014). In accordance with US case law analysis, courts tend to enforce pre-existing obligations to participate in mediation. The Court of Appeals of the State of Kansas in one of their cases (Santana v. Olguin, 2009) has noted that:

"the signed agreement to mediate is binding, and parties must submit the dispute to mediation. The agreement to mediate does not bind the parties to results that might be achieved during mediation, and parties retain the right to go to court in the event that mediation is unsuccessful."

Mediation can be considered as a failure when the parties do not reach a mediated business dispute settlement. Additionally, mediation is unsuccessful when the legal or contractual term within which to attempt mediation has expired. The Legal term to use mediation according to Lithuanian law is one month and is stipulated in Paragraph 2 of Article 3 of Mediation Law.

Since mediation in Lithuania is a voluntary process, parties may terminate it at any time.\(^3\) Thus, the requirement to attempt to settle the dispute through mediation before pursuing a court action does not violate the principle of mediation voluntariness. In considering parties' lawful right to go to court, it should be underlined that the parties entering into a mediation agreement do not eliminate their business disputes out of court and arbitral competence.\(^4\) Moreover, the Directive ensures that parties retain the right to initiate judicial proceedings even if limitation or prescription periods expire during the mediation process\(^5\).

We may conclude that mediation is not considered to be a substitute for the judicial process or any other alternative dispute resolution procedures. In contrast to the arbitration agreement, which creates an alternative arbitration jurisdiction (Dominas, Mikelėnas, 1995), mediation agreements do not exclude the jurisdiction of national courts. As a result, the legal consequences of agreements to mediate business disputes completely differ from the negative effects caused by an arbitration agreements\(^6\).

\(^1\) Ibid.

\(^2\) The United States of America’s Court system not only tend to enforce pre-existing obligations to participate in mediation but also directly encourages disputants to pursue medication after court proceedings have begun. Often times, litigants are required to attempt mediation before the court will proceed further with the case.

\(^3\) The right to terminate the mediation process at any time is laid down in Paragraph 5 of Article 5 of the Mediation Law: Section 13 of the Directive.

\(^4\) According to the Paragraph 2 of Article 3 of the Mediation Law, parties to a dispute have the right to initiate court or arbitration proceedings after they attempt mediation.

\(^5\) The Paragraph 1 of Article 8 of the Directive.

\(^6\) More information about the effects caused by an arbitration agreements can be found in the previous article (Atutienė, E. 2013. Notaro funkcija arbitraže ir jo vaidmuo šalims sudarant arbitražinį susitarimą. Notariatas. 15:(61-64)).
In a nutshell, business dispute mediation agreements are like any other agreements but with a specific subject matter. The parties to a business dispute mutually agree on a dispute resolution procedure rather than on substantive issues of law. According to Lithuanian national legal regulation, an agreement to mediate business disputes is binding. The parties to a business dispute must attempt mediation before filing a lawsuit. This contrasts or differs slightly to the law in other countries like Estonia and the US. In the event that mediation is unsuccessful, the parties retain the right either to go to court or settle their business disputes through any other alternative or traditional dispute resolution procedures.

Types of Mediation Agreements

Mediation agreements can be generally divided into two types: the ones created before the dispute arises (pre-dispute mediation agreements) and the other ones which are created after the parties have arisen (post-dispute mediation agreements, also known as mediation clauses). The parties may enter into a mediation agreement regarding existing disputes as well as disputes which may arise between them in the future. This provision is clearly laid down in Paragraph 1 of Article 3 of the Mediation Law. Hence, we may first distinguish, mediation agreements in which the parties enter in the absence of a particular business dispute. Such mediation agreements are usually drawn up as mediation clauses. Alternatively, the agreement can be concluded to mediate a particular existing business dispute which, in most cases, will be concluded as a separate agreement between the parties.

The term "post-dispute mediation agreements" is not widely used in the legal sources of mediation law. Post-dispute agreements to mediate are usually simply called mediation agreements. Such agreements are concluded after the particular dispute has arisen and tend to be longer than pre-dispute mediation agreements. As far as the dispute between the parties already exists, a mediation agreement will usually contain details of the subject matter of a dispute, the place of mediation, the governing law, the complete mediation procedure, the nomination of mediator, the number of mediators, the confidentiality clause, and will clearly identify that the dispute is being referred to mediation. These type of mediation agreements are usually prepared by a mediator or mediation provider and are delivered to the parties to a dispute before the mediation proceedings begin. The agreement to mediate is usually signed on the day of mediation (Richbell, 2015).

Richbell (2015), in his book, gives an example of the typical mediation agreement. The author states that he favors simple and brief rather than a complex multi-page form of mediation agreement. There is no regulation on the length of mediation agreements. It mostly depends on the document compiler. However, there are main provisions that exist in all mediation agreements. It is important to set down essential principles such as confidentiality, authority to settle, without prejudice and the requirement to negotiate in good faith. The agreement should be sent out early so that parties have time to acquaint themselves with its content (Richbell, 2008).

Many commercial contracts in recent years tend to have an embedded dispute resolution clause. Therefore, another type of mediation agreement is often used to carry out legal business relationships and it is known as a mediation clause. Mediation clauses are pre-dispute mediation agreements because they dictate that if a dispute should arise, it will be resolved through mediation. According to Poon (2010),
it is almost a common practice in the US to include in every business contract a mediation clause. Andrews (2013) defines mediation clauses as "agreements which require both parties to pursue mediation with a view to settling or terminating their existing or future disputes". The most basic mediation clause generally provides that the parties shall apply mediation to their dispute which arises out of or relates to a contractual or other legal relationship.

In summary, there are two types of mediation agreements. The first one is signed after the dispute between the parties has arisen and usually is prepared by a mediation services provider. The second type of mediation agreement is a mediation clause which proposes that future disputes will be resolved through mediation and is included into the main business contract a dispute resolution clause.

**Mediation Clauses in Business Contracts**

A mediation clause is normally one of the substantive clauses of the main business contract. Many business relationships are governed by contracts between the parties. Therefore, it is beneficial to use this type of mediation agreement for several reasons. In particular because the subject matter of mediation clauses are disputes which may arise in the future. Most business entities are interested in resolving their disputes rapidly and cost efficiently, however, it is challenging to reach any agreement after a dispute has arisen. It may be even more difficult for conflicting parties to reach an agreement on their dispute resolution method in the moment. As a result, the dispute between the parties prolongs, the business relationship gets worse and businesses may end up in losing their profit. Hence, the ability to arrange a business dispute settlement in advance helps parties to save money and time. Pre-dispute mediation agreements enable parties to not waste time trying to draw up a dispute resolution agreement but to start dealing with a business dispute at its earliest stage before their dispute is over-developed.

Since mediation clauses are provisions included in the main business contract, the parties may agree in a single document not only on their mutual contractual rights and obligations but also on their future disputes resolution method. However, the insertion of such dispute resolution clauses into legal business contracts raises the question of the separability of mediation clauses. In other words, does the invalidation of some sections or provisions in the business contract affect the validity of the mediation clause? According to Ralph (2005), mediation clauses are contracts, author states that:

"ultimately, mediation clauses are considered to be contracts, and thus fall under generally applicable contract doctrine."

From such a standpoint, a mediation clause is a contract inserted into the main contract. It is a separate provision despite the fact it is included in the main business contract.

As far as the validity of mediation clauses, it is worthwhile to mention a US court decision in the *Auchter Company v. Zagloul case* (2007). In this dispute, the validity of the mediation agreement was in question. Parties to the dispute in this particular case had terminated their business contract. The terminated contract included mediation prior to the arbitration clause. The Florida District Court of Appeals determined that the mediation prior to arbitration clause survived the termination of the main
contract. The Court held that:

"the dispute resolution provisions of the contract are intended to survive purported termination of the contract by a party."

Consequently, the Court ordered parties to attempt mediation. In case of unsuccessful mediation, parties were ordered to proceed to binding arbitration since it was required by the written agreement of both parties (Auchter Company v. Zagloul, 2007).

It is interesting to observe that the full or partial termination of a main business contract does not necessarily affect the validity of the mediation clause. Regrettably, the national sources of law do not provide any regulations regarding the separability of mediation clauses. There is no legislative basis for enforcing mediation clauses if the underlying contract is pronounced invalid for any reason. It would be advisable for national legal amendments to be made which regulate the separability of mediation clauses from the underlying agreements.

Mediation clauses are usually rather short since the subject matter of a mediation clause are business disputes that may arise between the parties in the future. Hence, the nature of a dispute, the most appropriate tools for solving it, as well as whether such dispute will arise at all in the future are unknown. In addition, while parties are signing the mediation clause they often naively expect that disputes will not arise and that they will not have to apply the mediation agreement in the future. However, disputes in business relationships occur very often. Therefore, it is useful to draft an effective mediation clause.

The vast majority of permanent national mediation institutions provide model mediation clauses. For example, in Lithuania, the Vilnius Court of Commercial Arbitration provides a model mediation clause which may be included in a business contract. It states:

"Any dispute, disagreement or claim arising out of or related to this contract shall be settled by mediation at the Vilnius Court of Commercial Arbitration following the Rules of Mediation of this court. In case of failure by the parties to settle the dispute amicably within three months after the commencement of the mediation, the relevant dispute may be referred for final resolution on the initiative of any of the parties under the procedure prescribed by legal acts."\(^1\)

Parties who choose to include into their business contract such a mediation clause are obliged to mediate their dispute at the Vilnius Court of Commercial Arbitration following the rules of mediation adopted by this particular court.

International model mediation clauses are formulated similarly but they include different rules which will be followed in the mediation. For instance, the International Chamber of Commerce’s (hereinafter ICC) model mediation clause suggesting an obligation to consider the ICC Mediation Rules is as follows:

"In the event of any dispute arising out of or in connection with the present contract, the parties agree in the first instance to discuss and consider

\(^1\) The model mediation clause provided by the Vilnius Court of Commercial Arbitration. [interactive], [accessed 2016-05-07], <http://www.arbitrazas.lt>.
referring the dispute to the ICC Mediation Rules."

It is obvious that both national and international model mediation clauses are very similar. Both recommend the broad definition of mediation clause by regulating that any dispute arising out of or in connection with a contract will be a subject matter of mediation. This formulation is important to ensure the autonomy of mediation clauses.

It is also now common to draft multi-tiered dispute resolution clauses\(^2\) (e.g., med-arb clauses), particularly in complex business contracts (Tevendale, C., et al, 2015). Med-arb clauses can optionally provide that the referral of future disputes to mediation prior to arbitration will be:
- discussed and considered, or
- mandatory.

Dispute resolution clauses providing mediation as a condition precedent to arbitration require even more care in drafting. It is worth mentioning *International Research Corp. PLC v. Lufthansa Systems Asia Pacific Pte Ltd.*, (2013) case. Parties to a dispute had entered in an agreement which contained dispute resolution mechanism. It prescribed that any dispute shall first be resolved by a specified mediation procedure, failing which, the dispute shall be resolved by arbitration. It was argued that the preconditions for arbitration were unenforceable due to uncertainty. However, The Singapore Court of Appeal held that preconditions for arbitration were not uncertain and were enforceable because they were clear – set out in a mandatory manner and provided a specific set of procedures to resolve disputes as a precondition to arbitration (Tevendale, C., et al, 2015 and *International Research Corp. PLC v. Lufthansa Systems Asia Pacific Pte Ltd.*, 2013).

When considering how to formulate an effective mediation regime it should be underlined that the mediation clause should neither be too short nor too long nor too complicated. In order for it to be effective, the mediation clause must be accurate and perspicuous. Parties entering into a mediation agreement should avoid ambiguity and imprecision. Any mediation clause should be comprehensible and simple, but not too simplistic. According to Andrews (2016), no problem of certainty should arise if parties create a mediation clause which adheres closely to the institutional set of mediation rules.

If parties decide not to model their mediation clause on a well established institutional set of rules, they should avoid these mistakes:
- *The absence of an agreement to mediate*. An agreement to mediate is the essential basis of referring the dispute to mediation. Parties must express their will to mediate freely, without any influence that may cause a defect of their consent.
- *Exaggerated complexity*. Complex mediation clauses which lack clarity (e. g., have too many supporting explanatory notes) should be avoided.
- *Providing too much specificity*. Nonessential details should not be included because they become unnecessarily burdensome. For example, the education or

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1 The model mediation clause provided by the International Chamber of Commerce’s [interactive], [accessed 2016-05-07]. <http://www.iccwbo.org/>.

2 Multi-tier dispute resolution clauses (can also be called multi-step or executive escalation clauses) are clauses that comprise different steps, each incorporating a form of alternative dispute resolution process (Tevendale, C., et al, 2015). According to DeGroote (2010), multi-step clause *is a "contractual provision that requires the parties to an agreement to escalate a dispute through varying levels of management or other processes, such as mediation, using agreed-upon procedures before litigation or arbitration may proceed"*. 
capabilities of mediator do not need to be included.

- Providing an ineffective mediation provider. The mediation services supplier should be identified correctly and accurately (e.g., "Vilnius Court of Commercial Arbitration", "International Chamber of Commerce’s"). When naming a particular mediator, parties should make certain that the mediator is not deceased or retired.

The leading English decision concerning mediation clauses is Sulamerica cia national de seguros S.A. and others v. Enesa Engenharia S.A. (2012). In this case, the English Court of Appeal set down minimum requirements for the validity of mediation clauses. According to it, mediation clauses should provide:

1) clear, definable minimum duties to participate in a mediation that is capable of having legal effect;
2) the nomination of the mediator or an agreement on a process for his or her selection;
3) a defined ad-hoc mediation process or reference to the procedure of a specific mediation provider.

In practice, it often happens that mediation clauses have flaws, are inaccurate or are incomplete. Hence, it is interesting to discuss the Garrett v. Hooters-Toledo (2003) case as an illustrating example of a "pathological clause". The US District Court, in this case, found that the mediation agreement established by the parties was illegal in two aspects: procedural and substantive. For the first time in US case law history, the District Court of United States invalidated a mediation requirement on these grounds. Garrett v. Hooters-Toledo (2003) was a gender discrimination case in which the plaintiff alleged that her former employer unlawfully discharged her after she disclosed that she was pregnant. The plaintiff alleged that she was compelled to sign the "Agreement to Mediate and Arbitrate Employment-Related Disputes" (hereinafter ADR Agreement), or she could not lay claim to extra income and other bonuses. Thus, the plaintiff signed the agreement. After the dispute between the parties arose, the plaintiff argued that the ADR Agreement was unconscionable.

The Court analyzed the disputable provisions of the ADR Agreement and considered three provisions presented hereafter as a substantive unconscionability.

- Cost splitting provision. The plaintiff argued that the expenses she would incur would deter her from pursuing her claim. Hence, the cost-splitting provision of the ADR Agreement was discussed as a provision preventing the plaintiff from vindicating her statutory rights.

- Time limit for filing a claim provision. The ADR Agreement stated that all

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1 The term "pathological clauses" is owned by author Frédéric Eisemann who proposed a term "pathological arbitration clauses", which refers to defective arbitration clauses. Such defective clauses Eisemann called "pearls" pulled out from the dark arbitration museum. They have four criteria. The first, which is common to all agreements, is to produce mandatory consequences for the parties. The second is to exclude the intervention of state courts in the settlement of the disputes, at least before the issuance of the award. The third is to give powers to the arbitrators to resolve the disputes likely to arise between the parties. The fourth is put in place an efficient and rapid procedure which leads to the rendering of an award that is judicial enforcement. Arbitration clauses which do not comply with these four criteria are considered to be pathological clauses. According to Davis B. G. (Pathological Clauses: Frédéric Eisemann’s Still Vital Criteria). Arbitration International, 1991(4). P. 365. Since these criteria were created in the light of arbitration clauses, not all four of them may be applied to mediation clauses. However, in our opinion, the first and the fourth criteria are common to mediation clauses as well. Even the third one could be considered as relevant to mediation clauses if it was formulated as the prerogative of mediators to help the parties solve their dispute through mediation in an amicable manner. The pathological mediation clauses are not a subject matter of present article but are an object of the author’s further research.
claims against the defendant should be filed within ten days from the last day on which the claim arose. The Court held that the ten-day time limit for bringing a claim was unreasonable and unfair.

- **Mediation requirement provision.** The plaintiff alleged that she was compelled to sign the agreement which was excessively preferential to the defendant. Accordingly, the agreement was considered to be unreasonable and unfair because it required the claimant to participate in a process which was exceptionally favorable to only one of the parties.

In determining procedural unconscionability, the United States District Court held that there was unequal bargaining power between the parties. The Court stated that the pressure on the plaintiff to accept the ADR Agreement was obvious. The court also ascertained a lack of the plaintiff's autonomous will to accept the ADR Agreement.

Ultimately, the ADR Agreement was acknowledged as illegally, unjustly and unjustifyably favoring one of the parties to the dispute. From the Court's perspective, the agreement between the parties had striking power imbalances since one of the parties’ free-will to accept the agreement was violated. Hence, the Court stated that the agreement was both substantively and procedurally unconscionable, violated US common law and was considered to be unenforceable (*Garret v. Hooters-Toledo*, 2003).

The latter case analysis shows that a mediation clause signed by the parties may become a subject matter of their dispute. Thus, it is very important to respect the most general principles of contract law. According to Poon (2010), mediation agreements are considered to be valid only if they are determined by the contract principles governing the formation of contracts.

Ralph (2005), who analyzed aspects of unconscionable mediation clauses, states that the *Garret v. Hooters-Toledo* (2003) case may greatly influence the practice of how mediation agreements are formulated and concluded. In accordance with the *Garrett v. Hooters-Toledo* case and Ralph’s (2005) insights, there are several more aspects which parties should take into account when drafting mediation clauses.

- They should not give a limited choice of mediators from a list of mediators who are specifically pre-authorized by one of the contracting parties. It is especially dangerous when there is a power imbalance between the contractors (e.g., employer and employee). To accomplish knowledgeable choices it is more useful to use the assistance of a neutral third party or representatives.

- They should always mutually agree on a **forum selection clause.** The decision regarding the place of mediation should be negotiated autonomously by both parties. It is also advisable to avoid forum selection clauses that have little justification for stipulating a particular forum.

- They should make sure that the time limits for filing a claim if the mediation fails are definitely and correctly delineated (e.g., Paragraph 2 of Article 3 of Mediation Law, suggests that the minimum should be at least one month).

Parties to international business contracts should also consider indicating a mediation style in the mediation agreements. The various institutional model sets of mediation rules generally permit the mediators to conduct any style of mediation. However, some authors suggest that parties of an international business relationship should clarify the style of mediation in order to avoid cross-cultural confusions (Abramson, 1998 and Kolkey et al., 2012).

Indeed, the formulation effective mediation clauses are very challenging.
Therefore, it is recommended to design mediation clauses which are similar to a well-established institutional model or at least follow the doctrine of certainty and provide minimum requirements for the validity of the mediation clause.

Conclusions

Business dispute mediation agreements are binding and require parties to engage in mediation. An agreement to mediate business disputes should be determined both mutually and autonomously. According to Lithuanian legal regulation, a case is not admissible in court with a mediation clause. This contrasts or differs slightly to the law in other countries like Estonia and the US. Nevertheless, parties entering into a mediation agreement do not eliminate their business disputes out of national court and arbitral competence. If parties have tried to settle through mediation then they can implement their lawful right to go to court.

There are two types of mediation agreements: those which are concluded before and those which are concluded after a dispute has arisen. Both mediation agreements create the same legal consequences.

Mediation clauses are considered to be contracts and are included in underlying business contracts as separate provisions. Effective mediation clauses should provide minimum requirements to be valid. These include: the commitment to mediate, the mediator and the complete mediation procedure. To be enforceable they should not violate the fundamental principles governed by contract law. To avoid the clauses being deemed "pathological", it is recommended that parties make a reference to a institutional model set of mediation rules or at least draft a mediation clause which adheres closely to the recommended model mediation clauses.

References


The Decree on The Development of Conciliatory Mediation System and Endorsement of its Conception authorized by the Minister of Justice of the Republic of Lithuania. Official Gazette. 2015, 1R-268.


HIGHER EDUCATION SERVICE: CONCEPTION AND PROPERTIES

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Abstract

Article deals with specification of higher education services. The conception as well as the properties of higher education services are analysed. Higher education services are specific and differ from the other types of services as well as education services. In order to identify all properties of higher education services it is necessary to analyse both general properties of services and specific properties of education services, vocational training services and higher education services. All these properties of higher education services are analysed and summarised in this article. A survey of the relevant literature is provided in this study.

Purpose – to analyse higher education service conception and main properties systematically: to review the diversity of conceptions of service, education service, higher education service involving the main properties of each service category; to present the list of properties of higher education services which includes both generic and specific properties of higher education services.

Design/methodology/approach – the study is performed using the following methods: systemic analysis, review and generalization of scientific literature and legal regulation.

Finding – higher education is an economic category equivalent to the service, which is characterized not only by service generic properties, but also by specific properties inherent to education, vocational training and higher education services. The general list of properties of higher education services consists of 45 characteristics that reveal the complexity of higher education services, uniqueness and specificity. However this list is not exhaustive. Properties of higher education services are necessary phenomenon which helps better understand the nature of higher education and assist in other research areas of higher education.

Research limitations/implications – this study is based on review of the newest scientific literature and legal acts of the Republic of Lithuania, which are regulating the research object.

Practical implications – properties of higher education services assist in other research areas of higher education. Understanding and assessment of the properties of higher education services affect better quality of research in such research areas as higher education funding model development, higher education service pricing, higher education finance management, higher education service quality assessment and improvement, and etc.

Originality/Value – the structured list of higher education services properties is presented, according to the generic properties, inherent to all types of services and specific properties, inherent to education, vocational training and higher education services.

Keywords: higher education service, education service, service, properties of higher education services.

Research type: literature review.
Introduction

Higher education is one of the components of the education system and is the main source of human capital formation of a stable national economy. Higher education has a positive impact on the country's economic growth, society and each and every individual. Higher education is directly related to service category. However, it should be emphasized, that higher education services are very specific and differ from other types of services. Different aspects of higher education services were analysed by Crosson (1985), Soutar and McNeil (1996), Panruchin (1995, 1997), Barannik (1998), Spiriuchova (2003), Langviniene and Vengriene (2005), Kotler and Armstrong (2006), Ksenofontova (2006), Guščinskienė and Čiburienė (2008), Yeo (2008), Lifanova (2008), Tsinidou et al. (2010), Schreyer (2010), Skorobogatova (2010); Grigorash (2014), Blinova (2015) and other.

Purpose of the research – to analyse higher education service conception and determine main properties systematically. Tasks of the research: (1) to review the diversity of conceptions of service, education service, higher education service involving the main properties of each service category; (2) to present the list of properties of higher education services which includes both generic and specific properties of higher education services. Methods of the research: systemic analysis, review and generalization of the newest scientific literature and legal regulation.

The Conception of Higher Education

Higher education – is a service (Spiriuchova, 2003; Langviniene and Vengriene, 2005; Guščinskienė and Čiburienė, 2008; Blinova, 2015). Higher education (studies) (Lithuanian – aukštojo mokslo studijos) is type of the education services. It is important to pay attention to the basic concepts and processes while analysing higher education services as a type of education services and specificity of higher education services (properties).

Firstly, it should be noted that the concept of higher education is not objectively revealed in the scientific literature or in the legislation. For example, higher education (especially university higher education) concept was analysed by Jučevičienė et al. (2000), Kraujutaitytė (2002), Tinfavičienė (2007), Pilkiene and Sajienė (2009) and others. However, as authors have noted, scientific research works was not providing much attention to the concept of higher education itself, but was used in the context of solving certain problems (Pilkiene and Sajienė, 2009; Blinova, 2015). On the other hand, it is generally agreed that higher education is the studies, carried out in a higher education institution, leading to a qualification, qualification degree or science degree, so that the primary meaning of the “higher education” phrase is forgotten and is not being discussed a lot. (Pilkiene and Sajienė, 2009).

In most languages (e.g. English – Higher education, Russian – Высшее образование) highlighted not a science (e.g. like in Lithuanian – Aukštasis mokslas = Higher Science), but education (Pilkiene and Sajienė, 2009). Lauzackas (2005) points out that science itself cannot be lower or higher. However, the emphasis on education defines the term as a link to a higher school studies carried out on the basis of science (Pilkiene and Sajienė, 2009). Jučevičienė et al. (2000) points out that higher education differs from other educational units – in higher education a high level of intellectual activity is required, scientific methods of operation are mastered and applied, the
critical thinking is developed. The authors give eight properties that are exclusive to higher education as a specific educational subsystem (Juceviciene et al., 2000):

1. Studies activity (develops intelligent personality, which is capable of self-realization);
2. Parity relationship (combines academic community members for equal interaction with this material, taking into account the different interests and points of view);
3. Research (describes the specificity of the Science and active participation in the creation of new knowledge);
4. Critical thinking (helps the individual to change themselves by analysing various objects and phenomena in the search for appropriate solutions);
5. Autonomy (associated with self-government and self-control, which makes opportunities for institutions to self-realize);
6. Academic freedom (emphasises unity of rights and obligations in the academic community);
7. Scientific and qualifications acquisition (gives the possibility for the institutions to assess the intellectual and professional development of its members);
8. Openness to the society (higher education functions in society are the dissemination of knowledge and intellectual education).

Kraujutaitytė (2002) points out, that higher education activity is very important for society, as it implements cultural process specialization and actualization. For some, higher education is valuable because it enables academic self-expression. For others, acquiring a diploma is a way to determine status of the personality and to prove the ability to create a better future, for someone else it can be a way to ensure public cultural regeneration (Kraujutaitytė, 2002). It is important to emphasise, that objective definitions of higher education are not easy to come by, but it is broadly accepted that higher education fulfils four major functions (Cemmell, 2003):

1. The development of new knowledge (the research function);
2. The training of highly qualified personnel (the teaching function);
3. The provision of services to society;
4. The ethical function, which implies social criticism.

The conception of Higher education (studies) (Lithuanian – aukštojo mokslo studijos) is provided by the Law on Education of the Republic of Lithuania1. According to the Law on Education of the Republic of Lithuania, the purpose of higher education studies should be to assist an individual in the acquisition of a higher education qualification corresponding to a modern level of knowledge and technologies, meeting demands of economy as well as help in preparation for an active professional career, social and cultural life. According to the Law on Higher Education and Research of the Republic of Lithuania2, the mission of higher education and research is to help ensure the country’s public, cultural and economic prosperity, provide support and impetus for a full life of every citizen of the Republic of Lithuania, and satisfy the natural thirst for knowledge. A cohesive system of higher education and research is the foundation for the development of the knowledge society, for strengthening of the knowledge-based economy and the sustainable development of the country, a dynamic and competitive life of the national economy, and social and economic well-being; such a system cultivates a creative, educated, dignified, morally responsible, public-spirited, independent and entrepreneurial personality, fosters the civilizational

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1 Law on Education of the Republic of Lithuania (as last amended on 22 December 2015 - No XII-2213).
2 Law on Higher Education and Research of the Republic of Lithuania (as last amended on 17 December 2015 - No XII-2198).
According to the previously valid Law on Higher Education of the Republic of Lithuania\(^2\), the objective of higher education was to develop an educated personality and society with an aptitude for learning, with knowledge of the latest technologies and cultural values, to create, accumulate and disseminate scientific knowledge and cultural values, and to foster a specific character of national culture.

According to mentioned law provisions, the main functions of current higher education can be defined:

1. Training (learning) (Lithuanian – mokymo(si)) (helps a person to acquire skills and participate in working life, satisfy the natural desire of knowledge);
2. Science (scientific knowledge dissemination);
3. Culture (cultural values dissemination; supports, develops and creates national and world cultural traditions);
4. Education (Lithuanian – ugdymo) (develop creative, educated, dignified, ethically responsible, public-spirited, independent and entrepreneurial personality);
5. The socio-economic function (based on the development of the knowledge society, for strengthening of the knowledge-based economy and the sustainable development of the country, a dynamic and competitive life of the national economy, and social and economic well-being).

It should be noted, that Lithuanian higher education is governed by a special law – Law on Higher education and Research, however this law does not provide a precise definition of Higher education or Higher education studies, but provides conceptions of Qualification of higher education and separately defines the Studies conception. According to the Law on Higher education and Research, qualification of higher education means a qualification degree (professional bachelor’s, bachelor’s, master’s), the doctor of science degree, the doctor of arts degree as well as a qualification which is awarded by a higher education institution in accordance with the procedure laid down by legal acts. Studies is used to describe a process, where person, who has at least completed his secondary education, and is studying in a higher education institution according to a certain study programme or when preparing a dissertation.

Consequently, the conception of Higher education (studies) can be given – it is a process, where person, who has completed at least his secondary education, is studying in a higher education institution according to a certain study programme or when preparing a dissertation in order to acquire contemporary knowledge and technological level and needs of the economy in line with a higher education qualification, preparing for an active professional, social and cultural activities.

The Triple Approach to Services, Education Services and Higher education Services

The scientific literature provides higher education as education services’ concept. Higher education (studies) as a type of the services has its own features. Firstly, higher education is a service, secondly – it is an education service and lastly – it is a higher education service. Each of these categories (services, education services and higher education service) has its own distinct characteristics (for example, services differ from the products, education services differ from other types of services, and

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1 Law on Higher Education and Research of the Republic of Lithuania
2 Law on Higher Education of the Republic of Lithuania (as last amended on 18 July 2006 – No X-769.)
Taking into account this point, we will look at each category, distinguishing the conceptions and characteristics, thus revealing the higher education service properties. Since higher education is particular type of services, we will start from the service concept. In the scientific literature, the service is understood in many different ways, and it should be noted that there is no uniform definition of a service, but the theoretical definition of the services placed on essential services and different properties of material goods and services, the economic process logic (Vengriene, 1998). Unlike tangible products, a service is a complex phenomenon and many fragmented definitions have emerged (Hirvonen, 2007; Jallat and Wood, 2005). Blinova (2015) points out that, according to the given variety of service definitions, it can be classified taking into account three approaches: service as a process, service as a result, service as an economic activity. According to this triple approach to services, we give the list of the services definitions by authors (see. Table 1).

<table>
<thead>
<tr>
<th>Approach to the service</th>
<th>Authors</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>Service as a process</td>
<td>Kindurys (1998)</td>
<td>Service – is the aim to meet user's needs and to obtain compensation for services, because services cannot be separated from the client, they are provided and used at the same time.</td>
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<td></td>
<td>Vengrienė (1998)</td>
<td>Service – an action or series of actions, which have intangible nature and impact the interaction between the users and service providers, where service provider offers physical resources, products or systems to deal with users problems.</td>
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<td></td>
<td>Čelenkov (1998)</td>
<td>Service – is coordinated process between two or more operators in the market, where some operators impact others in order to create, develop or restore their access to fundamental benefits (goods).</td>
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<td>Kotler (1997)</td>
<td>Service – is action or activity which can be offered by one party to another, this action or activity is basically intangible and cannot affect any ownership.</td>
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<td></td>
<td>Gronroos (1989)</td>
<td>Service – is a process which involves a series of immaterial actions, which arises between the buyer and the service staff, physical resources, company-services provider.</td>
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<td></td>
<td>Sipina (2011)</td>
<td>Service – is the optimal (cost effective) and logical combination of service elements (activity, transactions, inventory or material) that give added value to the customer.</td>
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<td></td>
<td>Zeithaml et al. (2006)</td>
<td>Services – are deeds, processes and performances.</td>
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<td></td>
<td>Kotler and Keller (2006)</td>
<td>Service – is an act or performance that one party can offer another that is essentially intangible and does not result in the ownership of anything.</td>
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<td></td>
<td>Vitkienė (2004)</td>
<td>Services – activities and benefits, which one side can offer another, it is usually intangible and is not a result of the sale of property.</td>
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<td></td>
<td>Kotler and Bloom (1984)</td>
<td>Service – is a benefit or activity that one side may propose to the other, characterized imponderable and it is not an object of property. Its expression can be linked or not linked to a physical product.</td>
</tr>
<tr>
<td>Service as a result</td>
<td>Kulagina (2011)</td>
<td>Service – is the result of activity that meets certain personal or social needs, but has no tangible nature.</td>
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<td></td>
<td>Lozovskij et al. (1997)</td>
<td>Service – is the result of activity or work. No new material product is created during this process, however, the quality of existing products is changed.</td>
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<table>
<thead>
<tr>
<th>Approach to the service</th>
<th>Authors</th>
<th>Description</th>
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<tbody>
<tr>
<td>Service as an economic activity</td>
<td>Law on Service of the Republic of Lithuania (2009)</td>
<td><strong>Service</strong> – shall mean any self-employed economic activity, normally provided for remuneration, in so far as it is not governed by the provisions relating to freedom of movement for goods, capital or persons, as referred to in Article 50 of the Treaty establishing the European Community.</td>
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<tr>
<td></td>
<td>Lavlok (2005)</td>
<td><strong>Service</strong> – kind of economic activity, which creates values and provide benefits to consumers.</td>
</tr>
<tr>
<td></td>
<td>EU (2007)</td>
<td><strong>Services</strong> – any economic activity which is performed for remuneration.</td>
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</table>

It should be noted, that all three approaches are important and the fairest solution would be to assess services by using all three components (process, result and economic activity). For example, Jallat and Wood (2005) defined a service as a simultaneous process, a social interaction, a relationship and an intangible result. However, the various definitions recognize that services are intangible, interactive, experiential and do not involve the transfer of ownership (Kotler and Armstrong, 2006).

The scientific literature provides different conceptions of education services. Some authors argue that education service – is a result (product) of educational industrial activities, others emphasize procedural side of education services, emphasizing that the education service – is the process leading to the knowledge and skills transfer, still others emphasize education services as an economic activity dimension. Council for Trade in Services of the World trade organization (1998) confirms that education services are commonly defined by reference to four categories: Primary Education Services; Secondary Education Services; Higher (Tertiary) Education Services; and Adult Education. While these categories are based on the traditional structure of the sector, rapid changes taking place in the area of Higher Education – which normally refers to post-secondary education at sub-degree and university degree levels – may be significantly affecting the scope and concept of education (WTO, 1998).

Schreyer (2010) provides target definition of education services. Author emphasizes, that a useful starting point for the definition of education services is the description of education services as provided by the UNESCO, consistent with the International Standard Classification of Education. According to ISCED-2011, educational activities are understood as “deliberate activities involving some form of communication intended to bring about learning”. Schereyer (2010) argues, that:

1. **Communication** involves the transfer of information between two or more persons;
2. **Organized communication** is planned in a pattern or sequence, with established aims or curricula. It should involve an educational agency that organizes the learning situation and/or teachers who are employed to consciously organize the communication;
3. **Sustained communication** has elements of duration and continuity as part of the learning experience;
4. **Learning** is taken as any change in behaviour, information, knowledge, understanding, attitudes, skills, or capabilities which can be retained and cannot be ascribed to physical growth or to the development of inherited behaviour patterns.

This description of education emphasizes the process approach to the education services. The list of definitions of education service is given in Table 2.
Table 2. Education service definitions according to the triple approach to the services

<table>
<thead>
<tr>
<th>Approach to the service</th>
<th>Authors</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service as a process</td>
<td>Ėčkmariovas (1998)</td>
<td>Education service – a process in which human capital is created through the manufacturer's working potential individual consumption and an individual user's working potential production.</td>
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<td></td>
<td>Višlejemsik (2002)</td>
<td>Education service – is the transfer of knowledge to other individuals.</td>
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<td></td>
<td>Belyakov (2007)</td>
<td>Educational service – is the process where knowledge is created and where not only teacher but also student participate.</td>
</tr>
<tr>
<td></td>
<td>Syrovatkina et al. (2012)</td>
<td>Education service – is the process of intellectual potential production, through the consumption of individual intellectual work, the labour or human capital production supplied.</td>
</tr>
<tr>
<td></td>
<td>Miškinis and Kučaidze (2012)</td>
<td>Education service – is the action where the effects of interactions (connections) arise between consumers (students, parents, guardians or caretakers) and education providers (schools, freelance teachers or other education providers which have the right to provide education services by the law), when service providers offer physical resources to resolve consumers issues (i.e. provide education and training).</td>
</tr>
<tr>
<td></td>
<td>Grigorash (2014)</td>
<td>Educational service – is forward operation because service itself is not on sale, instead, its provision result is on sale, which depends not only on the subject (i.e. education services provider), but also on the object (i.e. student, listener).</td>
</tr>
<tr>
<td></td>
<td>Raclaf and Sedova (2014)</td>
<td>Education service – a tool to meet the individuals’ cognitive need to study as well as qualification-professional preparation needs.</td>
</tr>
<tr>
<td>Service as a result</td>
<td>Polovova and Batalova (2009)</td>
<td>Education service – is a result of scientific-pedagogical work, which is produced in order to meet consumers needs.</td>
</tr>
<tr>
<td></td>
<td>Ėčkmariovas (1998)</td>
<td>Education service – is a result (product) of educational production activity.</td>
</tr>
<tr>
<td></td>
<td>Schetinin (1998)</td>
<td>Education service – a system of knowledge, information, skills which are used to meet a variety of individual, society and state education requirements.</td>
</tr>
<tr>
<td>Service as an economic activity</td>
<td>Romanova (2005)</td>
<td>Education service – is an economic units’ work activity, which aims to meet the specific subject’s educational needs (etc., systematized knowledge, skills and abilities), which is implemented by subject’s free will.</td>
</tr>
<tr>
<td></td>
<td>Voitovich (2012)</td>
<td>Education service – is a natural or legal person's type of activity, complex process which is intended to transfer knowledge, skills and abilities to the consumer, to meet intellectual and spiritual human needs, in order to develop personal, group and societal needs.</td>
</tr>
</tbody>
</table>

Higher education services are understood as the operation or function of a particular market demand and price; they are often intangible, used in the production site (Langvinienė and Vengrienė, 2005; Vengrienė, 2006). It should be noted, that such services cannot be transferred directly to other users or arbitrated (cannot be acquired for one price, and then sold for another). By Guščinskiene and Ėčburienė (2008) higher education services are interpreted as a higher education which is provided by the education package, consisting of tangible and intangible services, which make up the overall result – provided service. According to Sultan and Wong (2010) education services are related to teaching, research and community services. Blinova (2015) provides three higher education service definitions (see Table 3).
Table 3. Higher education services’ definition according to the triple approach to the services

<table>
<thead>
<tr>
<th>Approach to the Services</th>
<th>Definition</th>
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<tbody>
<tr>
<td>Higher Education Service as a result</td>
<td>Higher education services – is a result of students’ knowledge, skills and abilities, thanks to which it can carry out professional activities related to the diagnostic and heuristic challenges.</td>
</tr>
<tr>
<td>Higher Education Service as a process</td>
<td>Higher education services – is a bilateral process of two-party (student on the one side and teacher on the other) in order to transfer knowledge, skills and abilities to solve the diagnostic and heuristic tasks.</td>
</tr>
<tr>
<td>Higher Education Service as an economic activity</td>
<td>Higher education services – is an economic activity carried out by educational organization responsible for the higher education with other organizations in order to provide students with knowledge, skills and abilities to solve the diagnostic and heuristic tasks.</td>
</tr>
</tbody>
</table>

Source: prepared according to Blinova, 2015

The basic concepts and processes of higher education services components were reviewed; further the main properties of each category are discussed.

Properties of Higher Education Services

It is important to note, that scientists have concluded in their researches that education services have generic properties, which all services inherit, and specific properties, which are unique only to education service category. The properties of higher education services include both generic properties of services and specific properties of education, vocational training and higher education services. All these properties in corpore characterise higher education services. This aspect is illustrated in Figure 1.

![Figure 1. Higher education service properties](image-url)
It should be noted, that all services include these main properties (Vengriene 1998; Lifanova, 2008): *intangibility* (service has immaterial expression), *unity of services production and consumption* (the service is provided and consumed at the same moment, the service provider and the provided services are inseparable), the recipient participation in service production, services are *not accumulated* (available and consumed at the same time, so they cannot be pre-fabricated, collected and stored as goods), *heterogeneity* (service is produced by both – service provider and consumer, the service is a multistage process, and the subjective specific service providers and consumers interaction (relations) as well as and distinctive service value perception influence service development process).

Lifanova (2008) assigns *volatility of quality* to the generic properties of education service, but the author notes that education services comprise relatively the generic properties of services. Zeithaml et al. (2000, 2006), Soutar and McNeil (1996) identified *inseparability, intangibility, variability and perishability* as the basic characteristics that differentiate a service from goods. In contrast to products, services are usually *short-lived* as they are consumed as long as the activity or process lasts (Yeo, 2008). Zeithaml et al. (1990) remarked *intangibility, heterogeneity, perishability and inseparability* as the fundamental characteristics that makes services different from goods in terms of how they are produced, consumed and evaluated. Services are consumed at the same time as they are produced without any clear transfer of ownership (Yeo, 2008).

Skorobogatova (2010) makes the following exclusive list of *education service properties*: process of education service consumption takes place only at the same time as the process of education services provision; inequality of education service and it’s consumption’s result, creative education service consumption process, collective education service consumption opportunity, a property that allows to change the consumer of education service, delayed effects of education service (russian “эридитарность”).

Grigorash (2014) provides education characteristics that distinguish them from other types of services from the perspective of the service providers’ side – the author adds additional properties to the education services: education services impossible to keep, high cost of education services, the relative duration of the education service provision, educational services affect people and society as a whole.

Tsinidou et al. (2010) points out, that education services are often *intangible and difficult to measure*, since the outcome is reflected in the transformation of individuals in their knowledge, their characteristics, and their behaviour. Other authors (Barannik, 1998; Ksenofontova, 2006) complement education services with specific list of characteristics: education services attributable to the public, quasi-public goods; appropriate license is necessary for education services provision.

Blinova (2015) notes that in view of the fact that the higher education service prepare future professionals, higher education in addition to the generic properties of the services and specific education services properties, attributable to professional training specific properties, such as: the competitive nature of services, a narrow specialization, targeting to the future profession.

The specific properties of higher education service are distinguished as well. Panruchin (1995, 1997) analysed the education services marketing aspects in higher education and provided these properties of higher education services: seasonality, high cost, relative duration of service provision, delayed manifestation of performance and
dependence of result on future high school graduate’s work, the need to consume education services further, education services consumption depends on areas of education service provision and potential students residential areas, education services cannot be resold. It should be noted, that some of these properties can be assigned to the generic properties of education services (i.e. seasonality, high cost, relative duration of service provision). Blinova (2015) makes the following list of higher education service properties: higher education services focus more on theoretical matters and less on practical, scientific and professional orientation, short higher education services result in storage period, if the work does not start immediately, high complexity of consumption; long service provision period (4-6 years).

Guščinskienė and Čiburienė (2001) provides list of higher education services properties, without distinction of generic and specific education services properties. The authors present the following characteristics (Guščinskienė and Čiburienė, 2001):

1. **Intangibility** – higher education services are intangible, so these services are intended to be accompanied with physical objects (e.g., a books, etc.);
2. **Heterogeneity** – these services involve both service provider and the consumer. The results as well as consumers’ risk, operational standardization depends on their properties and relationships;
3. **Common identity of production and consumption** – in advance is not possible to assess the specific quality of higher education service, because the service does not exist: it is produced and consumed at the same time. This means that even the same type of services are not the same, it is necessary to align supply and demand, it is impossible to reserve services;
4. **The service provider and consumer are necessary factors of higher education service production, the simultaneous participation and high degree of contact**;
5. **Service consumers create their own part of the service, at the same time – its quality**;
6. **There is no transfer of ownership in service provision** – after graduation and with a higher education degree the property is not acquired, but the higher education diplomas confirms the completion of studies and qualifications, that higher education services has been provided.

The properties of higher education services are revealed through service, education service, vocational training service and lastly higher education service characteristics. After analysing all the relevant higher education services conceptions and characteristics it is possible to distinguish the properties of higher education service with respect to each category (see Table 4).
# Table 4. List of properties of Higher education studies services

<table>
<thead>
<tr>
<th>Category</th>
<th>Properties</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Service</strong></td>
<td>INTANGIBILITY • Inseparability of services production and consumption • The recipient participation in service production • Services are not accumulated</td>
</tr>
<tr>
<td></td>
<td>HETEROGENEITY • VOLATILITY OF QUALITY • INTERACTIVE • EXPERIENTIAL • PERISHABILITY • SHORT-LIVED PERIOD</td>
</tr>
<tr>
<td>Education service</td>
<td>SEASONALITY • Education services impossible to keep • High cost of education services • The relative duration of the education service provision • Education services affect people and society as a whole • Education services consumption takes place only in the process of education services provision • Inequality of education service and it's consumption's result • Creative education services consumption process</td>
</tr>
<tr>
<td></td>
<td>COLLECTIVE EDUCATION SERVICES CONSUMPTION OPPORTUNITY • A PROPERTY THAT ALLOWS TO CHANGE THE CONSUMER OF EDUCATION SERVICE • DELAYED EFFECTS OF EDUCATION SERVICES • EDUCATION SERVICES CANNOT BE RESOLD • EDUCATION SERVICES ATTRIBUTABLE TO THE PUBLIC, QUASI-PUBLIC GOODS • THE APPROPRIATE LICENSE IS NEEDED FOR EDUCATION SERVICES PROVISION • DIFFICULT TO MEASURE • THERE IS NO TRANSFER OF OWNERSHIP IN SERVICE PROVISION</td>
</tr>
<tr>
<td>Vocational training service</td>
<td>The competitive nature of services • A narrow specialization • Targeting to the future profession</td>
</tr>
<tr>
<td>Higher education service</td>
<td>Delayed manifestation of performance and dependence of result on future high school graduate's work • Need to consume education services further • High level of intellectual activity is required • Scientific methods of operation are mastered and applied • Critical thinking is developed • Education services consumption depends on areas of education service provision and potential students residential areas • Higher education services focus more on theoretical matters less on practical • Scientific and professional orientation</td>
</tr>
<tr>
<td></td>
<td>SHORT HIGHER EDUCATION SERVICES RESULT IN STORAGE PERIOD, IF THE WORK DOES NOT START IMMEDIATELY • HIGH COMPLEXITY OF CONSUMPTION Simultaneous participation and high degree of contact of service provider and consumer Long service provision period (4-6 years) • Service consumers create their own part of the service, at the same time – its quality • The acquisition of contemporary knowledges and technological level and needs of the economy in line with a higher education qualification • Implements cultural process specialization and actualization • Service consumer is prepared for an active professional, social and cultural activities</td>
</tr>
</tbody>
</table>

*Source*: composed by the author according to Pankruchin (1995, 1997); Barannik (1998); Vengerienė (1998); Jučevičienė et al. (2000); Guščiškienė and Čiburienė (2001); Kraujutaitė (2002); Kotler and Armstrong (2006), Soutar and McNeil (1996), Kaenofontova (2006); Lifanova (2008); Tsinidou et al. (2010); Skorobogatova (2010); Grigorash (2014); Blinova (2015).
Conclusions

To summarise, higher education – is an economic category equivalent to the service, which is characterized not only by service generic properties (characteristics), but also by specific properties inherent to education, vocational training and higher education services. The general list of properties of higher education services consist of 45 characteristics that reveal the complexity of higher education services, uniqueness and specificity. However this list is not exhaustive. Properties of higher education services are necessary phenomenon which helps better understand the nature of higher education. Higher education services characteristics assist in other research areas of higher education. Understanding and assessment of the higher education services properties affect better quality of research in such research areas as higher education funding model development, higher education service pricing, higher education finance management, marketing, higher education service quality assessment and improvement, and etc.

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BLACKLISTING DUE TO POOR PAST PERFORMANCE IN LITHUANIAN PUBLIC PROCUREMENT

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Abstract

Purpose – to analyse the main rules of blacklisting due to poor past performance in Lithuanian public procurement.

Design/methodology/approach – document analysis, comparison, generalisation.

Finding – Blacklisting due to poor past performance in Lithuanian public procurement comes from the directive of European Union (2014/24), which came into effect in April 2016. It is designed to prevent corruption and protect from economic operators who do not perform public contracts properly. Blacklisting is introduced as a step-forward in Lithuanian public procurement. However, this new institution must be used wisely and no party can abuse the applicable rules. To ensure the proper implementation of blacklisting the Public Procurement Office and Lithuanian courts should prevent both economic operators and contracting authorities from abusing the newly introduced rules of blacklisting.

Research limitations/implications – Blacklisting due to poor past performance is a new institution in Lithuanian public procurement and therefore it is still unknown how exactly it will function. Moreover, the new version of the Law on Public Procurement has not been adopted yet at the time the publication is being prepared, leaving it unclear how Lithuania will regulate the new institution. Finally, there are many situations where the Law on Public Procurement and EU directives are not detailed enough to answer some practical questions arising from the new legal regulation. The findings of this research paper may differ from the real practice, but this should be understandable.

Practical implications – Blacklisting due to poor past performance in public procurement is particularly important to all economic operators participating in public procurement. No economic operator wishes to be blacklisted from participation in public procurement procedures in Lithuania for three years. Contracting authorities are also very interested in the new institution of public procurement and are concerned about how the new legal regulation of blacklisting due to poor past performance will function in practice.

Originality/Value – Blacklisting due to poor past performance in public procurement is a brand new institution in Lithuania and so far there has been no scientific analysis of its functioning. This analysis is new and may have central importance in the future development of blacklisting in Lithuanian public procurement.

Keywords: public procurement, blacklisting, public contracts, contracting authority.

Research type: research paper
Introduction

New European Union’s directives on public procurement enable the national law to introduce blacklisting of economic operators failing to properly perform public contracts (otherwise known as unreliable economic operators). As blacklisting due to poor past performance is a new legal regulation, this research and the problems it addresses are very actual in Lithuania.

It is considered that many countries and international organisations, such as multilateral development banks, have introduced blacklisting systems due to corruption. Blacklisting may be used as a form of (administrative or criminal) sanction to those companies and individuals involved in corruption: a deterrent to corrupt behaviour; an incentive for companies to establish appropriate anti-corruption policies; as a means to strengthen and promote open and transparent procurement processes, and as a means to support honest competitive bidding. Thus, blacklisting helps to ensure both the transparency of public procurement and fair competition. Debarment can be an effective tool for governments to promote integrity in public procurements, reduce performance risk. The threat of debarment as well as the impact of negative publicity can deter contractors from committing wrongdoing. However, as explained below, the objective of fair competition will be achieved only when the said institution of public procurement is applied fairly and in accordance with the principles of transparency and equality.

Blacklisting due to poor past performance aims at protecting contracting authorities from economic operators who fail to perform their contracts properly. Essentially, this is achieved in two ways. First, the list of unreliable economic operators is publicly available and any person (not necessarily a contracting authority), at any time, may have access to details of economic operators who are listed as unreliable. Making this information available to the public is one of the key requirements for blacklisting in public procurement procedures. It is considered best practice to maintain a register with details of all debarred companies, including the relevant offence, the length of the debarment and the reasons for debarment.

Preferably, the list should be made publicly available so that citizens and other companies have access to the information. The private sector also uses blacklists that are publicly available, even though they have a legal power only in the public sector. For instance, in Brazil the private sector has also been using the list to acquire information on whether certain companies should be hired or included in their supply chains.

5 A list of unreliable economic operators is published on the website of the Public Procurement Office at <http://vpt.lrv.lt/lt/kiti-duomenys/nepatikimu-tiekeju-sarasas>.
chain. Secondly, contracting authorities have the right to establish in the procurement conditions that any blacklisted economic operator will be excluded from the procurement procedure. Authors who analyse blacklisting in public procurement state that “it seems sensible to introduce its use for ‘negative’ purposes in order to allow contracting authorities to (self) protect their interests by not in view”.

Main aims of the research are: 1) to analyse the key conditions in new legal regulation; 2) to evaluate if blacklisting due to poor past performance is a proportionate measure; 3) to analyse the main points of evaluation of blacklisted economic operators’ qualification; 4) to analyse material breach of contract as a ground for blacklisting due to poor past performance; 5) to analyse blacklisting in case of consortia and subcontracting.

**Key conditions in new legal regulation**

Firstly it should be noted that in the literature and in legislative provisions on blacklisting, such measures are variously referred to as disqualification, debarment, exclusion, suspension, rejection or blacklisting. These terms may be used interchangeably, as they are used in very similar contexts, with small nuanced differences depending on jurisdiction.

According to preamble article 101 of Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 (hereinafter – the ‘Directive’), contracting authorities should further be given the possibility to exclude economic operators which have proven unreliable. They should also be able to exclude candidates or tenderers whose performance in previous public contracts has shown major deficiencies with regard to substantive requirements, for instance failure to deliver or perform, significant shortcomings of the product or service delivered, making it unusable for the intended purpose, or misbehaviour that casts serious doubts as to the reliability of the economic operator. National law should provide for a maximum duration for such exclusions.

Some authors believe that “this is something that the private sector does quite naturally. If a supplier lets you down, then you don’t give them the next contract. It is as simple as that. So we might wonder why it has taken the EU and public procurement generally so long to realise that this is a sensible move”.

Article 57(4)(g) of the Directive establishes that contracting authorities may exclude or may be required by Member States to exclude from participation in a procurement procedure any economic operator in any of the following situations: where the economic operator has shown significant or persistent deficiencies in the performance of a substantive requirement under a prior public contract, a prior...

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contract with a contracting entity or a prior concession contract which led to early
termination of that prior contract, damages or other comparable sanctions.

This provision establishes the so-called blacklist, also known as “a list of
unreliable economic operators” due to poor past performance. The introduction of past
performance as an exclusion ground responds to long-standing requests of practitioners and brings the EU system closer to that of the US\(^1\). Moreover, “this new
ground for exclusion addresses a key concern for contracting authorities, namely when
it is entitled to reject a bidder it knows has let it or others down in the past from being
awarded public contracts in future”\(^2\).

On 9 June 2015, the Seimas of the Republic of Lithuania adopted law No XII-
1768 amending Articles 2, 8\(^2\), 10, 21\(^1\), 33, 38, 87, 93, 94, 96, Annex 2 and Annex of the
Law of the Republic of Lithuania on Public Procurement No I-1491 and supplementing
the Law with Article 18\(^1\). Article 6 of this law came into force on 1 January 2016.
Article 33(2)(8) of the Law on Public Procurement establishes that the contracting
authority may establish in procurement documents that any application or any
proposal shall be rejected if the economic operator concerned has failed to perform a
procurement contract or has performed it improperly and that was a material breach
of procurement contract, a procurement contract has been terminated within the last
three years or an effective court decision was adopted satisfying the requests of the
contracting authority to recognise the non-performance or improper performance of
the procurement contract a material breach of contract and to compensate the losses
incurred.

It is so far (at the time the publication is being prepared) not clear what legal
regulation of public procurement will look like in the Republic of Lithuania after
implementing the Directive. However, blacklisting due to poor past performance is
likely to remain and legal regulation will not see any significant changes. After all, the
Directive itself establishes a possibility of blacklisting.

The Explanatory Notes on the Law on Public Procurement\(^4\) (hereinafter – the
“Explanatory Notes”) maintain that the purpose of the proposed amendment is to
“ensure that only those economic operators who pay taxes honestly and perform
contracts properly could participate in public procurement procedures”. Moreover, the
Explanatory Notes point out that “problems often arise during procurement
procedures and the evaluation of economic operators’ qualification when a proposal is
submitted by an economic operator who has improperly performed a previous contract
<...> or has failed to perform it at all. The problem is that after evaluating the
proposal of such economic operator and determining that it is the winning proposal,
the contracting authority is forced to conclude a contract with this economic operator,


\(^2\) Kale, W. Excluding poorly performing bidders [interactive]. *Thomson Reuters: Practical Law Public Sector
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\(^3\) Law amending of Articles 2, 8\(^2\), 10, 21\(^1\), 33, 38, 87, 93, 94, 96, Annex 2 and Annex of the Law of the Republic
of Lithuania on Public Procurement No I-1491 and supplementing the Law with Article 18\(^1\). *Register of

\(^4\) Explanatory Notes on the draft law amending Articles 2, 8\(^2\), 10, 21\(^1\), 33, 38, 87, 93, 94, 96, Annex 2 and
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while being fully aware of a strong probability that it will fail to fulfil its obligations under the new contract or will fulfil them improperly.”

Considering that blacklisting-related amendments to the Law on Public Procurement entered into force only on 1 January 2016 and that Article 57(4)(g) of the Directive (which must be implemented by 18 April 2016) creates a framework for blacklisting, such legal regulation is brand new and the application of the law in practice may raise various questions that will need to be answered.

It should be noted that a blacklisted due to poor past performance economic operator will not necessarily be excluded from participation in public procurement procedures. Both the Law on Public Procurement and the Directive stipulate that contracting authorities have the right (but not the responsibility) to establish that any blacklisted economic operator will be excluded from participation in a public procurement procedure conducted by the contracting authority. Of course, the Directive must be implemented in national law and the Republic of Lithuania may choose a stricter form of implementation, requiring to exclude from participation in a public procurement procedure (that falls in the scope of the Directive) any blacklisted economic operator. Member States are entitled to introduce this legal regulation under Article 57(4)(g) of the Directive. However, according to the current legal regulation (applicable at the time the publication is being prepared), contracting authorities have the right to choose whether to establish exclusion grounds (for blacklisted economic operators) in the procurement conditions or not. Another very important aspect is that if contracting authorities do not establish this exclusion ground in the procurement conditions, at a later stage they will not have the right to change their mind and exclude from participation in a public procurement procedure any blacklisted economic operator. This conclusion is derived from the obligation of contracting authorities to ensure transparency in public procurement. The Supreme Court of Lithuania has noted that one of the elements of the principle of transparency is compliance with the public procurement law and conditions established by contracting authorities in procurement documents1. That is why before launching a specific public procurement procedure contracting authorities should think carefully and decide whether to exclude blacklisted economic operators already when drafting the procurement conditions.

Another important aspect is that any blacklisted due to poor past performance economic operator may be (or must be, depending on the procurement conditions) excluded from participation in any other public procurement procedure. Article 57(4)(g) of the Directive and Article 33(2)(8) of the Law on Public Procurement do not provide for any exceptions in relation to the exclusion of blacklisted economic operators based on certain conditions. Thus, any economic operator who has failed to perform a public contract or performed it improperly, regardless of the nature and subject-matter of the contract (products, services or works), will be debarred from participation in another public procurement procedure, even though the subject-matter (products, services or works) is different. Moreover, any economic operator who has failed to properly perform a public contract with a contracting authority may be excluded from participation in any public procurement procedures conducted by any other contracting authority. Finally, considering the fact that the possibility of excluding any economic operator from a public procurement procedure is established

1 The Supreme Court of Lithuania, Civil Division, 4 May 2010 ruling of the board of judges in civil case No 3K-3-126/2010.
by the Directive (Article 57(4)(g)), an economic operator is obligated to properly perform all public contracts at the European Union level. An economic operator who fails to properly perform a public contract in another Member State may also be excluded from participation in a public procurement procedure conducted in Lithuania.

However, economic operators have the right to defend themselves against blacklisting by contracting authorities. However, their legal defence should be very expeditious as legislation provides for very short deadlines for such remedies. Article 93(1)(5) of the applicable Law on Public Procurement establishes that an economic operator who believes that the contracting authority has not complied with the requirements of this law and violated or will violate its legitimate interests by illegally terminating the contract on the basis of a material breach of contract shall have the right to refer to a regional court as a court of first instance for declaring termination of the contract invalid. According to Article 94(5) of the Law on Public Procurement, an economic operator who believes that the contracting authority has wrongly terminated the contract based on a material breach of contract has the right to bring an action before court within 15 days after the termination of the contract. 15 days provided for by legislation for going to court for the termination of contract is a very short term. With this legal regulation in place, economic operators will have to quickly respond to actions by contracting authorities to terminate public contracts. Moreover, the legal regulation will encourage economic operators to promptly respond to any notices of contracting authorities in relation to derogation from the contract and promote close cooperation with contracting authorities when performing public contracts. Overall, any legal regulation resulting in better performance of contracts is viewed as positive.

Is blacklisting due to poor past performance a proportionate measure?

The principle of proportionality restricts the length of debarment in terms of protecting the rights of individuals, owners and firms, and averts reactions that are “harsher” than they “need” to be, given the purpose of these specific rules. A period for which economic operators may be debarred from participation in public procurement procedures is a subject for discussion. For instance, in Brazil it is two years and in the US (who was the first to implement the concept of a blacklist) three years.

Thus, the current three-year period of debarment (blacklisting) should not be considered disproportionate. What is more, if a debarment period is not sufficiently long, it might not be deterrent at all.

It may seem that debarment from participation in any public procurement procedure for three years is a substantial sanction, in particular if a large part of the

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economic operators’ customers comes from the public sector (contracting authorities). Therefore, one of the legal requirements for blacklisting due to poor past performance is assurance of due process, i.e. the process of suspension or exclusion of a company or individual from contracting with the public administration should ensure that due process is respected, and that those involved have an appropriate opportunity to defend themselves. In addition, clear rules for removing individuals and companies from the blacklist should be in place, as well as referral mechanisms in case the information provided in debarment registers is incorrect.

To avoid any disproportionate sanctions for economic operators, the Directive provides for the so-called self-cleaning. A supplier who has made convincing efforts in becoming trustworthy, for example by introducing control and compliance systems, reorganized and replaced management, or reconsidered its institutional work ethics and visions, should be considered differently than suppliers who have failed to take such steps. Even though the current version of the Law on Public Procurement does not provide for this doctrine, in the near future (when a new version of the Law on Public Procurement has been adopted in accordance with the Directive), the doctrine of self-cleaning will have to be implemented in Lithuania, too. This doctrine means that any economic operator has the right to prove to the contracting authority that it has made certain improvements that will prevent the economic operator from repeated failure to properly perform a public contract. In such a case, the economic operator, even if it is blacklisted, will not be excluded from participation in other public procurement procedures. Article 57(6) of the Directive establishes that any economic operator that is in one of the situations referred to in paragraphs 1 and 4 may provide evidence to the effect that measures taken by the economic operator are sufficient to demonstrate its reliability despite the existence of a relevant ground for exclusion. If such evidence is considered as sufficient, the economic operator concerned shall not be excluded from the procurement procedure. For this purpose, the economic operator shall prove that it has paid or undertaken to pay compensation in respect of any damage caused by the criminal offence or misconduct, clarified the facts and circumstances in a comprehensive manner by actively collaborating with the investigating authorities and taken concrete technical, organisational and personnel measures that are appropriate to prevent further criminal offences or misconduct. The measures taken by the economic operators shall be evaluated taking into account the gravity and particular circumstances of the criminal offence or misconduct.

Literature considers blacklisting due to poor past performance in public procurement as a proportionate measure for economic operators, in particular where the doctrine of self-cleaning exists: “this seems particularly proportionate in view of the rules on ‘self-cleaning’ that allow contractors to compensate such poor past performance by showing that they have implemented changes to avoid them recurring, always provided that only serious instances of properly documented poor past performance are used as an exclusion or negative qualitative selection criterion, given that exclusion grounds need to be interpreted strictly”.

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self-cleaning will be applicable to many cases of exclusion (e.g. where the economic operator has been the subject of a conviction for corruption or fraud, is guilty of grave professional misconduct or is subject to a bankruptcy proceedings, etc.), it will also be applicable to blacklisted economic operators. Subject to self-cleaning, any blacklisted economic operator will be able to prove to contracting authorities that it has taken appropriate measures (technical, organisation, etc.) to prevent further misconduct. If the evidence presented by the economic operator is considered sufficient by the contracting authority, the economic operator concerned may not be excluded from the procurement procedure and its proposal may be considered acceptable. However, the principle of self-cleaning is applied on a case-by-case basis, not automatically to all public procurement procedures. A blacklisted economic operator may convince one contracting authority that it has taken preventive measures to avoid any misconduct in future, but fail to convince other contracting authorities. Whether an economic operator manages to convince contracting authorities of self-cleaning highly depends on the nature of misconduct, i.e. the reason why the economic operator concerned has been blacklisted, since it may determine what preventive measures it can and must take to prevent similar misconduct in future.

**Evaluation of blacklisted economic operators’ qualification**

One of the non-mandatory requirements for the qualification of economic operators is not to be blacklisted due to poor past performance. The reason why an economic operator has been blacklisted plays no role when considering whether the economic operator concerned should be excluded from participation in a public procurement procedure. The mere fact that a particular economic operator is blacklisted is sufficient.

Nevertheless, there are two main ways for economic operators to be blacklisted due to poor past performance.

In the first case, any economic operator may be blacklisted without a court order. For this, the economic operator concerned must commit a material breach of public contract, which results in termination by the contracting authority. In this case, terminating the contract does not require any legal proceedings. It is sufficient that the contracting authority informs the economic operator concerned about the termination of the contract in accordance with legislation and the contract itself.

In the second case, any economic operator may be blacklisted if there is a legal dispute between the contracting authority and the economic operator. However, the legal dispute must concern a particular matter, namely recognition of the non-performance of the public contract a material breach of contract and compensation for the losses incurred. The economic operator is blacklisted only if the court satisfies both of the requests. Thus, if the contracting authority files a claim and the court only awards damages (but does not recognise the non-performance of the contract a material breach of contract), the economic operator is not blacklisted.

The economic operator’s qualification in relation to blacklisting is evaluated on the last day of the term for submission of proposals. Following the case law of the court of cassation, the compliance of the economic operator to the qualification requirements may be evaluated only if the factual circumstances confirming the economic operator’s competence, capacity and reliability arise no later than the last day of the term for submission of proposals (as established by the procurement
According to Article 33(8) of the Law on Public Procurement, the contracting authority cannot request documents or information that are available to it free of charge in registers of the Republic of Lithuania, state information systems and other information systems in accordance with the Law of the Republic of Lithuania on State Information Resources Management. Information about blacklisting is made public and is freely available. Contracting authorities have the right and obligation to check whether the economic operator who submitted a proposal is blacklisted.

**Material breach of contract as a ground for blacklisting due to poor past performance**

Not all breaches of a public contract by an economic operator (together with the compensation for losses or termination of the contract) may serve as a ground for blacklisting due to poor past performance. Article 33(2)(8) of the Law on Public Procurement establishes that it must be a material breach of contract. Similarly, Article 57(4)(g) of the Directive states that an economic operator may be excluded from participation in a procurement procedure, where the economic operator has shown significant or persistent deficiencies in the performance of a substantive requirement under a prior public contract.

The Law on Public Procurement does not specify what constitutes a material breach of contract, making it a subject of civil law. This is also confirmed by Article 8²(1)(18) of the Law on Public Procurement, stipulating that one of the functions of the Public Procurement Office is to administer information about economic operators who have failed to perform or improperly performed a contract, where the contract was terminated because of a material breach of contract as defined by the Civil Code of the Republic of Lithuania (hereinafter – a “material breach of contract”) or where there is an effective court ruling satisfying the requests of the contracting authority to recognise the non-performance or improper performance of the contract a material breach of contract and compensate the losses incurred.

The Civil Code defines criteria for a material breach of contract. According to Article 6.217(2) of the Civil Code, the following criteria must be taken into account: (1) whether the aggrieved party is substantially deprived of what it was entitled to expect under the contract, except in cases when the other party did not foresee or could not have reasonably foreseen such result; (2) whether, taking into consideration the nature of the contract, strict compliance with the conditions of the obligation is of essential importance; (3) whether the non-performance is made of malice prepense or of great imprudence; (4) whether the non-performance gives the aggrieved party the basis to suppose that it cannot believe in the future performance of a contract; (5) whether the defaulting party, who was preparing for performance or was effectuating the performance of the contracts, would suffer significant damages if the contract were dissolved. The court of cassation has noted that “the analysis of the content of criteria for a material breach of contract should firstly include the evaluation of two types of performance of the obligation: the promised one and the actual one. The larger the gap between these two types of performance, the higher the probability of a material breach of contract. The gap reaches its maximum in case of total non-performance. Secondly, looking at whether strict compliance with the obligation is of essential performance”.

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¹ The Supreme Court of Lithuania, Civil Division, 24 February 2016 ruling of the board of judges in the civil case No e3K-3-112-969/2016.
importance within the context of the contract, it should be considered whether particular terms of the contract will determine the loss of the creditor’s interest in the obligation. Thirdly, to decide whether the obligations was not performed intentionally or due to gross negligence, it is important to analyse the form of the offender’s fault in accordance with general civil liability provisions and to decide whether the offender’s fault is major and, if so, whether it its intentional. The greater the fault, the smaller the reasonable interest of the aggrieved party to remain in contractual relations. Fourthly, deciding whether non-performance gives the aggrieved party the basis to suppose that they cannot believe in the future performance of a contract requires determining whether the defaulting party acts passively in fulfilling the obligations assumed, also whether it is capable of performing the contract even with the best intentions in mind. And fifthly, it is important to consider whether the defaulting party, who was preparing for performance or was performing the contract, would suffer significant damages if the contract were terminated. This refers to very large, disproportionate damages rather than ordinary damages.1”

The Supreme Court of Lithuania has spoken in great detail about termination conditions. The court of cassation has noted that “according to Article 6.217 of the Civil Code, a breach of contract may be considered material on two grounds: a breach may be considered material by law and the parties may agree on what constitutes a material breach”2. Moreover, “if the parties agree that a breach of a contract clause leads to unilateral termination, they do not necessarily have to agree to consider this breach material”3.

The said rule and the case law of the Republic of Lithuania allow concluding that within the context of the Law on Public Procurement, a public contract is considered terminated for a material breach of contract, if this breach is consistent with Article 6.217(2) of the Civil Code or is described as material by the contract itself. Hence, contracting authorities are recommended to specify in the procurement conditions (as well as the contract) all and any cases where a breach of contract is considered material.

On the other hand, contracting authorities are not totally free to define a material breach of contract in the contract. It may be the case that a contract establishes that missing a deadline by one day or failing to inform about changes in contact details within two days is a material breach of contract. Of course, there may be cases where the said breaches are indeed material. However, contracting authorities do not have the right to distort the principle equality of parties and consider even the slightest inconsistency with the performance of the contract a material breach of contract. The court of cassation has pointed out that “the basis for termination established by the contract is a contract clause and therefore is considered and controlled by the court in terms of the legitimacy and fairness of contract clauses4”. In case of a dispute with the contracting authorities, economic operators will be able to prove that the breach of contract is not material.

1 The Supreme Court of Lithuania, Civil Division, 26 June 2012 ruling of the board of judges in civil case No K-7-297/2012.
2 The Supreme Court of Lithuania, Civil Division, 26 June 2012 ruling of the board of judges in civil case No 3K-7-297/2012.
3 The Supreme Court of Lithuania, Civil Division, 15 May 2015 ruling of the board of judges in civil case No 3K-3-298-687/2015.
4 The Supreme Court of Lithuania, Civil Division, 8 May 2015 ruling of the board of judges in civil case No 3K-3-261-421/2015.
Quite often a public contract is being properly performed, but the economic operator is simply late with the deadlines. In such cases, the contracting authority has the right to request the economic operator to pay a penalty (e.g. default interest), and if the economic operator fails to do so, the contract authority has the right to claim it in court. If, in addition to a penalty, the contracting authority requests the court to recognise the non-performance of the contract by the economic operator a material breach of contract, will the economic operator be blacklisted, provided that the court satisfies the requests of the contracting authority? Article 33(2)(8) of the Law on Public Procurement uses the term “losses” (which is not the same as penalty), while Article 57(4)(g) of the Directive goes with “damages or other comparable sanctions”. A penalty is clearly a comparable sanction. Moreover, a penalty as a form of contractual civil liability performs a compensatory function – it compensates the aggrieved party for losses\(^1\). Therefore, a penalty (e.g. default interest) should be treated as a similar sanction to compensation for losses. And if the court awards a penalty as well as recognises the non-performance of the contract by the economic operator a material breach of contract, the economic operator concerned should be blacklisted.

**Blacklisting in case of consortia and subcontracting**

In certain cases, public contracts are performed by a group of economic operators rather than by one individual economic operator. Article 5(2) of the Law on Public Procurement establishes that an application or a proposal may be submitted by a group of economic operators. There may be a question of how liability is distributed among joint activity partners (members of the group of economic operators), if any act or omission by one of them leads to non-performance of the public contract and its termination by the contracting authority. On the one hand, a group of economic operators consists of individual legal entities with independent (individual) legal capacity. On the other hand, a group of economic operators is considered a contracting party to a particular public contract. The contracting authority should not be obligated to establish which member of the group of economic operators have committed an act or omission resulting in improper performance of the entire public contract. The contracting authority is usually unable to identify the entity that has failed to perform the contract (where the contract had to be performed by a group of economic operators) for objective reasons (information on relations among member of the group of economic operators, cooperation and internal actions in relation of the performance of the contract), therefore if a contract is poorly performed by a group of economic operators, all (individual) member of the group of economic operators concerned should be blacklisted. This may seem to violate the right of the economic operator that has properly performed the public contract, but, in fact, economic operators have several ways how to avoid negative legal consequences. On the one hand, economic operators need to choose their partners more carefully and participate in a public procurement procedure only with reliable partners. On the other hand, economic operators should also use due care in performing public contracts. Finally, if a contract is improperly performed through the fault of one member of the group of economic operators, the remaining members of the group who performed the contract properly will be able to

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\(^1\) The Supreme Court of Lithuania, Civil Division, 13 March 2015 ruling of the board of judges in civil case No 3K-3-138-686/2015.
use self-cleaning (Article 57(6) of the Directive) and implement certain preventive measures.

A question may arise whether this kind of legal regulation does not contradict the objective of public procurement to ensure competition. Following the case law of the court of cassation, the main aim of the regulation of public procurement procedures is to ensure competition\(^1\). Unfounded exclusion of economic operators from participation in public procurement procedures undoubtedly restricts competition. Undeniably, debarment reduces the number of suppliers available and will sometimes force procuring entities to buy at higher prices or lower quality than what they would otherwise select, or from a supplier whose technology is unknown\(^2\). A very important blacklisting-related aspect is the fact that contracting authorities cannot abuse their position and act in a way that results in blacklisting. Experts have raised concerns over the economic impact such systems may have if not applied fairly and uniformly\(^3\). Also, contracting authorities cannot abuse their position in another sense – they cannot make any exceptions or give any privileges to large businesses. If there is a legal basis, the contracting authority must take all necessary measures to blacklist any economic operator who has failed to properly perform a public contract, regardless of whether the economic operator concerned is a small company or a large business entity. A practice where large companies have more opportunities to influence decisions by contracting authorities is noticed in foreign countries and therefore is also relevant in the Republic of Lithuania. For instance, according to studies, debarment tends to be used more frequently against small firms, while large and powerful firms are rarely suspended or debarred from contracting with the public administration\(^4\). It is therefore crucial to ensure that legal regulation of blacklisting is applied not only to small and medium-sized business, but also to all economic operators without exception and in accordance with the principle of equality, i.e. without discrimination and any privileges.

On the other hand, fair competition would also be impaired if an economic operator who has failed to properly perform a prior public contract is allowed to participate in other public procurement procedures. A restriction may be justified if it pursues a legitimate aim in the public interest and is proportional in that it is suitable for securing the attainment of that objective and does not go beyond what is necessary in order to attain it\(^5\). The objective of ensuring competition does not mean that every public procurement procedure should be open to all or the maximum number of economic operators operating in a particular market. Ensuring competition means that all economic operators must have a level playing field to compete with each other, and economic operators who violate the law (e.g. have not paid their taxes or have committed an offence), also economic operators who fail to properly perform public contracts cannot expect their unlawful acts not to evoke any legal consequences. With

\(^{1}\) The Supreme Court of Lithuania, Civil Division, 24 May 2011 ruling of the board of judges in civil case No 3K-3-249/2011.


the exclusion of dishonest suppliers, the market is supposedly reduced to trustworthy players, and it will be more difficult for dishonest players to survive in the market for public contracts\(^1\). One has to agree with the authors saying that blacklisting is a proportionate measure to exclude from public procurement procedures dishonest economic operators\(^2\). In the longer term, debarment is an investment in public trust and the public procurement system\(^3\). There is less competition, but at least this competition is presumed to be fair\(^4\).

Additional questions arise when a group of economic operators perform a public contract in cooperation with subcontractors. Article 32(3) of the Law on Public Procurement establishes that as necessary in a specific contract the economic operator may rely on the capacity of other economic entities, regardless of its legal relations with them. This rule is related to the objective of including in a procurement procedure as many potential economic operators as possible, providing them a level playing field to participate in procurement procedures, promoting competition, ensuring wider powers to the contracting authority in evaluating proposals and determining the successful economic operator\(^5\). A possibility of relying on the capacity of other economic operators enables large companies as well as small and medium-sized businesses to participate in larger-scale procurement procedures. The Law on Public Procurement does not provide for the distribution of responsibilities between the economic operator and subcontractors. However, Article 6.650(3) of the Civil Code\(^6\) establishes that the general independent work contractor shall be liable before the customer for the failure to perform or improper performance of the obligations by subcontractors, and before subcontractors for the failure to perform or improper performance of the obligations by the customer. Hence, economic operators are liable before the contracting authority for any obligations improperly fulfilled by subcontractors. If a subcontractor fails to properly perform a contract with the economic operator, which results in the improper performance of the public contract, the economic operator concerned (a group of economic operators) should be blacklisted. A subcontractor is not considered an economic operator within the meaning of the Law on Public Procurement and does not directly perform a public contract. Moreover, a subcontractor is not related with the contracting authority by any contractual relations. Thus, in case of improper performance of a public contract, subcontractors should not be blacklisted, irrespective of whose fault it is that the public contract has been poorly performed.

In some cases, an economic operator who is not blacklisted may intend to participate in a public procurement procedure with a subcontractor who is. A proposal submitted by such economic operator should be evaluated in accordance with the procurement conditions. Based on the case law, the contracting authority has discretion to determine minimum qualification requirements for economic operators

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intending to participate in the procurement procedure (each member of the group of economic operators), while to prove the compliance with the qualification requirements economic operators may rely on the capacity of other economic operators\(^1\). Likewise, the contracting authority lays down requirements for both economic operators and subcontractors in the procurement conditions. Unless the procurement conditions include a provision that the subcontractors proposed may not be included in the list of unreliable economic operators, economic operators may use blacklisted subcontractors for the performance of the contract.

**Conclusions**

Blacklisting due to poor past performance aims at protecting contracting authorities from economic operators who improperly perform their contracts.

Any blacklisted economic operator may be (or must be, depending on the procurement conditions) excluded from participation in any other public procurement procedure (even organised by other contacting authorities).

To avoid any disproportionate sanctions for economic operators, the Directive establishes a doctrine of self-cleaning, meaning that any economic operator has the right to prove to the contracting authority that it has made certain improvements which will prevent the economic operator from repeated failure to properly perform a public contract.

Contracting authorities cannot abuse their position and act in a way that results in blacklisting. It is therefore crucial to ensure that legal regulation of blacklisting is applied not only to small and medium-sized business.

In cases where a group of economic operators fails to properly perform a contract, all (individual) members of this group should be blacklisted. Meanwhile if a subcontractor fails to properly perform a contract with the economic operator, which results in the improper performance of the public contract, the economic operator concerned (a group of economic operators) should be blacklisted. Thus, in case of improper performance of a public contract, subcontractors should not be blacklisted, irrespective of whose fault it is that the public contract has been poorly performed.

The contracting authority lays down requirements for both economic operators and subcontractors in the procurement conditions. Unless the procurement conditions include a provision that the subcontractors proposed may not be included in the list of unreliable economic operators, economic operators may use blacklisted economic operators for the performance of the contract.

Within the context of the Law on Public Procurement, a public contract is considered terminated for a material breach of contract, if this breach is consistent with Article 6.217(2) of the Civil Code or is described as material by the contract itself. However, contracting authorities do not have the right to distort the principle equality of parties and consider even the slightest inconsistency with the performance of the contract a material breach of contract.

A penalty (e.g. default interest) should be treated as a similar sanction to compensation for losses. And should the court award a penalty as well as recognise the non-performance of the contract by the economic operator a material breach of contract, the economic operator concerned should be blacklisted.

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\(^1\) The Court of Appeal of Lithuania, 22 February 2012 ruling in civil case No 2A-1089/2012.
References


SOCIAL TRANSFORMATION OF PAKISTAN UNDER THE CONSTITUTION OF 1973

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Abstract

The Objectives Resolution was passed from the Constituent Assembly of Pakistan under the leadership of the first Prime Minister of Pakistan Liaquat Ali Khan in 1949 which has been made the preamble of the Constitution of Pakistan 1973. The first Constitution of Pakistan was enforced in 1956 and was abrogated in 1958 and the second Constitution of Pakistan was promulgated in 1962 and abrogated in 1969. The current Constitution of Pakistan was enacted and promulgated in 1973. It has validated all actions of the ruler Yahya Khan and Zulfiqar Ali Bhutto from 21st March 1969 till the enforcement of the Constitution in 1973 and later on the actions of General Zia ul Haq and Pervez Musharaf as well. The present Pakistan belongs to different people, who are different in language and there are some cultural differences as well, but majority belongs to the religion of Islam that is why the present constitution states that the Islam is the state religion of Pakistan. Initially, the constitution worked a little well and it seemed that it is working in favour of the nation at large, but later on the ruling elite made several amendments in it for their benefits rather than making it beneficial for the people of Pakistan at large. It is the voice of the people of Pakistan that the current Constitution of Pakistan 1973 should be amended according to the will of the people of Pakistan at large and for their benefits and the fairly elected government should eradicate those later amendments which are giving benefits to the ruling elite only.

Purpose – This research is the social study of Pakistan under the Constitution of Pakistan 1973 to examine the current Constitution of Pakistan and analyse the current social system of Pakistan and to suggest changes in the current Constitution of Pakistan 1973 for the betterment of the social justice in Pakistan.

Design/methodology/approach – This study is routed in qualitative method to examine the current Constitution of Pakistan 1973 and analyse the existing social system under the current Constitution of Pakistan and to find and fix hurdles in the better social legal system under the current Constitution of Pakistan.

Finding – This study will help the honest political parties and competent legislators to understand the barriers in the upbringing of the people of Pakistan under the current Constitution of Pakistan and recommend useful changes in the current Constitution of Pakistan for a better social transformed society.

Research limitations/implications – This study is the examination of the current Constitution of Pakistan and an analysis of the social system of Pakistan under it and it will not go into the deep details of every aspect of life rather focusing on the sociology of Pakistan under the current Constitution of Pakistan, its bad effects and what changes are required in it for a better social transformed society.

Practical implications – This study will point out deficiencies in the current social legal system under the current Constitution of Pakistan and recommend changes in the current constitution of Pakistan to the legislature to do so for the benefits of the people of Pakistan.
Originality/Value – This study is the unique work on the topic and there are not many articles written on related topics and this research will be conducted keeping in mind the principles of piracy and illegal methods of doing research.

Keywords: The Constitution of Pakistan-1973, the Objectives Resolution, fundamental rights, the Federal and the Provincial Governments of Pakistan. The Judiciary of Pakistan.

Research type: This study is the general review of the sociology of Pakistan and a critical analysis of the Constitution of Islamic Republic of Pakistan 1973.

Introduction

Islamic Republic of Pakistan took independence from the British Indian Empire on 14th August, 1947. Pakistan adopted the Indian Act of 1935 to use it as its initial temporary constitution. Later on in 1956, Pakistan managed to make its first constitution which was enforced on 23rd March, 1956 and which was abrogated by the first President of Pakistan General Iskendar Mirza on 7th October 1958. On 27th October, 1958 General Ayub Khan took charge as the second President of Pakistan and later in 1962 promulgated a new Constitution of Pakistan which went on until his resignation from the presidency and transferring power to General Yahya Khan in 1969. General Yahya Khan imposed emergency in Pakistan on 23rd November 1971 which was the last nail in the union of the East and West Pakistan and in result the East Pakistan become Bangladesh on 16th December, 1971. It is pertinent to mention here that the proclamation of emergency by Yahya Khan in 1971 has been validated by the Constitution of Pakistan 1973 which is a clear cut indication that there was a soft corner in the ruling elite of 1973 towards Yahya Khan. The executive power was shifted from Yahya Khan to Zulfikar Ali Bhutto on 20th December, 1971. The new Constitution of Pakistan was approved by the National Assembly of Pakistan on 10th April, 1973 which was officially promulgated on 14th August, 1973. The ruling elite has been making amendments in the current Constitution of Pakistan for their own benefits rather than making it beneficial for the people of Pakistan at large. General Zia ul Haq abrogated the Constitution of Pakistan 1973 on 5th July, 1977 and later on stated that he has not abrogated it rather it was held in abeyance. The same thing happened again and the ruling elite further molded the Constitution of Pakistan 1973 in their favour when all actions done by the President Zia ul Haq validated by the Parliament in 1985. Time went on until a new military general took over the executive power and again abrogated the Constitution of 1973 on 12th October, 1999 and later on the Parliament validated his actions as well from 1999 till 2003. The three validation articles 270, 270A and 270AA are laying in the current Constitution of Pakistan 1973 and asking that whether I have been made for the people of Pakistan at large or for some people in the ruling elite only. Later in 2010, the government of Pakistan People’s Party under the leadership of Asif Ali Zardari initiated the 18th amendment in the Constitution of Pakistan 1973 to make it easy for the current politicians to come into the power and take all decisions in their hands while doing deals with the opposition parties.

In this study, the guaranteed fundamental rights of the Constitution of Pakistan 1973; but are not protected by the government of Pakistan in a true sense; are briefly discussed. Islamic provisions are also there in the Constitution of Pakistan 1973 but are not in effective to create a good transformed Islamic Welfare State. The current structure of the Federal Government and the Provincial Governments under the
Constitution of Pakistan 1973 are briefly discussed and then the current structure of the Judiciary of Pakistan under the current Constitution of Pakistan 1973. The study will point out the things which are benefiting the ruling elite only and will also point out those provisions which are still in the Constitution but the current government do not follow them in its true spirit and not giving benefits to the people of Pakistan at large.

**Islamic Provisions**

The Constitution of Pakistan 1973 was approved by the National Assembly of Pakistan on 10th April, 1973 and was officially enforced; all over Pakistan; on 14th August, 1973. The Objectives Resolution; which was passed by the 1st Constituent Assembly of Pakistan on 12th March, 1949; has been made the preamble of the Constitution of Pakistan 1973. The preamble of the Constitution of Pakistan 1973 states that the sovereignty over the entire universe belongs to Al-Mighty Allah alone and the authority is to be exercised within limits prescribed by him by the people of Pakistan through its elected representatives and the principles of democracy, freedom, equality, tolerance and social justice shall be fully observed and the fundamental rights shall include the equality of status, the equal opportunity and the equality before law and includes the social, economic and political justice, freedom of thought, expression, belief, faith, worship and freedom of association; subject to law and public morality.

Muslims shall be enabled to order their lives in accordance with the teachings of Islam and minorities can freely profess and practice their religion and develop their culture whereas adequate provisions shall be made to safeguard the legitimate interests of minorities, backwards and depressed classes of Pakistan and units shall be autonomous within certain boundaries and limitations whereas their integrity, independence and sovereign rights on land, sea and air shall be safeguarded and the independence of judiciary shall be fully observed and Pakistan would be a democratic state based upon Islamic principles of social justice and will contribute towards international peace, progress and happiness of humanity.¹

The Objectives Resolution has been made the operative part of the Constitution of Pakistan in 1985 through the addition of Article 2A in the Constitution. Islam is the state religion of Pakistan. No law can be enacted in Pakistan against the injunctions of the Holy Quran and the Sunnah of Prophet Muhammad ﷺ.² A Muslim is a person who believes in the oneness of Al-Mighty Allah and the prophet hood of the last prophet Muhammad ﷺ and a non-Muslim is a person who is not a Muslim and includes a Christen, Hindu, Sikh, Buddhist, Parsi, Qadiani, Lahori, Ahmadi and Bihai.

There is an Islamic Ideology Council in Pakistan which is consisted of a Chairman appointed by the President of Pakistan and there are other eight to twenty members of the Islamic Ideology Council of Pakistan; appointed for three years; which are well versed in Islamic Law and have knowledge of economics, politics, legal and administrative issues of Pakistan. The President or the Governor may ask the advice

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¹ (1949). The Objectives Resolution. Islamic Republic of Pakistan.
of the Islamic Ideology Council on any enactment of the National Assembly or a Provincial Assembly and it will reply on the advice of the President within 15 days in accordance with the injunctions of Islam. The Islamic Ideology Council shall recommend and compel: in a rightful manner: and advice the President, Governors, National and Provincial Assemblies to make Pakistani laws in accordance with the injunctions of Islam. The Islamic Ideology Council can make its rules of procedure with the approval of the President of Pakistan.\(^1\) The problem with the Islamic Ideology Council is that the President of Pakistan appoints its chairman on political basis and members are also appointed on political affiliations that’s why their rulings are biased due to political affiliations. The appointment in the Islamic Ideology council should have been made based upon the knowledge and competence in the area of Islamic Law and competency and knowledge in economic, political, legal and administrative matters which the State of Pakistan is facing nowadays.\(^2\)

The Constitution of Pakistan requires form the state of Pakistan to ensure the elimination of all forms of exploitation and the fundamental principles shall be gradually fulfilled to each according to his work and to each as per his ability. Every citizen in Pakistan is protected by law and shall be dealt in accordance with the provisions of law and no person shall be stopped from doing a lawful thing and shall not be compelled to do an unlawful thing. No person shall be deprived of life, liberty, body, reputation or property except in accordance with law. Every citizen of Pakistan must be loyal to his country and must be obedient to the Constitution of Pakistan. Any person who violates the Constitution of Pakistan 1973 is guilty of a high treason and shall be given a capital punishment if the offence of high treason is proved against him before the court of law.\(^3\)

The Fundamental Rights

The guaranteed fundamental rights in the Constitution of Pakistan 1973 include the protection of life and liberty, protection against illegal detention, right of due process and fair trial, protection against slavery and forced labor, protection against retrospective punishment, protection against jeopardy and self-incrimination, protection of home against torture, freedom of movement, freedom of assembly, freedom of association, freedom of trade, business and profession, freedom of speech, right to information, freedom of religion, protection against imposed religious taxation, protection against compulsory attendance of religious institution, right to acquire property, protection of property rights, right to access public places, protection against discrimination in services and the protection of language and culture.\(^4\)

Nowadays the life of a political leader in Pakistan is considered more valuable than a life of a teacher or an engineer in Pakistan because the politician is in power and teacher is not in the power. Right of education is there in the Constitution of Pakistan 1973 but Government of Pakistan do not give a proper and good education facilities to the children of Pakistan, rather than making the Government School System better for all the children of Pakistan, politicians send their children abroad.

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for studying or putting them in expensive private schools, they should start sending their children in Government Schools then they will realize to build the good education system in Pakistan. Any law which is made against the fundamental rights shall be declared void by the Supreme Court of Pakistan and the given fundamental rights shall not be suspended in any case except if it is expressly provided by the Constitution of Pakistan 1973 and there are certain provisions of the Constitution of Pakistan 1973 which give the Government of Pakistan right to suspend some of the fundamental rights in emergency situations for some days.

The fundamental rights can be imposed through the court of law in Pakistan but there are certain principles which are called Principles of Policy for the government to adopt during its tenure according to the available resources and those principles are not binding upon the Federal and Provincial Governments of Pakistan and cannot be enforced through the court of law. These principles include the adoption of the Islamic way of life while declaring the knowledge of Islamic studies and the Holy Quran compulsory and the knowledge of an Arabic language shall be highly encouraged, promotion of local bodies institutions, discouragement of parochial, racial, tribal, sectarian and provincial prejudices, participation of women in all spheres of life, protection of family, marriage, women and children, promotion of social justice and elimination of social evil, promotion of social and economic wellbeing of the people, participation of people in the armed forces of Pakistan, strengthening bond with Muslim world and participation in international peace and stability.1 The Constitution of Pakistan enforced on 14th August, 1973 while all previous Constitutions of Pakistan are repealed with all their amendments and presidential orders. The President of Pakistan was empowered to issue directions for the smooth implementation of the Constitution of 1973.2 The same power was granted to the Parliament in 2010 for the enforcement of the 18th amendment of the Constitution of 1973.

The Federal Government

The Head of the State of Pakistan is the President. He is required to be a Muslim, 45 years of age and shall be elected for five years. He shall take oath from the Chief Justice of Pakistan and shall not hold any other office of interest during his presidency and shall not be a member of national or a provincial assembly. He can resign by giving the resignation to the speaker of the National Assembly. He has been given the power to pardon, reprieve and respite, permit, suspend or commute any sentence.

As per the provisions of the Islamic Law, no person can commute the sentence ordered by the judge. There is a famous tradition of Prophet Muhammad ﷺ that at the time of Prophet Muhammad ﷺ a women called Makhzumia was ordered to cut off her hand. One of the companion of Prophet Muhammad ﷺ Usama came and asked for the cancellation of the sentence, Prophet Muhammad ﷺ said that “do not transgress in the fixed rules of Al-Mighty Allah, previous nations were doomed because when their rich people used to commit an offence, they used to forgive them and when their poor

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people used to commit an offence, they used to convict them and punished them. Indeed if my daughter *Fatima (RZ)* steals, I will cut off her hand”.

The President shall be informed by the Prime Minister on every issue, he can be impeached; by the given notice of half of the members of either of the houses to move a resolution in the Parliament. The copy of the resolution shall be served to the president within 03 days and the joint sitting will be called within 7 to 14 days and if 75% votes come against him; on the violation of the constitution and on a gross misconduct as well as on physical or mental disorder charges; he shall be removed from presidency. The President of Pakistan shall act on the advice of the Prime Minister and the Federal Cabinet.

The Parliament of Pakistan includes the National Assembly and the Senate. The lower house of the Parliament is the National Assembly which is consisted of 342 seats, 183 from Punjab, 75 from Sindh, 43 from Khyber PAKHTUNKHWA, 12 from Baluchistan, 17 from FATA, 2 from the Capital Territory Islamabad and 10 seats are allocated to minorities. Members of the National Assembly shall be elected for five years. A member must be a citizen, 18 years of age, not declared an unsound mind person by any competent authority and his name should be in the official voter list. Speaker and Deputy Speaker of the National Assembly shall be elected in the opening session of the Assembly and they can be removed from their places if more than 50% members pass a resolution against them. The President of Pakistan shall call the sitting of the National Assembly at any time as well as more than 25% members of the Assembly can ask the speaker to call a sitting as well. At least three sittings must be held within one year, at least one within 120 days and if less than 25% members are in a sitting, the sitting will be adjourned. The President shall address the first joint sitting of the Parliament after the general elections as well as the first sitting of each year. The Prime Minister, Federal Ministers, Ministers of State, Advisors, and the Attorney Journal shall have the right to speak in the Parliament but they will not participate in the voting process. The President may dissolve the National Assembly on the advice of the Prime Minister and if the no confidence proceedings is initiated and successfully completed against the Prime Minister of Pakistan and there is no one else to take the vote of confidence, the President shall dissolve the National Assembly. The upper house of the Parliament is the Senate which is consisted of 104 members, 23 members from each province, 08 from FATA and 04 from Islamabad. The Senate shall be in place for six years while half of the members will retire after three years. Members of the senate shall elect the chairman and the deputy chairman for three years. Members of the Parliament should be citizens of Pakistan, 35 years of age for the Senate and 25 years of age for the National Assembly, have their names in the voter list, persons of good moral character, have adequate Islamic knowledge, have not indulged in big sins, truthful and trustworthy, must not go against the ideology of Pakistan and must not work against the integrity of Pakistan as well. Members of the Parliament must not be insane, insolvent, must be sole citizens of Pakistan and do not hold dual nationality, do not hold any other office of profit in government institution or privately, do not be disqualified from the Azad Kashmir Assembly, do not work against the ideology and state of Pakistan, must not have more than two years imprisonment upon conviction in an offence except if five years have passed after the completion of his punishment and must not be dismissed from the Service of Pakistan.

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1 Tradition 4304, Ismail, M. b. Sahi Bukhari.
except if upon dismissal, five years have passed and upon removal three years have passed.

This provision was added in 2010 by the Government of Pakistan People’s Party under the leadership of Asif Ali Zardari, this provision is made to give a way to convicted people to enter the parliament of Pakistan again. A new provision 63A was also added in 2010 for the benefits of the ruling elite which states that if any member of the Parliament go against the decision of his political party head and votes against him or joins another political party, his seat will be considered vacant and new elections shall be conducted on his seat. This is also very clear that this is inserted to protect the interests of the political leaders rather than protecting the rights of the people of Pakistan at large. Members of the Parliament may give his resignation to the speaker and his seat will be considered vacant if he does not participate in the proceedings of the Parliament for consecutive 40 days. ¹

The Provincial Governments

There are four provinces in Pakistan namely: Punjab, Sindh, Baluchistan and Khyber Pakhtunkhwa. The Head of the Province is the Governor and the head of the executive is the Chief Minister. The Governor of the province shall be appointed by the President after consultation with the Prime Minister. He shall be eligible to be a member of the National Assembly. He can resign from his office to the President. Chief Justice of the concerned High Court of that province shall take oath from the newly appointed Governor of a particular province. He cannot hold another office of interest during the tenure of his office as governor. If Governor is not available, the Speaker of a Provincial Assembly or if both are not available, a person appointed by the President shall act as the governor of that province unless the prior arrives to hold office. The Governor shall act on the advice of the Chief Minister and the Provincial Cabinet of a Province. He is required to appoint a care taker cabinet if he dissolves a Provincial Assembly and announces new elections in a Province within 90 days. The Provincial Assembly of Punjab is consisted of 371 members, Sindh 168 members, Khyber Pakhtunkhwa 124 members and Baluchistan 65 members. A person living in the province who is a citizen of Pakistan, above 18 years of age, have a name in the voter list and of a sound mind, can vote in the elections of the Provincial Assembly. A Provincial Assembly is elected for the term of five years. Speaker and Deputy Speaker shall be elected at the first meeting of the Provincial Assembly after the general elections. The Governor can summons the meeting of the Provincial Assembly and can prorogue the meeting of the Provincial Assembly as well. He may address the meeting of the Provincial Assembly as well.

The Advocate General of the Province has a right to speak in the meeting of a Provincial Assembly but he does not have a right of vote in the meeting. The Governor may dissolve the Provincial Assembly on the advice of the Chief Minister for 48 hours and the Governor may also dissolve the Provincial Assembly if the vote of no confidence is passed against the Chief Minister and there is no other person who has taken a vote of confidence as the Chief Minister of that Province. On the advice of the Provincial Government, the Provincial Assembly shall determine duties and functions of the Provincial Institutions. All executive work in the Province shall take place with

the name of the Governor. Governor shall appoint an Advocate General who shall have the qualification to become the Judge of the High Court and he will help the Provincial Government in Legal matters and he may resign from his office to the Governor. All provinces shall make Local Bodies Governments and shall transfer political, administrative and pecuniary liabilities to the Local Bodies Institutions. This is also one of the Principles of Policy as mentioned in Article 32 and again it is mentioned in Article 140A which was inserted in 2010 under the eighteenth amendment. The Provincial Governments are reluctant to give political, administrative and pecuniary powers and responsibility to the Local Bodies Institutions.

The Judiciary of Pakistan

There is one Supreme Court in Pakistan, One High Court in every Province and one High Court in Islamabad. The President shall appoint the most senior judge as the Chief Justice of the Supreme Court of Pakistan.

The Supreme Court of Pakistan is consisted of the Chief Justice and certain other judges as are determined by the enactment or by the President of Pakistan. The judge of the Supreme Court of Pakistan must be a citizen of Pakistan and has been the judge of the High Court for five years or a lawyer of the High Court for fifteen years. The Chief Justice shall take oath from the President of Pakistan and other judges of the Supreme Court shall take oath from the Chief Justice of the Supreme Court of Pakistan. The age of retirement of the Supreme Court Judge is 65 years. In case if the Chief Justice of the Supreme Court is not available, the President shall appoint the acting Chief Justice among the other judges of the Supreme Court and in case if the Judge is not available the President shall appoint any retired or present Judge of the High Court to act as the Judge of the Supreme Court. An ad-hoc judge for the Supreme Court of Pakistan may be appointed for the want of quorum by the President after consultation with the Judicial Commission of Pakistan. The ad-hoc judge may be appointed if he has retired as the judge of the Superior Judiciary of Pakistan and three years has not passed after his retirement. The seat of the Supreme Court of Pakistan is at Islamabad. The original jurisdiction of the Supreme Court of Pakistan is to resolve a dispute between the Centre and the Province and give a declaratory judgment in this regard and to hear writ petitions concerning fundamental rights.\(^1\)

High Courts of Pakistan shall have Chief Justices and certain other judges as are determined by the law or by the President of Pakistan. The judge of the High Court must be the citizen of Pakistan, 45 years old, either be an advocate of the High Court for ten years or at least worked as the District Judge or worked as a Civil Servant for ten years or hold a Judicial Office for 10 years. The Chief Justice of the High Court will take oath from the President of Pakistan and the other judges will take oath from the Chief Justice of the concerned High Court. The age of retirement of the High Court judge is 62 years. In the absence of the de jure Chief Justice, the President will ask one of the judges of the Supreme Court or the High Court to work as the Chief Justice.

There is one Federal Shariat Court in Pakistan at Islamabad consisted of eight judges including the Chief Justice of the Federal Shariat Court, he must be eligible to be a judge of a Supreme Court or a sitting judge of the High Court. Four judges should be eligible to be a judge of a High Court and three Islamic Jurists; who have fifteen years of experience in Islamic Law; for three years term, which can be renewed by the

President of Pakistan and he will take oath from all the judges of the Federal Shariat Court. The Federal Shariat Court cannot give decisions on the matters related to the Constitution, Islamic Personal Law, Procedural Law and Fiscal Laws for ten years. The Federal Shariat Court can take action on its own or on the request of the citizens of Pakistan or on the request of the Federal or Provincial Governments to declare a provision or a law against the injunctions of Islam.

The pleader before the Federal Shariat Court must be a Muslim and either be an advocate of the Supreme Court, or an advocate of the High Court for five years or an Islamic Jurist.

There is a Shariat Appellate Bench which is consisted of 03 Supreme Court Judges and 02 Islamic Jurists appointed by the President of Pakistan. An aggrieved party from the decision of the Federal Shariat Court may appeal before the Shariat Appellate Bench within 60 days and the Federal or Provincial Governments within 06 months. Decisions of the Federal Shariat Court and the Shariat Appellate Bench are binding on all subordinate courts. The decision of the Federal Shariat Court should be implemented immediately and a time limit should be made for the decision of the appeal before the Shariat Appellate Bench.

**Important Federal Authorities**

There is a Council of Common Interest, consisted of the Prime Minister, Chief Ministers of all Provinces and three members from the Federal Government. The council shall give its annual report to the Parliament. The council shall regulate and formulate policies and exercise supervision and control over certain institutions. The council shall meet at least once in 90 days and shall be formed within 30 days after the taken oath of the office by the Prime Minister. In water supplication complaints, the Federal Government and Provincial Governments may send the matter to the Council which shall give its decision or ask the President to form a commission.

There is a National Economic Council which is formed by the President of Pakistan and is consisted of the Prime Minister and four members appointed by him, Chief Ministers of all Provinces and one each member appointed by them. The National Economic Council shall formulate plans in respect to financial, commercial, social and economic policies. It shall meet at least twice a year and submit its annual report to the Parliament. The Federal Government may construct hydro-electric and thermal power installations in any Province. The Provincial Government may extend the electricity in the Province and require the supply, levy tax on electricity, install a grid station and power houses and determine tariff on distribution of electricity in a Province. In case of a difference between a Federal Government and a Provincial Government on electricity, the matter will be sent to the Council of Common Interest for the resolution. The gas resource shall be distributed first to the people of the Province, where it has been found. The Federal Government shall install a transmitter in a Province on its request of the Province and regulate a fee with respect to broadcasting and telecasting.

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There is a National Finance Commission which is consisted of the Federal Finance Minister and Provincial Finance Ministers and such other persons appointed by the President from time to time. The National Finance Commission shall distribute the money incurred through taxes, distribute the Federal grant to Provinces, exercise borrowing powers of the Federal and Provincial Governments and deal with other financial matters. Every year the sum of the Province should be increased and in no case it be decreased. The National Finance Commission shall submit its annual report to the National and Provincial Assemblies. ¹

There is a Judicial Commission for the appointment of the Supreme Court and High Court Judges. The Judicial Commission which is responsible for the appointment of the Judges of the Supreme Court of Pakistan is consisted of the Chief Justice of the Supreme Court, a former Judge of the Supreme Court; appointed by the Chief Justice for two years, four most senior Judges of the Supreme Court, an Attorney General, a Federal Minister of Law and Justice and the senior lawyer of the Supreme Court of Pakistan; appointed by the Pakistan Bar Council for two years and for the appointment of the High Court Judges, the following shall be added in the Commission: The Chief Justice of the concerned High Court; if his selection is in process, the previous retired Chief Justice or a senior Judge of the concerned High Court will take his place in the Commission; the senior Judge of the concerned High Court, the Law Minister and the senior Advocate of the High Court; appointed by the concerned Bar Association for two years and for the appointment of the Judges of the Federal Shariat Court the following shall be added, namely: the Chief Justice of the Federal Shariat Court and the senior Judge of the Federal Shariat Court. The Judicial Commission will send the approved name to the Parliamentary Committee which is consisted of 08 members, 04 from the Government and 04 from the opposition, they will approve the name within 14 days or disprove the name by 75% majority and then the Commission will be required to send a new name to the Parliamentary Committee and after approval from the Committee, the name will be sent to the Prime Minister and then to the President for final ratification and appointment. ²

There is a Supreme Judicial Council which is consisted of the Chief Justice of the Supreme Court and two most senior judges of the Supreme Court and two most senior Chief Justices of the High Courts. The Judicial Council will see whether any judge of the Supreme Court or a High Court is physically or mentally ill or has done a misconduct and if so, it will call an inquiry and if the inquiry proves right then that judge will be removed from the judicial office after the approval of the President. The inquiry of the Supreme Judicial Council cannot be challenged anywhere in Pakistan.³

There is one Election Commission of Pakistan which is consisted of the Election Commissioner appointed by the President of Pakistan who is either a retired judge of the Supreme Court or a High Court or has the eligibility to be a judge of the Supreme Court or a High Court. The Prime Minister and the Opposition Leader will send three names to the Parliamentary Committee which is consisted of 12 members: 06 each from the government and opposition; and headed by the speaker, who will finalize one name for the seat of the Election Commissioner and send it to the President for the

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² Hussain, F. (2011). The judicial system of Pakistan, Supreme Court of Pakistan.

final approval. The Chief Election Commissioner of Pakistan will take oath from the Chief Justice of Pakistan and will hold office for three years and he cannot hold any other office of interest during his tenure and cannot hold any office in the government of Pakistan within two years after his retirement as the Chief Election Commissioner of Pakistan. In case of the absence of the Chief Election Commissioner, the Chief Justice of Pakistan will appoint any other sitting judge of the Supreme Court of Pakistan to perform functions of the Election Commissioner. The Chief Election Commissioner is the Chairman of the Election Commission and there are four other members of the Election Commission; one each from every province; a judge of the High Court, appointed by the President. Duties of the Election Commission of Pakistan is to prepare electoral rolls and revise it annually, forming Election Tribunals and holding National, Provincial and Senate Elections in Pakistan. All administrative authorities will work in aid to the Election Commission of Pakistan in the completion of its functions. The Commission shall make rules for the appointment of employees in the Election Commission of Pakistan. The Parliament can make legislation for the allocation of the seats, related to constituencies, electoral rolls and elections but the Parliament cannot decrease the powers of the Election Commission of Pakistan. One person cannot hold a seat of the National Assembly and a Provincial Assembly together at the same time and cannot hold two seats of the same assembly at a time. Within 60 days of the completion of the period of the assembly, the Election Commission of Pakistan will hold a new general elections in Pakistan but in case of the dissolution of the assembly, the election will be held within 90 days. The Election Commission of Pakistan will announce results of elections within 14 days. When after the general elections, a National Assembly or a Provincial Assembly’s seat is vacant, the election will be held on that seat within 60 days and in case of the empty seat of the senate, the election will take place within 30 days.¹

There is a Federal Public Service Commission of Pakistan whose Chairman is appointed by the President of Pakistan on the advice of the Prime Minister and at the Provincial level the Punjab, Sindh, Baluchistan and Khyber Pakhtunkhwa Public Service Commissions, their Chairman’s are appointed by governors of their Provinces on the advice of their Chief Ministers. Rules for services of Pakistan at Federal level shall be enacted by the National Assembly of Pakistan and at Provincial level by the Provincial Assemblies of Pakistan. The President is the supreme commander of the Armed Forces and appoints the Chief of Army Staff, Chief of Naval Staff, Chief of Air Force and the Joint Chief of Staff Committee on the advice of the Prime Minister and determine their salaries and allowances. The Armed Forces of Pakistan work against the external threat towards Pakistan and in aid to the Civil Government of Pakistan.

Conclusion and Recommendations

The Constitution of Pakistan was passed by the National Assembly of Pakistan on 10th April, 1973 and officially promulgated on 14th August, 1973. The Objectives Resolution was passed in 1949 which is made the preamble of the Constitution of Pakistan 1973. The constitutional name of Pakistan is Islamic Republic of Pakistan which is consisted of four provinces namely: Punjab, Sindh, Baluchistan and Khyber Pakhtunkhwa, capital territory Islamabad and the Federally Administered Tribal

¹ Khan, H. (2005). Constitutional and political history of Pakistan, Oxford University Press, USA.
Area. Islam is the State religion of Pakistan and no law can be made in Pakistan which is contrary to the injunctions of Islam laid down in the Holy Quran and the Sunnah of Prophet Muhammad ﷺ. There is one Islamic Ideology Council of Pakistan which gives its recommendations to make the legislation of Pakistan in accordance with the injunctions of Islam. The Head of the State of Pakistan is the President. A non-Muslim cannot become the President of Pakistan. The bicameral legislature was formed under the Constitution of Pakistan 1973, the upper house is the Senate and the lower house is the National Assembly. The Constitution of Pakistan 1973 may be amended by ¾ majority in the Parliament. 21 amendments have been made in the Constitution of Pakistan 1973 until now. The Federal Government of Pakistan is consisting of the President, two legislative houses at the federal level namely: the upper house, Senate, which is consisted of 104 members and the lower house, National Assembly, which is consisted of 342 members. The head of the executive at the federal level: in Pakistan: is the Prime Minister, which is elected among the members of the National Assembly. The Provincial Governments of Pakistan are consisted of the Governor and the Provincial Assembly. The Provincial Assembly of Punjab is consisted of total 371 members, Sindh 168 members, Khyber Pakhtunkhwa 124 members and Baluchistan 65 members. The Head of the Executive in a Province is the Chief Minister, which is elected by the Provincial Assembly. There is one Supreme Court in Islamabad and five High Courts respectively in Islamabad, Lahore, Karachi, Quetta and Peshawar. There is a Council of Common Interest, a National Economic Council and a National Finance Commission. There is a Judicial Commission of Pakistan for the appointment of the judges of the Supreme Court and High Courts of Pakistan and a Supreme Judicial Council which conducts an inquiry on misconduct charges of the judges of the superior judiciary.

The Chairman and members of the Islamic Ideology Council of Pakistan are appointed on the basis of political affiliations rather than looking into the competency of the person in Islamic law, economics, politics, law and administration. I would like to recommend that the Islamic Ideology Council of Pakistan should be separated from political influence and it should be made an independent body whose members and chairman should be selected by a group of people from the Judiciary while making consultations with all major Islamic scholars of Pakistan of all sects and there should be some members in the council who should be well versed in economics, politics, law and administration.

The right of education is guaranteed in the Constitution of Pakistan 1973 but there are three education systems in Pakistan namely: The religious institutes, which are free of charge but only focus on religious studies. The Private School System, which is very expensive and away from the reach of the poor people. The Government School System, which is not very expensive but the quality of education and facilities are not good because of the damaged political and administrative system of Pakistan. I would like to recommend that there should be only one education system for all the children of Pakistan. One curriculum for all the students to make them feel equal, which will give them confidence and which will enhance their capabilities and will decrease the inferiority complex.

The President of Pakistan is the Head of the State of Pakistan and according to Article 45 of the Constitution-1973, he can pardon, reprieve, respite, permit, suspend and commute any sentence. This provision of the Constitution is against the injunctions of Islam and as mentioned earlier that no law in Pakistan can be made
against the injunctions of Islam thus this provision should be removed from the constitution as no person is above the law and no one has the right to pardon except the inheritors of the deceased murdered.

A convicted person who has been imprisoned for less than two years if more than two years have passed and a convicted person who has been punished for more than two years’ imprisonment if five years have passed after conviction and a person who has dismissed on misconduct charge from the Service of Pakistan if five years have passed after dismissal and three years have passed after removal from the Service of Pakistan can become a member of the Parliament of Pakistan. It is very clear that this type of provision is added to make a way to the convicted people to enter Parliament of Pakistan and they will harm the people of Pakistan again. This provision should be removed immediately from the Constitution of Pakistan as well as the article 63A which states that a member of the parliament cannot go against the decision of his political party leader.

It is the principle of policy of the Federal and Provincial governments to promote local bodies institutions under Article 32 of the Constitution of Pakistan 1973, secondly it is a clear cut duty imposed by the Constitution of Pakistan 1973 under Article 140A, on every provincial government to make Local Bodies Governments and shall transfer political, administrative and pecuniary liabilities to the Local Bodies Institutions, but it has never been materialized in true sense. It is strictly recommended that the duties of the Provincial Governments under the Constitution of Pakistan 1973 should be fully observed and required powers should be fully transferred to the local government’s institutions under the local bodies’ governments.

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FAILURE TO MEET THE DEMAND AS INFRINGEMENT
OF ARTICLES 106(1) AND 102 TFEU:
THE PROBLEM OF CAUSAL LINK

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Abstract

Purpose – this paper aims to analyse application of Article 106(1) in conjunction with Article 102 of Treaty of the Functioning of the European Union (TFEU) with respect to situations, when undertakings having statutory monopoly rights fail to satisfy demand/needs of their customers. In particular, this research paper aims to determine what kind of causal link needs to be established between State actions and failure to meet the demand by the holder of statutory monopoly.

Design/methodology/approach – theoretical methods (analytic and systematic) as well as case law analysis has been applied in the research.

Finding – there are two legal tests supported by case practice. Commission takes the position that the State and holder of monopoly rights are jointly liable for failure to meet the demand. Hence infringement may be found in all cases, when there is clear demand on the market which remains unsatisfied. On its turn, European Court of Justice (ECJ) considers that infringement can be found only in such cases, when failure to meet the demand results from the State actions only. This paper suggests that joint liability test is more adequate for finding the infringement, and the most recent practice of EU courts seems to support this view.

Research limitations/implications – findings presented in this paper are based on the analysis of case law of European Court of Justice and European Commission, which is admittedly rather scarce. Respectively, findings presented in this paper reflect status quo of the case law and doctrine, however some developments can be expected in the nearest future.

Practical implications – selection of causal link theory, which should be applied in failure to meet the demand cases, has direct impact on the burden of proof falling on the claimant. Having determined to apply direct causal link test, practical possibilities to prove the infringement would be limited to very extreme cases of failure to meet the demand. On the contrary, application of joint liability test entitles to prove infringement rather easily – such infringement can be found in all cases when the customer has demand for some services and such demand is left unsatisfied by the holder of monopoly rights.

Originality/Value – legal doctrine analyse the causal link in Article 106(1) and 102 TFEU cases, however the doctrine lack analysis of causal link problem specifically in failure to meet the demand cases, which are quite specific. The latter problem was addressed to some extent by Monti, Manaridou and Kersting. However their analysis touched upon only certain issues of causal link and does not take into account evolvements in the most recent case practice.

Keywords: failure to meet the demand, statutory monopoly, exclusive rights, causal link.

Research type: research paper.
Introduction

It is generally accepted that allocative and productive inefficiency appears to be an inherent feature of each monopoly. In such markets, companies don’t experience any pressure from their customers and competitors to innovate and increase production efficiency. In turn, absence of such competitive pressure always ends up in a situation, when customers are faced with the necessity to purchase monopoly goods, rather than goods actually they need most. They are also required to pay monopoly price for such goods, which by definition appears well above the competitive level. Needless to say that such competitive outcome is detrimental to consumers, thus States are usually opposing creation and operation of monopolies. Nevertheless, there is a number of examples suggesting that States do not follow the same rationale with respect to monopolies of State-owned undertakings or other undertakings in which the State has specific interest. When the question concerns business operations of such undertakings State authorities tend to find many seemingly legitimate reasons to monopolise goods supplied thereby. As a general rule, the necessity of monopolisation is explained as falling under the interest of national security, insufficient quality of services provided by private undertakings, the urgency to cross-subsidy provision of services to socially vulnerable people, etc. Nevertheless, in many cases the creation of monopolies merely aims to shield inefficient undertakings from competition as failure of State-owned companies is normally outside political agenda.

Since 1992 Article 46 of the Constitution of the Republic of Lithuania specifically prohibits monopolisation of goods and services, which leads to natural expectation that monopolies should no longer be created or exist in the Republic of Lithuania. Nevertheless, as suggested by the most recent examples such conclusion would be far from reality. For example, since 2014 Lithuania managed to establish legal monopoly of state-owned company for provision of television transmission services to national broadcaster (LRT)\textsuperscript{1}, attempted to re-establish legal monopoly of company providing secure IT and data transmission services to public sector companies and establish a new legal monopoly for provision of IT clouding services. There is also a number of examples of monopolies created at municipal level, e.g. in 2015 Lithuanian competition council (LCC) considered monopoly rights granted by Kaunas municipality to undertaking engaged in treatment of human remains and administration of cemeteries\textsuperscript{2}, public transportation monopolies operating in Klaipėda\textsuperscript{3} and Švenčionys\textsuperscript{4}, heat energy monopoly in Šiauliai\textsuperscript{5} and waste treatment monopoly in Joniškis\textsuperscript{6}.

Legality of all such monopolies could be analysed from the perspective of various legal instruments. These could be national instruments, such as Article 46 of Constitution and Article 4 of Law on Competition. The problem also could be analysed from the perspective of instruments offered by EU law, i.e. infringement of fundamental EU freedoms, such as free movement of goods/services and/or freedom of establishment. All these instruments are designed to challenge monopoly rights as

\textsuperscript{1} Law No XII-1032 on amedment of Article 2 of the Law No XI-1574, which amended Article 5 of the Law on National Radio and Television, 2014
\textsuperscript{2} Treatment of human remains and administration of cemeteries in Kaunas municipality, 2015
\textsuperscript{3} Public transportation in Klaipėda municipality, 2015
\textsuperscript{4} Public transportation in Švenčioniai municipality, 2015
\textsuperscript{5} Central heating in Šiauliai municipality, 2015
\textsuperscript{6} Waste treatment in Joniškis municipality, 2015
such and offer a possibility to analyse the situation from the perspective of the competitor. Nevertheless, EU law also contains a very interesting legal instrument offering possibility to consider legality of monopolies from the perspective of consumers whose interests are primarily impaired by creation of monopolies, – Article 106(1) TFEU applied in conjunction with Article 102 TFEU. This legal instrument shall be analysed in detail in this paper suggesting that existence of legal monopolies could be reasonably challenged in case holders of monopoly rights do not offer goods and/or services, which are needed by each individual customer, i.e. holder of monopoly rights does not meet the demand.

The Prohibition Established in Article 106(1)

Article 106(1) TFEU appears to be the reference rule, which is applicable only in conjunction with other provisions of TFEU. As noted by Lang, irrespective of rather complicated language of this provision, in effect it provides that “[e]ven in the case of State enterprises and enterprises to which the State has given monopoly or special rights, States may not adopt or maintain measures contrary to the Treaty”. Such prohibition is addressed to Member States and prevents them from adoption of any measures, which would impair effectiveness of any other provision contained in the Treaty.

Article 106(1) could also be applied in conjunction with provisions of competition law, such as prohibition of abuse of dominant position established in Article 102 TFEU. In such cases Article 106(1) requires that Member States refrain from any measures, which would impair the possibility to invoke abuse of dominant position committed by State-owned undertakings and/or undertakings holding special or exclusive rights, or more general impairment of effectiveness of such prohibition. There are many forms of State measures, which could lead to reduction of effectiveness of Article 102 and it could also be the case when the holder of legal monopoly is unable to meet the demand available on the market.

Failure to Meet the Demand is Considered Infringement of Article 106(1) and 102 TFEU

The idea that failure to meet the demand available on the market could amount to infringement of Article 106(1) applied in conjunction with Article 102 can be traced back to European Commission decision in Dutch Courier Services adopted in 1989. In this case the Commission considered the extension of dominant position of Dutch postal company PTT into a neighbouring market of express delivery services by the laws adopted by the Dutch Government. The Commission the declared presence of infringement of Article 106(1) and 102 inter alia taking into account that prior to monopolisation customers used to purchase express delivery services from private undertakings and such customers did not consider that quality of services provided by the state-owned company was comparable to the one previously provided by private companies. In this respect Commission concluded that “the Law requires them to use the PTT Post BV express services on the terms laid down by the latter, whether or not

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1 Temple Lang, 2003, p. 1
2 Dutch Courier Services, 1989
they correspond to their needs". Commission did not elaborate as to the conceptual grounds for finding such infringement (i.e. how the efficiency of Article 102 has been reduced by State measures). Nevertheless, the analysis made by the Commission suggests that Commission has concentrated on the failure to meet the demand as such (i.e. situation) without finding it necessary to investigate in detail, whether such failure has been caused by the State actions or inefficiency of state-owned company.

The conceptual grounds for finding such infringement have been slightly more explained by the Commission in Spanish post decision adopted a year later in a very similar situation. In the latter case Commission considered the extension of postal monopoly into express delivery services market realised by the laws of Spanish government. The Commission has found the infringement of Article 106(1) applied in conjunction with Article 102 on the same basis as in Dutch Courier Services case, i.e. *inter alia* taking into account that customers are deprived from the possibility to purchase goods and services they actually need. Nevertheless, the Commission has additionally explained that such State actions are prohibited as they have led to effects similar as the ones prohibited by Article 102(b) (i.e. limitation of supply and technical development) and such infringement has resulted from joint actions of the State and the holder of monopoly rights.

None of the abovementioned decisions of the Commission have been appealed before ECJ, hence it remained unclear whether ECJ was ready to accept such interpretation of Article 106(1) applied in conjunction with Article 102, which was strongly suggested by the Commission. Nevertheless, in 1991 the ECJ received a request for a preliminary ruling from German national court, which specifically asked to explain, whether failure to meet the demand could amount to infringement of Articles 106(1) and 102. The case concerned exclusive rights provided to the State employment agency AFG in Germany. The facts of the case suggested that AFG was manifestly not in the position to meet the demand for services related to employment of higher tier managers, openly declared its limited possibilities in provision of such services and even invited private market operators to provide their services. As a result, irrespectively of existence of legal monopoly for employment agency services, AFG managed to intermediate only in approximately 28 per cent of cases of employment of higher tier managers and there were 700-800 of private employment agencies, which actually was meeting the demand available on the market.

In this case the Commission considered that ECJ should find the infringement taking into account the combined effect of (i) German legislation prohibiting private recruitment services and (ii) AFG’s conduct in failing to satisfy the demand that clearly exists in the market, which has ultimately resulted in limitation of production, markets or technical development within the meaning of Article 102 (b). In the view of the Commission possibility of such kind of infringement has been accepted by ECJ in Volvo v. Veng, where the Court found that the holder of the exclusive right to registered design for case parts may be found abusing its dominant position in case

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1. Dutch Courier Services, 1989, 12 paragraph.
2. Spanish post, 1990
3. “Consequently, the State measure in question, together with the behaviour of the Spanish Post Office, has the effect of limiting supply and technical development within the meaning of Article 86, thus constituting an infringement of Article 90 in conjunction with Article 86 (b) of the Treaty.”, Spanish post, 1990, paragraph 11.
one would cease production of spare parts for a model with still many examples in circulation.

AG Jacobs, who delivered his opinion in the case, wasn’t as enthusiastic of the position suggested by the Commission. Nevertheless, he admitted that joint actions of German government and AFG placed “employer or executive <...> in the same situation as the Volvo owner who cannot obtain a new body panel for his car because the proprietor of the registered design for such parts does not manufacture them and refuses to allow anyone else to do so.” Respectively, AG Jacobs accepted the principle that “where national law confers an exclusive right on someone—whether in the form of a patent, a registered design or a monopoly in the provision of certain services—and he fails to produce the goods or services covered by the exclusive right, that failure may amount to abuse of a dominant position <...> The effect of that prohibition is that the exclusive right can no longer be enforced.”

In its preliminary ruling delivered in Hofner case ECJ accepted the position suggested by the Commission and AG Jacobs by concluding that failure to meet the demand could amount to infringement of Articles 106(1) and 102. As provided by the Court, in the view of Article 102(b) abuse may “consist in limiting the provision of a service, to the prejudice of those seeking to avail themselves of it”\(^1\). Respectively, the infringement could be found in case the State creates a situation in which provision of services is limited due to grant of exclusive right by the State to undertaking, which “is manifestly not in a position to satisfy the demand prevailing on the market for activities of that kind”\(^2\). On its turn, liability of the State could be invoked provided that the State “creates a situation in which a public employment agency cannot avoid infringing Article [102]”\(^3\).

The Problem of Causal Link between State Actions and Failure to Meet the Demand

As noted above, Article 106(1) could be invoked in cases, when measures adopted by the State reduce efficiency of Article 102, i.e. there is a causal link between State actions and the reduction of efficiency of Article 102. When it concerns the failure to meet the demand there are always two parties, which could be liable for such failure to, i.e. the (i) State, which established the legal monopoly; and (ii) the holder of monopoly rights, which actually provides services to customers and fails to deliver goods/services needed by the customer. Respectively, application of Articles 106(1) and 102 TFEU requires considering what should be the role of the State in failure to meet the demand cases in order to call into question its liability under Article 106(1). In other words, what should the causal link between State actions and “limiting the provision of a service, to the prejudice of those seeking to avail themselves of it” prohibited by Article 102(b) be?

The problem of causal link always has been subject to extensive debates. The early ECJ case practice suggested that infringement of Article 106(1) and 102 TFEU may be invoked only in such situations, when undertaking is placed by the State in such situation, when undertaking cannot avoid abusing its dominant position. In such kind of situations undertaking is effectively deprived from the autonomy of its actions,

\(^1\) Hofner, 1991, paragraph 30.
hence its liability cannot be invoked under Article 102 TFEU\(^1\). Nevertheless, in such kind of situations it’s quite rational to invoke liability of the State under Article 106(1) as undertaking managed to escape liability for infringement of Article 102 TFEU merely due to intervention of the State\(^2\).

It the context of failure to meet the demand case, such theory suggests that liability of the State could be invoked only in cases, when the establishment of legal monopoly was the primary reason for failure to meet the demand, i.e. there is *direct causal link* between State actions and the said failure. On the basis of this theory it’s possible to invoke the liability of the State only in cases, when the possibility to meet the demand is objectively impossible irrespective of the efforts placed by holder of monopoly rights. This situation could be perfectly illustrated by the example of *Hofner* case discussed above. It was the case of extreme failure to meet the demand and the Court had found that infringement could be established only in case the holder of monopoly rights “*is manifestly not in a position to satisfy the demand prevailing on the market*”\(^3\). Moreover, the ECJ declared that liability of the State could be invoked in case it “creates a situation in which a public employment agency *cannot avoid infringing* Article [102]”\(^4\). In other words, liability of the State under Article 106(1) could be invoked only in cases when the holder of monopoly rights objectively “*cannot*” meet the demand available on the market irrespective of the efforts made thereby. Analogous legal test has been employed by the ECJ in *Job Centre II* and *Carra*\(^6\) cases, which also concerned State monopolies for employment agency services, and *manifest* failure of State agencies to meet the demand available on the market.

Following *Hofner* the case practice gradually expanded the scope of State liability under Article 106(1) and 102 TFEU. In the modern case practice liability of the State could be also be invoked in case the State “*is led to abuse its dominant position*”\(^7\), without necessity even to show that any abuse actually occurred\(^8\). In this regard, the State may be liable for inducement to commit abusive actions. In such kind of situations, autonomy of undertaking is not restricted to such extent which would prevent invoking its liability for abusive actions under Article 102 TFEU. Nevertheless, the State still may be found liable under Article 106(1) for creation of such situation taking into account that State measures impair preventive effectiveness of Article 102 TFEU.

In the context of failure to meet the demand cases such theory suggests that the State and the holder of monopoly rights could be *jointly liable* for failure to meet the demand. Respectively, infringement of Articles 106(1) and 102 should be assessed from the perspective *consequences*, i.e. in case there is demand available on the market and such demand is not satisfied by the holder of monopoly rights it’s immaterial whether such failure was caused by actions of the State or inefficiency of the holder of monopoly rights. In other words, application of this theory suggests that liability of the State under Article 106(1) could be invoked in case the holder of monopoly rights “*is not willing or able to carry out that task fully, according to the

\(^1\) Ladbroke, 1995, Atlantic Container, 2003, paragraph 1130; Deutsche Telekom, 2010, paragraph 80;
\(^3\) Hofner, 1991, paragraph 31.
\(^5\) Job Centre II, 1997.
\(^6\) Carra, 2000.
\(^7\) Greek Lignite, 2014, paragraph 41; MOTOE, 2008, paragraph 49.
\(^8\) Greek Lignite, 2014, paragraph 42; MOTOE, 2008, paragraph 50.
demand existing on the market". This causal link theory has been suggested by the Commission to ECJ in Hofner case and employed in all infringement cases considered by the Commission (Dutch Courier Services\textsuperscript{2}, Spanish post\textsuperscript{3}, Italian GSM\textsuperscript{4}, Spanish GSM\textsuperscript{5}, Slovenska posta\textsuperscript{6} cases).

Interestingly, since 1989 when the Commission has adopted its decision in Dutch Courier Services case none of its decisions in failure to meet the demand cases has been appealed to ECJ. The lack of such appeal led to quite an odd situation. The Commission kept its original position and considered that failure to meet the demand cases should be analysed from the perspective of consequences and it’s immaterial to consider, whether failure to meet the demand has been caused by the State or the holder of monopoly rights. On its turn, ECJ in Job Centre II\textsuperscript{7} and Carra\textsuperscript{8} cases applied direct causal link theory and was ready to accept infringement only in case the State alone was liable for failure to meet the demand. In subsequent Albany\textsuperscript{9}, Pavlov\textsuperscript{10}, Ambulanz Glöckner\textsuperscript{11} and AG2R\textsuperscript{12} cases ECJ has shown some signs that joint liability test supported by the Commission could be accepted. Potential acceptance of joint liability test was also suggested by the general evolution of Article 106(1) and 102 TFEU case law. Nevertheless final position of the Court remained unclear. Respectively, to major extent the outcome of the case depended on the institution considering the claim, which is obviously not an acceptable form the perspective of legal certainty. Nevertheless, the situation is about to change in the nearest future taking into account that decision adopted by the Commission in 2008 in Slovenska Posta case\textsuperscript{13} has been appealed to the General Court, which delivered its judgement in 2015\textsuperscript{14} and the appeal before the ECJ in this case is currently pending.

**Which Theory to Apply: Pros and Cons**

Prior to discussing details of Slovenska Posta case it is worth considering pros and cons of direct causal link test suggested by the ECJ and joint liability test suggested by the Commission.

Without any doubt, the strongest point of direct causal link theory is legal certainty provided to the State in making its decision on the establishment of a monopoly for certain goods and services. At the outset of such decision the State can make *ex ante* assessment whether the decision to monopolise certain business areas would be in compliance with Article 106(1) and 102 TFEU. In case the State has reasonable grounds to believe that a sufficiently effective holder of monopoly rights would be able to satisfy the demand available on the market, such monopolisation

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\textsuperscript{1} Such test has been suggested by European Commission in Hofner case (see Hofner, 1991), paragraph 18
\textsuperscript{2} Dutch Courier Services, 1989.
\textsuperscript{3} Spanish post, 1990
\textsuperscript{4} Italian GSM, 1995
\textsuperscript{5} Spanish GSM, 1996
\textsuperscript{6} Slovenska posta, 2008
\textsuperscript{7} Job Centre II, 1997
\textsuperscript{8} Carra, 2000
\textsuperscript{9} Albany, 1999
\textsuperscript{10} Pavlov, 2000
\textsuperscript{11} Ambulanz Glöckner, 2001
\textsuperscript{12} AG2R, 2011
\textsuperscript{13} Slovenska posta, 2008
\textsuperscript{14} Slovenska posta, 2015
would be shielded from the objections raised on the basis of Article 106(1) applied in conjunction with Article 102 TFEU. Obviously, such legal certainty is not offered having accepted joint liability test suggested by the Commission. In fact, once joint liability test is applied the State cannot be entirely sure, whether monopolisation decision shall be in compliance with Articles 106 and 102. Compliance of the legal monopoly would depend on the effectiveness of the holder of legal monopoly (i.e. whether it’s capable to meet the demand available in the market). Moreover, the legality of legal monopoly would become dynamic phenomena as monopoly could be found illegal from the perspective of Articles 106 and 102 TFEU, when services requested by customers would not be provided. Nevertheless, the same monopoly could turn to be perfectly legal once services demanded by the customers would be accordingly offered.

The lack of legal certainty in joint liability theory was strongly criticized by AG Jacobs in Albany. As provided by AG Jacobs, Articles 106(1) and 102 TFEU „cannot be the appropriate legal basis for holding Member States responsible for independent anticompetitive behaviour on the part of undertakings merely because it takes place within their jurisdiction. Article [106(1)] can therefore be infringed only where there is a causal link between a Member State's legislative or administrative intervention on the one hand and anticompetitive behaviour of undertakings on the other hand. The Court has held that in the context of Article [106(1)] alleged abuses must be the “direct consequence” of the national legal framework “. Joint liability test has also been criticised by AG Tesauro in Corbeu case. As provided by Tesauro, Articles 106(1) and 102 should not constitute means of evaluating the economic efficiency of a national monopoly. If monopoly is legally justifiable „it is of little importance whether it is more or less effectively managed: in any event it will have to be regarded as consistent with the Treaty, whilst it will be for the national authorities to apply themselves to improving the quality of the services provided. Any other solution, moreover, would have the consequence that a national system conferring exclusive rights would be permissible in one case and prohibited in another, depending on how efficiently or, to put it another way, how ably and correctly the entity possessed of the exclusive right was managed.”. In other words, AG Tesauro considered that compliance of the legal monopoly with Articles 106(1) and 102 could not be dependent on the effectiveness of the holder of monopoly rights, which again leads to conclusion that inability to meet the demand should be considered as the direct consequence of State actions in establishing such monopoly.

It should be accepted that criticism expressed by AG Tesauro and AG Jacobs seems to be perfectly rational as joint liability theory does not bring any legal certainty for the State, which considers establishment of a monopoly. Nevertheless, direct causal link supported thereby has one material deficiency – it does not solve the problem faced by “Volvo owner without spare parts”, which historically led ECJ to admit that inability to meet the demand could amount to infringement of Articles 106(1) and 102 TFEU. Indeed, the application of direct causal link theory does not offer any legal protection to the customer having very specific needs, i.e. goods and services needed by specific customer are not offered by the holder of monopoly rights

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3 See paragraph 16 of AG Tesauro opinion in Corbeau, 1993.
and simultaneously the customer is, by the State, prevented from approaching any alternative suppliers who would be ready to adopt to his needs.

It could also be doubted whether AG Jacobs was correct to assume that application of joint liability theory makes the State liable “merely because [infringement] takes place within their jurisdiction”. Looking from the broader perspective AG Jacobs’ statement does not seem to be entirely correct. Indeed, it would be rather inaccurate to say that having established the legal monopoly the State completes its mission and does not have any relation to actions performed by the operator of such monopoly. The establishment of the legal monopoly involves a long-standing commitment of the State towards protection and supervision of such formation. The State devotes its enforcement mechanisms for protection of the monopoly, e.g. police and court system, which ensure judicial intervention into the business area covered by the monopoly and refuses the protection of legal interests of those providing services in contradiction to the legal monopoly. All such State enforcement mechanisms ensure on constant basis that customers purchase goods/services from the holder of monopoly rights, meaning that State liability in failure to meet the demand cases does not arise “merely because [infringement] takes place within their jurisdiction”. On the contrary, State liability arises due to active participation of the State in protection of legal monopoly, which enables the holder of monopoly rights to present customers with goods/services, which not necessarily meet their needs.

Quite similar approach was offered by Monti and Manaridou, which considered that State liability in such situation, could arise for failure to take the appropriate actions to eliminate such anticompetitive consequences (i.e. passive actions). As suggested by Manaridou, in case the failure to meet the demand is caused by inefficiency of undertakings, the State can be held liable “for maintaining an exclusive right in force if it does not intervene to make good the inefficiency or if other companies are better equipped to provide the same service.” In other words, the State has obligation to monitor effectiveness of monopolies and may be held liable under Article 106(1) TFEU in case the State fails to take appropriate measures to eliminate anticompetitive actions resulting from such monopolization, i.e. failure to meet the demand.

Even in case the above grounds for State liability would be rejected, there would be nothing odd to consider that State liability could arise from the actions of holder of monopoly rights without any fault of the State. Indeed, many European legal systems accept liability without fault in special cases. E.g. in Lithuania the State is liable for the all damage done by wild animals. In this regard, it should be recalled that State monopolies are created by the State in clear understanding that customers shall be deprived from the possibility to choose alternative suppliers to satisfy their specific needs. Moreover, operation of such monopolies is usually entrusted to State-owned operators controlled by State authorities and supervised by national regulatory authorities. Therefore, it seems rather rational to accept that in such cases liability of

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1 See paragraph 388 of AG Jacobs opinion in Albany, 1999.
5 Manaridou, 2015, p. 430.
6 See also Kersting, 2011, p.475.
7 AB „If draudimas” v. Republic of Lithuania, 2009.
the State could arise without (objective) fault. It was the State which created the monopoly with clear understanding that monopoly markets cease to innovate and does not achieve productive efficiency, and it was the State which had a possibility but failed to establish an adequate control mechanism to protect interests of consumers. Respectively, there are all reasonable grounds to believe that the State could be held liable for failure to meet the demand even in case we accept that all fault for not meeting the demand falls on the inefficient holder of monopoly rights. This seems particularly true considering that the State has much more possibilities to control monopolies created thereby than any actions done by wild animals.

Quite similar critics could be directed to the position held by AG Tesauro in Corbeau. As noted above, AG Tesauro considered that infringement of Articles 106(1) and 102 could not depend on the effectiveness of holder of monopoly rights, as such legal test would result in the dynamic legality of legal monopoly. In particular, legal monopoly could turn illegal and vice versa depending on the ability of the holder of monopoly rights to offer goods/services requested by its customers, although legislation establishing such monopoly would remain the same. Moreover, the same legal monopoly in one Member State could be considered compliant with Articles 106(1) and 102 TFEU and incompliant in another again subject to effectiveness of the holder of monopoly rights. In other words, joint liability test would not provide Member States with sufficient legal certainly in creating monopolies.

In this regard, it should be admitted that necessity for legal certainty corresponds to absolutely rational interests of Member States. Nevertheless, there is nothing in the law to suggest that Member States should be provided with such comfort. It should be noted that Article 102 requires dominant undertakings to run constant review of their business practices aiming to avoid abuse of dominant position. For example, in case the company in a dominant position does not increase its prices to cover production costs, such company could be found engaging in predatory pricing irrespectively that prices of such company remained the same for number of years. Having admitted that Article 106(1) operates as a reference rule and merely mirrors the content of Article 102, it does not seem odd to accept that compliance of legal monopoly with Articles 106(1) and 102 TFEU could change during passage of time in the same manner as could change compliance of business practices of dominant undertakings with Article 102. This was also accepted in the doctrine, e.g. Monti, Kersting and Manaridou.

Having responded to the criticism expressed by AG Jacobs and AG Tesauro, its worth adding that acceptance of joint liability theory appears to be material prerequisite to ensure effective enforcement of law in failure to meet the demand cases. In this regard it should be noted that direct causal link theory requires proving that holder of monopoly rights objectively cannot provide certain goods/services irrespectively of its efficiency, i.e. the State alone is liable for the failure to meet the demand. In most cases customers are perfectly aware that they don't receive goods/services they need; however they don't have detailed information on the obstacles, which leads to failure to meet their demand. Even in case they could name the obstacles, it would be rather impossible for them to explain in detail, whether such obstacles could not be remedied by the efficient operator of monopoly rights. Moreover, any claim resulting from the customers could be easily rejected by the court by having admitted that company holding monopoly rights in principle is capable to provide the

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1 Corbeau, 1993.
requested goods/services, however such supply shall be offered at some point of time in the future (e.g. when they will have more resources). It's rather doubtful whether this kind of claim could be proven to the requested legal standard even by the Commission. Respectively, having accepted that direct causal link theory should prevail, it should also be accepted that infringement of Article 106(1) and 102 could be invoked only in an extreme failure to meet the demand cases, which were considered in Hofner, Carra and Job Centre II. In this regard it should be admitted that effective protection of consumers could only be ensured by having admitted that the State and holder of monopoly rights are jointly liable for failure to meet the demand. In other words, it would be merely required from the customer or competition authority to prove that holder of monopoly rights “is not willing or cannot provide” certain goods and services, i.e. there is real demand for such goods/services and such demand is not satisfied.

**Slovenska Posta: Time for Reconciliation**

As noted above, Slovenska posta case is the most recent and very important case as this was the first case, where Commission decision in failure to meet the demand case has been appealed to EU courts. The case concerned extension of Slovak postal monopoly into hybrid-mail services. Having extended such monopoly major, customers have been forced to purchase hybrid-mail services from State-owned postal company (i.e. hybrid mail services as such have been provided). Nevertheless they were no longer offered with specific features of such services as delivery of postal items 7 days a week and submission of electronic reports on delivery of postal items, which was previously offered by private operators. All the circumstances of the case suggested that State-owned postal company could offer such additional features of hybrid mail services by making some investment, thus failure to meet such demand primarily depended on inefficiency of postal company, rather than the State which extended legal monopoly. Nevertheless, it did not withhold the Commission from finding infringement of Article 106(1) and 102 for failure to meet the demand assuming joint liability of the State and holder of monopoly rights1.

Slovak government appealed such decision to General Court, however the court decided to uphold conclusions made by the Commission. Although the court started its analysis by mentioning Hofner case, which requires determination of direct causal link, it seems that the court indicated such case merely as example that failure to meet the demand may lead to infringement of Article 106(1) and 1022. This becomes clear in subsequent sections, where the court concluded that infringement may be committed once holder of monopoly rights “is led” to infringement of Article 102, which correspond to the modern legal test accepted by the ECJ in Greek lignite. Such legal test presupposes existence of joint liability, which contrasts with “cannot avoid infringement” test employed in Hofner, which presuppose sole liability of the State.

And finally determination of the court to accept joint liability test could be derived from confirmation of conclusions made by Commission with respect to infringement committed by Slovak government. The court admitted that failure to offer such minor additional features of hybrid mail services as 7 days a week delivery and delivery of electronic reports could amount to infringement. Taking into account that such services previously were provided by private operators and obviously could

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1 Slovenska posta, 2008, paragraphs 149-155.
2 Slovenska posta, 2015, paragraph 315.
be provided by holder of monopoly rights, acceptance of the existence of infringement leads us to a very clear conclusion that General Court presupposes joint liability of the State and holder of monopoly rights for failure to meet the demand. In this regards the General Court

**Conclusions**

Absence of appeal on the Commission decisions in failure to meet the demand cases led to quite a peculiar situation that the ECJ and the Commission have developed their own legal tests, which are supposed to be applied in such cases. This divergence of views is mostly evident with respect to causal link, which needs to be determined between State actions and failure to meet the demand by the holder of monopoly rights. The ECJ considered that there should be *direct causal link* between the State measures and failure to meet the demand, which presupposes that the State measures should be the *sole* reason of such failure. On its turn, the Commission was ready to consider that the State and the holder of monopoly rights are jointly liable for the said failure, hence infringement may be found merely having determined that there is clear demand available on the market, which is not satisfied by the holder of monopoly rights.

Joint liability test suggested by the Commission has been criticised by AG Jacobs and AG Tesauro due to lack of legal certainty provided for the States, which is considering an establishment of a legal monopoly, and dynamics of infringement. Nevertheless, this research paper suggests that there is nothing in the law, that would support the application of *direct causal link*. Moreover, application of joint liability test is rational taking into account that the State actively contributes to the limitation of supply in failure to meet the demand cases by the entire State enforcement mechanism or fails to employ such mechanism to eliminate anticompetitive consequences caused by monopolisation.

Alternatively, it would be quite rational to keep the State liable even without fault in the same manner as the State is liable for damage done by wild animals. Economic doctrine suggests that monopolies don’t have sufficient incentives to innovate. In case the State decides to disrespect this principle and does not establish a sufficient supervision mechanism, the State should be ready to accept all consequences stemming from the operation of the monopoly, including failure to meet the demand. This research paper also suggests that it’s rather impossible to prove the infringement on the basis of direct causal link test, hence effective deterrence and enforcement could be achieved only having accepted joint liability of the State and the holder of monopoly rights.

Finally, this research paper takes a note that most recent *Slovenska Posta* case tends to reconcile different positions of the Commission and European Courts. General Court already accepted that joint liability test should prevail in failure to meet the demand cases concurring with the most recent ECJ case practice adopted in *Greek lignite*. Nevertheless, the appeal against such decision has been submitted, hence it shall be clear whether application of the joint liability test shall finally be confirmed by the ECJ quite soon.
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FAILURE TO MEET THE DEMAND AS INFRINGEMENT OF ARTICLES 106(1) AND 102 TFEU: THE NOTION OF FAILURE TO THE MEET THE DEMAND

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Abstract

Purpose – this paper analyses the application of Article 106(1) and Article 102 of the Treaty of the Functioning of the European Union (TFEU) with respect to situations, when statutory monopolies fail to satisfy demand of their customers. This research paper specifically concentrates on the nature of “failure”, which needs to be determined for the purpose of infringement. On its turn, causality between such failure to meet the demand and actions of the State, which makes the State liable for the actions of holder of monopoly is discussed in detail in Article “Failure to meet the demand as infringement of Articles 106(1) and 102 TFEU: the problem of causal link” also published in this journal.

Design/methodology/approach – theoretical analytical and systematic methods had been applied in the research.

Finding – for more than two decades the European Commission and the European Court of Justice (ECJ) have applied different legal tests in determining failure to meet the demand in Articles 106(1) and 102 TFEU cases. In the early case practice ECJ has taken the conservative approach and has been ready to invoke failure to meet the demand in rather extreme cases of failure. At the same time the Commission stood for more stringent legal test. It was ready to invoke infringement whenever factual circumstances suggested that some demand is left unsatisfied by the holder of statutory monopoly. Slovenska posta case seems to reconcile these two different approaches admitting that failure to meet the demand requires simple failure to meet specific demand of customers.

Research limitations/implications – as the doctrine is mostly silent on the notion of failure to meet the demand, this research is mostly based on the analysis of case law, which is rather scarce at the present stage of development of the law. Respectively, findings presented in this paper reflect status quo of the case law and doctrine, however some developments could be expected in the future.

Practical implications – absence of clear understanding what particular actions could be considered as failure to meet the demand for the purpose of Articles 106(1) and 102 TFEU implicates great legal uncertainty. Analysis provided in this paper enables to understand and interpret decisions adopted by the Commission and ECJ within last two decades. Such analysis also enables to list down parameters, which should be employed considering whether a customer may invoke infringement of Article 106(1) and 102 TFEU in case the holder of a statutory monopoly fails to meet his (the customer’s) personal interests.

Originality/Value – it is widely accepted in the legal doctrine that failure to meet the demand could result in infringement of Articles 106(1) and 102 TFEU. Nevertheless, in this regard doctrine mostly refers to Hofner test developed by ECJ claiming that infringement shall result from “manifest failure to meet the demand”. Nevertheless, there is lack of comprehensive analysis in the legal doctrine on the nature of “failure”, which may lead to infringement. To some extent this problem was addressed by Monti, Manaridou and Kersting.
However, their analysis touched upon only certain issues of causal link and nature of failure as such and does not take into account evolvements in the most recent case practice.

Such analysis is provided in this research paper.

**Keywords:** failure to meet the demand, statutory monopoly, exclusive rights, Article 106(1) TFEU.

**Research type:** survey.

### Introduction

In the European Union law, the status of statutory monopolies has always been subject to controversial debate. For many years after establishment of the European Community statutory monopolies has been perceived by Member States as symbol of their national identity. Nevertheless, having decided to complete creation of Single European Market by 31 December, 1992, the existence of statutory monopolies has been challenged from different legal perspectives. As noted by Szyszczak liberalisation has been mostly initiated by internal market provisions, however competition rules were “viewed as a crowbar, or can opener for greater market liberalization”.

In this regard, special mission has been given to Article 106(1) applied in conjunction with Article 102 TFEU, which prevents Member States from maintenance of measures impairing the effectiveness of abuse of dominant position prohibition. Such legal instrument has been effectively used to protect the process of competition by eliminating market structures, leading to abuse of dominant position (e.g. conflict of interest), or challenging measures, placing undertakings in a situation, which they could not achieve without abusing their dominant position (e.g. extension of dominant position by legal measures).

Such legal instrument has also been used to protect interests of consumers, which are primarily injured by the existence of inefficient monopolies. Such instrument entitles consumers to liberate themselves from constrains of legal monopoly in situations when the holder of monopoly rights fails to meet their needs. For several years, such legal instrument in the EU case practice has been invoked rarely, however following ECJ decision in Greek lignite case and on-going litigation in Slovenska posta case clearly reminded that Article 106(1) and 102 TFEU are still active and could employed by the consumers inter alia to liberate themselves from ineffective monopolies.

### Evolution of Case Law in Failure to Meet the Demand Cases

The case law in failure to meet the demand cases has been quite controversial for a long time. The conceptual idea that the failure to meet the demand could impair the effectiveness of Article 102 TFEU (and thus lead to State liability under Article 106(1) TFEU) could be traced back to Dutch Courier Services decision adopted by the Commission in 1989. In this case the Commission considered, whether extension of

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1 Karayigit, 2009, p. 575.
3 Greek Lignite, 2014.
4 Slovenska posta, 2015.
5 Szyszczak, Services of General Economic Interest and State Measures Affecting Competition., 2015.
6 Dutch Courier Services, 1989.
statutory postal monopoly to express delivery services by Dutch government could amount to infringement of Article 106(1) and 102 TFEU. The Commission has declared the presence of infringement inter alia for the reason that the State measure has in fact adversely affected customers who were deprived of “a service of the same quality, as the Netherlands post office and its EMS service are not as yet offering an express delivery service of comparable reliability or speed”. Such infringement has been found by the Commission irrespective of the fact that following intervention of Dutch government customers could still use services provided by private courier companies by accepting to pay higher prices determined by the State.

In Dutch Courier Services\(^1\) the Commission did not elaborate on the conceptual grounds for finding such infringement or the criteria, which should be determined in failure to meet the demand cases. Nevertheless, decision adopted by the Commission suggested that failure to meet the demand could be found in rather daily-life situations. Liability of the State does not require establishment that customers were totally deprived from some services (e.g. in Dutch Courier Services customers could still use post services and and/or purchase express delivery services at higher price). It is rather sufficient to determine that customers are prevented from getting services of some quality, which they actually need.

The conceptual grounds for such kind of infringement have been explained by the Commission in Spanish post\(^2\) decision adopted a year later. The factual circumstances of the latter case were very similar to the ones considered in Dutch Courier Services\(^3\), although in Spanish post extension of statutory monopoly had much stronger negative effect on customers. Following extension of monopoly provision of courier services by private companies were fully prohibited. Such extension took part irrespective of the fact that comparable services provided by State-owned postal company at that time did not even cover the whole territory of Spain and entitled customers to reach only the largest destination points. Following the example of Dutch Courier Services\(^4\) the Commission has admitted that extension of statutory monopoly has resulted in infringement of Article 106(1) and 102 TFEU inter alia for the fact that statutory monopoly failed to meet the demand existing on the market. Nevertheless, at this time the Commission additionally explained the conceptual grounds for such infringement – State measures were considered illegal as they lead to effects similar as the ones prohibited by Article 102(b) (i.e. limitation of supply and technical development by the dominant undertaking)\(^5\).

None of these decisions has been appealed before the ECJ, therefore it remained largely unclear, whether interpretation suggested by the Commission could survive the judicial review. Such legal uncertainty remained until Hofner case decided by ECJ in 1991 where ECJ delivered its preliminary ruling concerning failure to meet the demand by the State employment agency, which held statutory monopoly in employment intermediation services. Hofner concerned a rather extreme example of failure to meet the demand. Irrespective of the existence of statutory monopoly, governmental employment agency managed to intermediate only in ~28% of

\(^1\) Dutch Courier Services, 1989.
\(^2\) Spanish post, 1990.
\(^3\) Dutch Courier Services, 1989.
\(^4\) (Dutch Courier Services, 1989.
\(^5\) “Consequently, the State measure in question<...> has the effect of limiting supply and technical development within the meaning of Article 86, thus constituting an infringement of Article 90 in conjunction with Article 86 (b) of the Treaty,” Spanish post, 1990, paragraph 11.
employments of higher tier managers, while such demand has been generally satisfied by 700-800 private intermediation companies. Moreover, the holder of statutory monopoly publicly declared its inability to meet the demand and invited private companies to provide their services falling within the limits of its monopoly.

In the latter case Commission suggested ECJ followed its approach taken in Dutch Courier Services and Spanish post cases. Such position has been upheld by AG Jacobs, who delivered his opinion in the case. In particular, the Commission recalled the Court on Volvo v. Veng decision. ECJ accepted that infringement of Article 102 TFEU could take part in case dominant undertaking having exclusive rights to the registered design of spare parts would cease to “produce spare parts for a particular model even though many cars of that model are still in circulation.” The Commission considered that failure to meet the demand by the statutory monopoly caused exactly the same effect on consumers, who were not offered with required services by statutory monopoly and simultaneously were prevented by the State of acquiring these services from alternative suppliers. In result, statutory monopoly considered in Hofner case placed the “employer or executive <…> in the same situation as the Volvo owner who cannot obtain a new body panel for his car because the proprietor of the registered design for such parts does not manufacture them and refuses to allow anyone else to do so.”

In its preliminary ruling ECJ concurred with the position suggested by the Commission and accepted that failure to meet the demand indeed could amount to infringement of Articles 106(1) and 102 TFEU. ECJ also accepted that failure to meet the demand reduces effectiveness of prohibition contained in Article 102(b) TFEU, i.e. prevention of actions “limiting the provision of a service, to the prejudice of those seeking to avail themselves of it”. Nevertheless, ECJ noted that this kind of infringement could be invoked in case a holder of statutory monopoly “is manifestly not in a position to satisfy the demand prevailing on the market for activities of that kind”. The reasoning used by Commission in Dutch Courier Services and Spanish post referred to failure per se and did not take into account the gravity of such failure. Thus the reference of the Court to “manifest” failure in Hofner case resulted in legal confusion.

Hofner case confirmed that failure to meet the demand indeed could amount to infringement of Article 106(1) and Article 102 TFEU. However, the approach of ECJ and Commission with regards to legal standard applied for the assessment of such failure diverged. The Commission’s decisions in postal cases suggested that mere failure to provide services could be sufficient for the purpose of finding the infringement. At the same time ECJ position in Hofner case suggested that failure to meet the demand should be sufficiently weighty in order such failure could be described as “manifest”.

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2 Dutch Courier Services, 1989.
3 Spanish post, 1990.
8 Dutch Courier Services, 1989.
9 Spanish post, 1990.
Interestingly, until 2015, none of the Commission decisions in failure to meet the demand cases were appealed to the ECJ. Hence, it remained unclear what legal standard should be applied considering whether particular failure of statutory monopoly may result in infringement of Articles 106(1) and 102 TFEU. In order to bring more clarity in this respect, this paper analyses evolution of ECJ and Commission’s case law aiming to reveal how should Hofner test be interpreted in the context of subsequent case law and the most recent decision of General Court in Slovenska posta case.

**Approach of ECJ: “Manifest” Failure is Required**

The ECJ's practice in failure to meet the demand cases has been developed through preliminary rulings, whereby the ECJ provided guidance to national courts on interpretation of EU law without facing the necessity to apply such guidance with respect to specific circumstances of the case. Many of decisions in failure to meet the demand cases were provided with regards to legal justification offered by Article 106(2) TFEU. This practice deprived the ECJ from the possibility to explain its position on the criteria, which needs to be assessed in aiming to determine failure to meet the demand leading to State liability under Article 106(1) TFEU. For this reason, Hofner and Job Centre II still remain the most extensive decisions, which explain application of Articles 106(1) and 102 TFEU in failure to meet the demand cases. In particular, these ECJ decisions explain (i) the intensity of failure, which needs to be determined for the purpose of infringement; and (ii) the context in which such failure should be considered.

As noted above, Hofner case suggests that failure to meet the demand could amount to infringement of Article 106(1) and Article 102 TFEU only in case the supplier “manifestly” fails to meet the demand. The ECJ did not provide any guidance, that should be employed aiming to determine, whether the failure of statutory monopoly should be considered as “manifest”. Although, analysis of ECJ case law suggests that understanding what could be considered as “manifest” failure changed over time significantly.

In the early case practice (Hofner (1991) and Job Centre II (1997)) ECJ considered rather extreme examples of failure to meet the demand of public employment offices. Irrespective of the effort placed by the holder of monopoly rights all the circumstances of the case suggested that total demand on the market could not be satisfied for objective reasons: neither then, nor at any time in the future. As declared by ECJ in Job Centre II case, “on such an extensive and differentiated market, which is, moreover, subject to enormous changes as a result of economic and social developments, public placement offices may well be unable to satisfy a significant portion of all requests for services”\(^2\). In the perspective of such extraordinary circumstances of the case the Court was able to conclude that failure to meet the demand is “manifest” without even conducting any further analysis.

Such case practice induced some commentators to believe that failure to meet the demand could amount to infringement of Article 106(1) and 102 TFEU only in extreme cases. For example AG Jacobs in Albany noted that infringement in Hofner and Job Centre II cases was declared “owing to the specific economic context and the nature of

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1 Job Centre II, 1997.
2 Job Centre II, 1997, paragraph 34.
the services involved, the monopolist could not avoid abusing its dominant position by constantly “limiting production, markets or technical development to the prejudice of consumers” within the meaning of Article 86(b).” In the opinion of AG Jacobs, it was the exceptional circumstances the Court felt justified in making a real exception to the principle of not challenging Member States' freedom to grant exclusive rights. Respectively, “by referring in Höfner to an undertaking manifestly not in a position to satisfy demand the Court made it clear that it exercises only marginal review of the legality of monopolies”.

Interpretation of law suggested by AG Jacobs seems rather reasonable. Nevertheless, as the Court itself was silent on meaning provided to the concept of “manifest” failure in Höfner case, it could be also claimed that such reference merely reflected factual circumstances of the case. Classification on this point has been provided by the ECJ in Pavlov case decided in 2000.

Pavlov case concerned the mandatory obligation to participate in State-owned pension funds. The claimants did not challenge participation in state-owned pension fund per se, instead, they intended to change one state-owned fund for another. In delivering its decision, the Court repeated that such situation could be analysed from the perspective of legal test formulated in Höfner case (i.e. that manifest failure to meet the demand could amount to infringement). Nevertheless, the Court rejected the presence of infringement for the lack of evidences: “There is no evidence in the case-file <..> that <..> pension services offered by the Fund might not meet the needs of medical specialists?”

Reference to “manifest” inability (not just inability) to meet the demand without any evidence in the file enabling to compare conditions offered by pension funds, clearly suggests that “manifest” failure should be considered as separate legal criteria and not the mere reflection of the factual circumstances of the case.

As noted above, in addition to the intensity of failure, Höfner and Job Centre II also provided some guidance on the context in which such manifest failure should be considered. This is a very important question as different context of assessment may lead to very different conclusions as to the failure to meet the demand. Importance of the problem could be illustrated by the example of public transportation. Should we consider that failure to meet the demand must be considered from the perspective of an individual customer/service, we could invoke infringement in case public transportation services would not be suitable for disabled people (100% of the disabled do not receive service). Nevertheless, should we accept that failure must be assessed from the perspective of average customer, failure to meet the needs of disabled would not result in infringement, as public transportation services are suitable for 99% of the population.

As noted above, in the Höfner case the ECJ considered the failure to meet the demand of public employment agency, which held monopoly over entire employment intermediation services. Although, factual circumstances of the case suggested that statutory monopoly is not able to meet the demand in all types of intermediation services, ECJ concentrated only on the ability to meet the demand of services falling within the ambit of dispute (employment of higher tier managers) and concluded infringement of Articles 106(1) and 102 TFEU only with respect to such services. Thereby the ECJ suggested that failure should be analyzed from the perspective of

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2 Pavlov, 2000, paragraphs 127, 128.
each type of services, rather than the total scope of statutory monopoly. On its turn, failure to provide some type of service does not invalidate the entire statutory monopoly entrusted on undertaking¹.

Such position has been confirmed by the ECJ in *Job Centre II*, which considered very similar situation to the one considered in *Hofner*. *Job Centre II* concerned refusal to grant licence for private company, which intended to provide various employment intermediation services falling within the ambit of statutory monopoly. In this regard *AG Elmer* noted that employment intermediation market is very diverse, thus assessment of the Court should be made with respect to each separate *market* and *sub-market* covered by monopoly. Although Elmer did not provide it explicitly, the overall reasoning seems to suggest that analysis should be made separately for each *relevant market* falling within the statutory monopoly².

By delivering its judgement the Court did not adhere to the proposal submitted by *AG Emler*. Instead, the Court indicated that national courts should make its assessment with respect to each *activity* (which is even narrower than the relevant market) falling within the monopoly: “A Member State which prohibits any activity as an intermediary between supply and demand on the employment market, whether as an employment agency or an employment business, unless carried on by those offices, is in breach of Article 90(1) of the Treaty where <…> the public placement offices are manifestly unable to satisfy demand on the market for all types of activity”. As suggested by Olson³ and Blum⁴ by such reasoning ECJ extended the grounds of liability of the State for failure to meet the demand by the statutory monopoly. In their opinion entire legal monopoly could amount to infringement of Article 106(1) and 102 TFEU in case holder of monopoly rights was not able to provide any of the services falling within the ambit of monopoly. Although careful analysis of the reasoning provided by the court does not seem to uphold interpretation suggested by Olson and Blum. Indeed, in *Job Centre II* the court declared that infringement could be committed once statutory monopoly is unable to meet the demand for all types of activity, however such statement has been given only with regards to such State measures, which prohibit “any activity” of competing undertakings. In other words, the Court merely stated that the *entire* statutory monopoly is invalid once the holder of monopoly rights ceases to meet the demand for the *entire* services, which brings the Court back to the reasoning suggested in *Hofner*. Irrespective of the fact that *Job Centre II* was not as extensive as suggested by Olson and Blum, such decision still remains important for the development of the case law. *Job Centre II* made it clear that the assessment of failure to meet the demand should be made in the context of each service (“any activity”) rather than relevant market or entire monopoly.

Respectively, following *Hofner*, *Job Centre II* and *Pavlov* position of the ECJ could be summarized as follows: (i) failure to meet the demand must be “manifest”; (ii) failure is not necessarily related to *absolute* failure to provide the respective service – failure to provide services of appropriate *quality* could be sufficient (in *Hofner* and *Job Centre II* intermediation services were performed, however deficiently); (iii) failure should be assessed in the context of each *service* falling within the scope of monopoly.

¹ *Hofner*, 1991, paragraph 86.
² See Opinion of AG Elmer *Job Centre II*, 1997, paragraphs 55, 56, 60 of AG Elmer. See also Olson, 1998, p. 626.
³ Olson, 1998.
The subsequent decisions adopted by the ECJ in failure to meet the demand cases mostly concerned with the possibility to justify failure to meet the demand on the basis of Article 106(2). Hence they provided only with some hints on the legal test, which should be applied considering failure to meet the demand. The most important of such cases is Ambulanz Glockner considered by the Court in 2001. This case concerned statutory monopoly of ambulance transportation services. The claimant stated that state-owned company failed to meet the demand available on the market as inter alia on certain occasions he failed to arrive to the destination within the statutory time limits. Interestingly, in this case opinion again was delivered by AG Jacobs, who explicitly stated in Albany that failure to meet the demand could be established only in extreme cases. In Ambulanz Glockner AG Jacobs was much more ready for compromise. In the opinion delivered to the Court Advocate General repeated his perception that infringement of Article 106(1) and 102 TFEU requires “manifest” failure to meet the demand. Nevertheless, in this case AG Jacobs associated such legal criteria with difficult economic and social assessment criteria, which legitimize some margin of discretion for the Member States, rather than possibility of the ECJ to intervene into exclusive competence of Member States on exceptional / marginal cases as suggested in Albany.

Such compromise approach could be found in the specific guidance for the national courts provided by AG Jacobs. As suggested by the Advocate General, in making its decision a national court should analyse, whether (i) indeed the holder of statutory monopoly rights fails to provide rapid and high quality services at most marginal cases, i.e. even at peak hours; and (ii) whether authorisations for independent service providers would contribute to shorter arrival times and to generally higher quality services. In the affirmative, a national court could declare presence of infringement of Articles 106(1) and 102 TFEU. It’s rather obvious that such approach was no longer associated with extreme cases of failure to meet the demand in very specific circumstances. The legal test suggested by AG Jacobs merely required the determination that failure to meet the demand is sufficiently significant.

Regrettably, in Ambulanz Glockner the ECJ did not disclose its position how to interpret the notion of manifest failure for the purpose of application of Articles 106(1) and 102 TFEU. Nevertheless, in explaining the justification established in Article 106(2) TFEU the Court specifically noted that such justification would cease to apply in case holder of monopoly rights would be “manifestly unable to satisfy demand for emergency ambulance services and for patient transport at all times” and in this respect the Court concurs with the position suggested by AG Jacobs. In remained generally unclear, whether the Court accepted AG Jacobs position solely with respect to interpretation of the notion of manifest failure to meet the demand for the purposes of justification established in Article 106(2) TFEU. Nevertheless, taking into account that AG Jacobs in its opinion given the same legal meaning to such failure for the purpose of finding the infringement on the basis of Article 106(1) and 102 TFEU as well as justification on the basis of 106(2) TFEU, such statement of the Court could be interpreted as a hint that manifest failure to meet the demand should be given the same meaning for the purpose of application of both provisions. On its turn, “manifest” failure requires determination that failure to meet the demand appears to be sufficiently significant, rather than extreme.

1 See opinion AG Jacobs in Ambulanz Glöckner, 2001 paragraphs 147-151.
Ambulanz Glockner completed the saga of failure to meet the demand cases, which were considered by the ECJ in 1999-2001. Thereafter the Court was invited to comment on such infringement only following a decade in AG2R (2011) case. In this case Mr. Beaudout challenged mandatory participation in state health insurance scheme claiming that private suppliers are ready to provide him with better insurance conditions. All factual circumstances of the case resembled Albany, Brentjens\(^1\), Drijvende Bokken\(^2\), Pavlov\(^3\). Hence in AG2R ECJ naturally came to the same conclusion that mandatory participation in social schemes is justified by 106(2) TFEU. Nevertheless, the Court also made some hints on the legal standard, which should be applied in the assessment of „manifest“ failure to meet the demand. In particular, the Court rejected presence of failure to meet the demand taking into account that the case file lacked evidences suggesting that Mr. Beaudout indeed has been offered with better insurance conditions from private suppliers in comparison to the conditions offered by State owned health insurance scheme\(^4\). Such reasoning again suggested that assessment of failure to meet the demand could be limited to the individual instances and may entail analysis of demand of each particular customer. This in turn also suggests that the State may be held liable for maintaining legal monopoly in case operator of such monopoly at any point of time is unable to match quality of services offered by its potential competitors\(^5\).

**Approach of the Commission: Simple Failure is Sufficient**

Irrespective of the fact that Commission and the ECJ admitted that failure to meet the demand cases could amount to infringement almost at the same time (i.e. 1989-1991), the first decision of the Commission was appealed to the ECJ only in 2015. Such lack of judicial review resulted in quite strange situation that Commission and ECJ developed their own concepts of failure to meet the demand. As noted above, ECJ explicitly accepted that manifest failure to meet the demand could be invoked in extreme cases of failure and very slowly moved towards acceptance of the position that infringement could be also declared in situations concerning significant failure. On its turn, the Commission always have been the most pro-market institution of the EU, which deemed market liberalisation as its main priority\(^6\). Thus it was quite natural that the Commission applied much more stringent test and was ready to declare failure to meet the demand in rather daily life situations. For that purpose Commission merely required to prove that there is certain demand on the market and such demand left unsatisfied by the company holding monopoly position.

In Dutch Courier Services\(^7\) and Spanish post\(^8\) the Commission declared the failure to meet the demand merely having concluded that customers were deprived from the possibility to use services of private companies, without offering services of analogous quality by the holder of monopoly rights. In its reasoning the Commission did not suggest that failure to meet the demand must be “manifest”, which was quite

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1 Brentjens v Stichting, 1999.  
5 This was also the interpretation of the court decision in AG2R offered by Kersting (see Kersting, 2011).  
7 Dutch Courier Services, 1989.  
8 Spanish post, 1990.
natural taking into account that Hofner test has not been introduced by the Court at that time. Despite that, it was quite obvious that Commission has applied a softer legal test. While the Court in Hofner required that statutory monopoly objectively would not be able to satisfy demand available on the market (irrespective of the efforts placed), in Dutch Courier Services\(^1\) and Spanish post\(^2\) Commission was satisfied with the fact that services of appropriate quality were not offered at particular moment of time, irrespective of abilities and/or any plans, which the statutory monopoly could have had in the future. In other words, the legal test applied by the Commission suggests that failure to meet the demand could be associated with simple failure to provide the service, rather than extreme failure suggested by AG Jacobs in Albany. Moreover, liability of the State could be invoked in the State, which created the legal monopoly, fails to take appropriate measures ensuring that statutory monopoly would be always ready to meet the demand existing on the market\(^3\).

The next couple of cases have been adopted by the Commission in 1995-1996 in Italian GSM\(^4\) and Spanish GSM\(^5\) cases. Both of these cases concerned provision of second GSM network license at substantial licensing fees for new market entrants, which effectively shielded incumbent telecommunication operators from their competition. In such case Commission accepted presence of infringement on a mere assumption that placing substantial licensing fee on newcomers might run against the interests of consumers: such licensing (i) “might also encourage Telefónica de España to delay the development of the GSM radiotelephony network”; (ii) Telefónica de España <...> might be encouraged to retain higher tariffs for its GSM services than it would in the absence of the State measure in question.\(^6\) Interestingly, both of such decisions have been adopted following Hofner, however Commission seems to ignore such ECJ practice intentionally as Hofner was mentioned only in Spanish GSM case and only in context unrelated to the assessment of failure to meet the demand. Moreover, there are no indications in the decisions adopted by the Commission that infringement of 106(1) and 102 TFEU could be invoked only in cases of “manifest” failure. On the contrary, Commission seemed to be satisfied with substantially realistic possibility that unidentified failure caused by the State shall take part in the future.

In this regards, it should be noted that in all those cases assessment of the Commission has been made in the context of interests each particular customer, rather than relevant market or the scope of monopoly. E.g. in Dutch Courier Services\(^7\) and Spanish post\(^8\) cases Commission seems to accept that some services provided by statutory monopoly would be suitable for consumers (e.g. the ones living in major cities and intending to deliver postal item to major European cities). It could also be the case that provision of such services could satisfy the major part in total demand for express delivery services. Nevertheless, for the Commission it was sufficient that

\(^{1}\) Dutch Courier Services, 1989.
\(^{2}\) Spanish post, 1990.
\(^{3}\) As suggested by Monti and Manaridou in failure to meet the demand case liability of the State is associated with failure to take appropriate measures to ensure that holder of legal monopoly would meet the demand, rather than inducing holder of such monopoly to disregard its customers. See Monti, 2007, p. 449 and Manaridou, 2015.
\(^{4}\) Italian GSM, 1995.
\(^{5}\) Spanish GSM, 1996.
\(^{6}\) Spanish GSM, 1996, paragraph 21.
\(^{7}\) Dutch Courier Services, 1989
\(^{8}\) Spanish post, 1990.
services provided by statutory monopoly were not suitable for some customers having different needs (residing in small cities and intending to send post items to less popular destinations).

**Slovenska Posta: Time for Reconciliation**

The Slovenska posta case is very important for the evolution of case practice in failure to meet the demand cases. It is the first Commission decision in failure to meet the demand case, which was appealed to the Court within two decades. Differently from preliminary rulings adopted by the ECJ, Slovenska posta decisions are full of factual circumstances and entitle us to understand how general explanations provided by the Court should be applied in practical situations. Such decision also entitles to reconcile slightly different approaches used in the assessment of failure to meet the demand by the Commission and EU courts.

Slovenska posta case originated in 2008, when the Commission has adopted the infringement decision challenging the decision of Slovak government to extend statutory monopoly of State postal company to hybrid mailing services inter alia on the basis of failure to meet the demand. Hybrid mailing services are rather specific mailing services usually required by the clients having demand to deliver large quantities of letters (usually invoices). In provision of such services clients provide service providers with electronic files, which in turn are printed, enveloped and delivered to address specified by the client. Having conducted the investigation Commission concluded that holder of monopoly provided clients with hybrid mail services (i.e. demand for services as such was satisfied). Although Slovenska posta did not offer two features of such services, which were previously offered by private companies, i.e. (i) provision of electronic reports on delivery of postal items; and (ii) delivery of mail items 7 days a week. Failure to provide such services was sufficient for the Commission to adopt the infringement decision.

Interestingly, in its reasoning the Commission specifically mentioned that failure to meet the demand should be assessed in the light of Hofner test. Nevertheless, it does not follow from its reasoning that Commission sought to determine “manifest” failure to meet the demand by Slovenska posta. In making its decision Commission was rather satisfied with the fact that private suppliers previously offered such features of hybrid mailing services and such services were no longer provided by Slovenska posta. The same conclusion was made with regards to both features of hybrid mailing services, although the facts of the case does not suggest that delivery of mail items 7 days a week was indeed important for any customer. Such decision suggest that in the opinion of Commission infringement may be related to simple failure to provide some services or services with specific quality elements, which could be reasonably needed by some consumers.

Such approach has been confirmed by the General Court in 2015. The General Court upheld that failure to offer these two specific features of hybrid mail services is sufficient to claim infringement of Article 106(1) and 102 TFEU. In making its decision the General Court noted that demand for such features of hybrid mailing service was very different. The case file clearly suggested that major clients for hybrid

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2 Slovenska posta, 2008, paragraph 149.
mail services provided high importance for electronic reports on delivery of letters, as such reports are necessary to invoicing process. At the same time case file suggested that delivery of letters 7 days week was considered as rather unimportant additional feature of hybrid mail services. The General Court hesitated, whether the latter services was needed by some customers at all. Irrespectively of that the court decided that having deprived customers of these two specific features of hybrid mail service, Slovak government infringed Article 106(1) and 102 TFEU as Slovenska posta failed to meet the demand available on the market.

Conclusions

Analysis of evolution of case practice in failure to meet the demand cases entitle us to make several conclusions on the legal test accepted by modern jurisprudence.

Firstly, as suggested by Hofner and Pavlov, the “manifest” failure to meet the demand constitutes a separate legal criterion, which needs to be considered in each case. Although interpretation of such legal criterion changed significantly over time, the Commission considered that failure to meet the demand could be associated with simple, rather than extreme failure to provide some services. Since Hofner, the ECJ has been gradually moving towards the same position, while in Slovenska posta General Court seems to reconsolidate both positions. By declaring the presence of infringement in Slovenska Posta both Commission and the General Court admitted that “manifest” failure is required for the purpose of infringement. Nevertheless, they both confirmed the presence of such manifest failure with respect to simple failure to provide service. Respectively, reference to “manifest” failure to meet the demand suggested by Hofner in modern jurisprudence seems to be associated with manifest absence of some kind of service, rather than extreme failure to meet the demand.

Secondly, the failure to meet the demand should be analysed from the perspective of each particular service, which may have its own demand. Such approach suggests that failure to meet the demand for the respective services invalidate statutory monopoly only with respect to provision of such services without invalidating the entire monopoly.

Thirdly, the failure to meet the demand does not require establishment that statutory monopoly does not provide some service at all. For the purpose infringement it is sufficient that statutory monopoly does not provide service of some quality, which is required by customers.

In this regard, it should be accepted that Slovenska Posta is currently under appeal in ECJ, hence more legal certainty shall be provided following final decision of ECJ. Nevertheless, the evolution of case practice suggests that the most intense discussion within ECJ most possibly shall take part on the intensity of demand available on the market, which needs to be determined for the purpose of infringement, without challenging the entire approach taken by the Commission and the General Court.

1 Slovenska posta, 2015, paragraphs 322-355.
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CRIMINAL LIABILITY FOR INFRINGEMENTS OF WELL-KNOWN TRADEMARKS RIGHTS: THE DEMAND AND POSSIBILITIES

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Abstract

Purpose – to examine the demand for the infringements of Well-Known Trademarks rights criminalization and to examine the possibilities to protect the Well-Known Trademark rights by criminal measures without infringement of criminal law principle nullum crimen sine lege (“no crime without law”) and other defendant rights.

On the one hand, the TRIPS1 agreement foresees the need to apply criminal liability for counterfeit trademarks related only to the registered trademarks. On the other hand, not registered, but the Well-Known Trademarks (product) counterfeit causes a threat and violates criminal codes stored values in states usually more than registered trademarks, because they are usually more prevalent, recognized and appreciated, and they are more trusted.

It is particularly important to protect the market from the counterfeit specialized food market products for people with allergies (products without lactose, gluten, etc.), with specific diseases (diabetes, etc.). Also, there is a lot of risk in children goods as counterfeited children goods; toys often contain unauthorized or even toxic substances. When we are talking about the registered trademarks, regardless of their prevalence and merchantability in society, these trademarks are protected by the criminal law. Trademark registration is objectively determined circumstance. However, when it comes to a non-registered trademark, there are legal barriers related to the rights of a defendant in a criminal procedure by the criminal law measures. As a Well-Known Trademark is recognized exclusively by a court decision, it results in an inability to check whether a particular use of a Trademark is criminal until the national court’s (administrative unit) decision.

Methodology – The article is written applying the teleological, systemic, linguistic, logical, historical and comparative methods.

Finding – As it is known, there are regional (EU), international (Madrid system) and national registrations of trademarks. Depending on the regulation states, the trademark owner’s activity and other factors situations appear which lead to where Well-Known Trademarks are not registered in particular countries. It provides the access to the use of the public Well-Known Trademarks, to get income out of them, to deceive consumers and could even endanger them. In states, of course, where the counterfeited goods are realized illegal income increases. This illegal income is successfully hidden from the public authorities and is actualized in the illegal market. This income is used for financing: Racketeering, Human Smuggling, Money Laundering/ Illegal Money Transfer Service, Illegal Gambling, Loan-Sharking, Narcotics Trafficking, Prostitution, Weapon Trafficking, Contract Killing, Document Forgery Services.2 Harmonized and efficient intellectual property protection system is necessary in order to change these visible negative trends.

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**Research implications** – By doing this study, the criminal measures to protect the Well-Known Trademark will be found without any prejudice to the rights of a defendant in a criminal procedure or it will be concluded that it is currently impossible.

**Practical implications** – The results of the research could be used to the fight against counterfeits, especially Well-Known Trademark, and for the further researches in this legal area.

**Originality** – Despite of the spread of counterfeits and their huge damage in various areas, this research topic is not very common. In Lithuania, Trademark Protection criminal liability issues were examined by both dr. Nevera A. and dr. Klimkevičiūtė D. in the article „Criminal aspects of infringement of trademark rights”; as well as the author of the Master thesis „The Problems of Interpretation and Application of the Offence for the Use of Another’s Trademark or Service Mark (Article 204 of the Criminal Code)”. It was written about some relevant aspects of the topic analyzed in the copyright context: Geiger, Ch. „Criminal Enforcement of Intellectual Property: A Handbook of Contemporary Research, Adam, A. What is "commercial scale"? A critical analysis of the WTO panel decision in WT/DS362/R.; Sugden P., How long is a piece of string? The meaning of “commercial scale” in copyright piracy; Nevera, A. „Problems of the Criminal Liability for the Infringements of Intellectual Property Rights: National and International Aspects”; Kiškis, M., Šulija, G. „Criminal Liability for the Infringements of Intellectual Property Rights in European States”.

**Keywords**: Well-Known Trademarks, counterfeiting, criminal enforcement, intellectual property.

**Research type**: general review.

**Introduction**

Counterfeits are a very painful problem both in Lithuania and the world. Unauthorized use of trademarks (labelling or realization) not only violates the intellectual property rights of their owners but also the rights of consumers as well as harms the economy and business order. High prevalence of counterfeit medicines gives a cause for concern in relation to counterfeits causing harm to health and life.¹ “Counterfeiting […] and infringements of intellectual property in general, are a constantly growing phenomenon which nowadays have an international dimension since they are a serious threat to national economies and governments. The disparities between the national systems of penalties, apart from hampering the proper functioning of the internal market, make it difficult to combat counterfeiting […] effectively. In addition to the economic and social consequences, counterfeiting and piracy also pose problems for consumer protection, particularly when health and safety are at stake. […] this phenomenon appears to be increasingly linked to organized crime. […] Counterfeiting […] have become lucrative activities in the same way as other large-scale criminal activities such as drug trafficking. There are high potential profits to be made without risk of serious legal penalties.”², moreover, it is another niche for the legalization of illegally obtained assets.

The Well-Known Trademarks counterfeit is a specific object for providing the ability to protect unregistered trademark too, if it meets specific criteria.

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Protection for the Trademark is given by the court decision when it is recognized as a Well-Known Trademark.

In the context of criminal law, it is important that, when it comes to a non-registered trademark, there are legal barriers related to the rights of a defendant in a criminal procedure by the criminal law measures.

As a well-known brand is recognized exclusively by a court decision, it results in an inability to check whether a particular use of a trademark is criminal until the court’s decision.

On the other hand, to understand unlawfulness of counterfeiting of a Well-Known Trademark, it is not necessary to know about the registration of this trademark. It is important that the Trademark has been chosen for counterfeiting precisely because of its recognition and reputation in society.

Individual rights are by far the most fundamental rights in criminal procedure consolidated in the international and regional human rights documents.

For introducing the topic, the criminal law principle *nullum crimen sine lege* ("no crime without law") is very important. The international agreements such as the article 7 No punishment without law in Convention on Human Rights which says that nobody should be held guilty of any criminal offense on account of any act or omission which did not constitute a criminal offense under the national or international law at the time when it was committed oblige to apply the aforementioned principle in the national criminal law. Similar requirements are indicated in the article 15 of International Covenant on Civil and Political Rights of United Nations Organization and other international agreements too.

In Article author reviews definitions of both Well-Known Trademark and criminal law principle “*nullum crimen sine lege*” (“no crime without law”). Also, author analyses the the demand for the infringements of Well-Known Trademarks rights criminalization and opportunities of it. In the Article attempts are put to present the criteria which should reveal the Well-Known Trademark counterfeiter dangerousness allowing application for criminal responsibility, but at the same time not violating the *nullum crimen sine lege* (“no crime without law”).

**Definition of a Well-Known Trademark and demand of its criminalization**

The origins of legal protection of Well-Known Trademark is Article 6 bis of the Paris Convention for the Protection of Industrial Property (hereinafter - Paris Convention). The rule of international law declares that:

(1) The countries of the Union undertake, ex officio if their legislation so permits, or at the request of an interested party, to refuse or to cancel the registration, and to prohibit the use, of a trademark which constitutes a reproduction, an imitation, or a translation, liable to create confusion, of a mark considered by the competent authority of the country of registration or use to be well known in that country as being already the mark of a person entitled to the benefits of this Convention and used for identical or similar goods. These provisions shall also apply when the essential part of the mark constitutes a reproduction of any such well-known mark or an imitation liable to create confusion therewith.

(2) A period of at least five years from the date of registration shall be allowed for requesting the cancellation of such a mark. The countries of the Union may provide for a period within which the prohibition of use must be requested.
(3) No time limit shall be fixed for requesting the cancellation or the prohibition of the use of marks registered or used in bad faith. At the same time, it should be noted that the Paris Convention does not provide any definition and a Well-Known Trademark concept, thus, the Convention Member States have to create it with the help of courts practice on their own.\(^1\)

According to the Article 6 bis of the Paris Convention, Well-Known Trademark protection is not wider than registered Trademarks. If the Trademark seeking the protection as a Well-Known, in particular, the Member State (in which protection is sought) is already registered, usually there is no need to apply the Article 6 bis of the Paris Convention provisions, because as it was mentioned before, it does not give more rights than the registration of a Trademark would give.\(^2\)

Consequently, the Paris Convention Article 6 bis is important in such cases when a particular Trademark seeking the protection as Well-Known, is one of the Member States of the Paris Convention and has not already acquired the protection of the national legal procedures (e.g. registration). Such protection crossing the territorial principle of the trademark protection provided condition - wide brand awareness.

Well-known Trademark protection and the boundaries of this protection legal regulation in international law was continued to develop in Agreement on Trade-Related Aspects of Intellectual Property Rights (hereinafter - the TRIPS Agreement), in particular - paragraphs 2 and 3 of the Article 16 of the TRIPS Agreement. Paragraph 2 of the Article 16 of TRIPS agreement, provides that the Article 6 bis of the Paris Convention (1967) shall apply, mutatis mutandis, to services. In determining whether a Trademark is Well-Known, Members shall take into account knowledge of the trademark in the relevant sector of the public, including knowledge in the Member concerned which has been obtained as a result of the promotion of the trademark. In the third part it is noted that Article 6 bis of the Paris Convention (1967) shall apply, mutatis mutandis, to goods or services which are not similar to those in respect of which a trademark is registered, provided that use of that trademark in relation to those goods or services would indicate a connection between those goods or services and the owner of the registered trademark and provided that the interests of the owner of the registered trademark are likely to be damaged by such use.

Paragraphs 2 and 3 of the Article 16 of TRIPS Agreement show that the requirements for the Member States to provide protection for Trademarks as Well-Known, in particular, are associated with aforementioned Article 6 bis of the Paris Convention. So, the Article 6 bis of Paris Convention is the legal framework of the Well-Known Trademark protection in accordance to the TRIPS agreement too. At the same time, it should be noted that the TRIPS Agreement, during the development of Well-Known Trademark legal protection standards mentioned in the Article 6 bis of Paris Convention laid down, determines a number of substantial new elements compared to the Paris Convention.\(^3\)

When deciding on the brand recognition of being a Well-Known, strength of a feedback in a market formed should be evaluated: a manufacturer or a service

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3 Klimkevičiūtė D. (2005) Concept of a Well-Known Trade Mark and Criteria for Determination of whether a Trade Mark is a Well-Known (Some Theoretical and Practical Aspects)
provider - the trademarked goods and (or) services – society (it means: a user of goods and (or) the service). Well-Known Trademark protection guarantee is its awareness.

When a particular segment of a society is aware of a Trademark which marks the particular goods and (or) services as belonging to the respective product manufacturer or service provider, i.e. the Trademark and marked goods, and (or) services, clearly identify as goods originated from a particular source (even without knowing the company supplying goods bearing a particular brand to the market name), failure to provide protection for such Trademark would mean an impression formed about that trademark in a society (in particular layers of it) and the product it covers disregard. This would distort the reality of feedback clearly formed in the market: a manufacturer or service provider - the Trademarked goods and (or) services - society (i.e. user of goods and (or) the services).¹

Also, when deciding on the Trademark wide recognition the 1999 Joint Recommendation Concerning Provisions on the Protection of Well-Known Marks of the Assembly of the Paris Union for the Protection of Industrial Property and the General Assembly of the World Intellectual Property Organization (WIPO) interpretations must be taken into account. In the aforementioned the Article 2, paragraph 1 (a) is established the principle provision that in determining whether a mark is a Well-Known Trademark, the competent authority shall take into account any circumstances from which it may be inferred that the mark is well known.

Paragraph 1 (b) of article 2 of Recommendation, the criteria likely to be significant are pointed (but not limited not to pay attention to other factors) in deciding on the mark recognition: 1. the degree of knowledge or recognition of the Trademark in the relevant sector of the public; 2. the duration, extent and geographical area of any use of the Trademark; 3. the duration, extent and geographical area of any promotion of the Trademark, including advertising or publicity and the presentation, at fairs or exhibitions, of the goods and/or services to which the Trademark applies; 4. the duration and geographical area of any registrations, and/or any applications for registration, of the Trademark, to the extent that they reflect use or recognition of the Trademark; 5. the record of successful enforcement of rights in the Trademark, in particular, the extent to which the mark was recognized as Well-Known by competent authorities; 6. the value associated with the Trademark.

On the other hand, as indicated in paragraph 1 (C) of the Article 2 of Recommendation, these criteria are not conditions for a Trademark to be recognized as a well-known and widely recognised. Recognition in each case may depend on the specific circumstances of the case. In the recommendation it is also noted that in some cases, all of these possible criteria may be relevant to other cases - only some of these criteria, and in other cases - none of the criteria noted in the Recommendation will be significant, and the decision of the mark wide recognition will be based on additional criteria not specified in this Recommendation. In turns, these additional criteria can be important both themselves individually and in combination with one or more of the criteria presented in the Recommendation.

In terms of criminal liability, it should be noted that this recommendations criteria may be important as a criminal offense subject describing symptoms and additional criteria for describing a person who uses an unregistered but clearly Well-

¹ Klimkevičiūtė D. (2005) Concept of a Well-Known Trademark and Criteria for Determination of whether a Trademark is a Well-Known (Some Theoretical and Practical Aspects)
Known Trademark must exist reflecting the personal danger (possible additional criteria analyzed in the next section of Article).

Article 61 of the TRIPS Agreement is perhaps the most fundamental rules of binding to criminalize intellectual property rights, including trademarks and providing for criminal liability of the minimum standards. This legal norm states that Members shall provide for criminal procedures and penalties to be applied at least in cases of wilful trademark counterfeiting or copyright piracy on a commercial scale. Remedies available shall include imprisonment and/or monetary fines sufficient to provide a deterrent, consistently with the level of penalties applied for crimes of a corresponding gravity. In appropriate cases, remedies available shall also include the seizure, forfeiture and destruction of the infringing goods and of any materials and implements the predominant use of which has been in the commission of the offense. Members may provide for criminal procedures and penalties to be applied in other cases of infringement of intellectual property rights, in particular where they are committed wilfully and on a commercial scale. Thus we see that at least the TRIPS Agreement obliges to criminalize intentional conduct infringing the registered trademark rights.

However, not registered, but the Well-Known Trademarks (product) counterfeit causes a threat and violates criminal codes stored values in states more than registered trademarks, because they are usually more prevalent, recognized and appreciated, and they are more trusted.

Also, when a Well-Known Trademark is selected for counterfeiting, a bigger personal danger is seen, because a person chooses the most recognizable brand. In this way, it allows the market to release recognizable counterfeits of Well-Known Trademarks, for which the price of realization is higher than bearing a particular brand.

In terms of damage made by offenses against intellectual property, it should be noted that it is not only the intellectual property rights owners problem, it also concerns both organized crime and the financing of terrorism, which cause a serious harm to the society.

This illegal income is successfully hidden from the public authorities and is actualized in the illegal market. This income is used for financing: Racketeering, Human Smuggling, Money Laundering/ Illegal Money Transfer Service, Illegal Gambling, Loan-Sharking, Narcotics Trafficking, Prostitution, Weapon Trafficking, Contract Killing, Document Forgery Services.¹

Also, as registered, unregistered trademarks’ counterfeits mislead the consumer and, depending on the type of product can make or cause damage to the health or even life. Most dangerous counterfeit groups can be considered as medicine, toys, fertilizers, certified food and other food products. However, in the author's opinion, the most dangerous is medicine, because even not counterfeited medicine misuse can be extremely dangerous to health, specially when the use of the medicine composition de facto is unknown, sometimes poisonous.

World Health Organization, considering a large number of cases, when people die from some of the counterfeit medicine or irreparable damage is caused to health, declared that the counterfeiting of medicine is not only a threat to the intellectual property, but also to the person’s life and health. According to the organization,
health, and protection of the intellectual property are non-conflicting areas.\(^1\)
Therefore, the criminal rate of criminalization of counterfeiting market has to be operated effectively against medicine counterfeiters.\(^2\) The Counterfeited specialized food products (organic, for diabetes, etc.), fertilizers (for the cultivation of green or other certifiable products) cause danger for certain groups of people who are allergic, intolerant of certain products or who due to a certain type of disease should not used specific products. So products certifying sector should especially protect products from counterfeiting as potential buyers of such products are also potential victims.

Toys counterfeiting dangers lie in the low-cost materials and unsafe children sensitivity to them. Paint based on lead, has been banned in Europe since 1978.\(^3\) The Counterfeiters, in order to save costs, choose insecure, prohibited materials, and it can have a negative impact on children's health.

The above-mentioned sequence, the well-known trademark protection by criminal means is necessary due to a large brand recognition leading to a competitive advantage and greater marketability. The quality of counterfeited goods is not assured, which leads to unsafe products entering the market. Society must be protected from counterfeiting, regardless of the particular trademark registration of a particular country.

**The principle *nullum crimen sine lege* content and Well-Known Trademark criminalization opportunities**

Applying criminal liability for the use of not registered trademark, the question arises whether the person using such a label has to realize that to use it is a criminal, but it depends precisely on the registration of presence or absence of a particular country. As explained below, the criminal law components of concreteness and clarity is a part of the *nullum crimen sine lege* (“no crime without law”) volume.

This part of the article in terms of Well-Known Trademarks talks about unregistered trademarks that are not yet recognized as Well-Known by a court. Well-known Trademarks recognized by the court, as mentioned before are protected and unregistered. The initial breach of the situation is that the infringement was carried out in the State where that mark is not registered, but from the outside it is quite

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2 p. 353 - 354: [...] the annual turnover of counterfeit drugs was estimated at US$ 39 billion [...] These examples show a huge spectrum of events and they effects [...] 1990: Over 100 children in Nigeria died from a cough syrup that was diluted with toxic solvent; 1995: 89 people in Haiti died after the intake of Paracetamol syrup (an analgesic) containing diethylene glycol; 1996: more than 59 children died after the intake of counterfeit fever syrup; 1999/2000: Approximately 60 people in Combodia died after the intake of counterfeit anti-malarial drugs. According to a study published in the leading medical journal *The Lancet* in 2001, up to, 40% of anti-malarial drugs sold in Third World countries do not contain enough or do not contain any active ingredient. The drugs are practically worthless, leading to thousands of deaths annually; 2002: In Switzerland, approximately 22,000 fake Viagra tablets were confiscated; 2002: AIDS medication designated for Africa was illegally reimported to Germany anf the Netherlands on a large scale via France and Belgium. It had previously been delivered to developing countries at prefential prices; [...] 2006: At least 20 persons died in Chine after the intake of counterfeit antibiotics; During the second half of 2009, the multinational police operation 'Storm II' in several Southeast Asian countries led to the arrest of 30 suspects and the seizure of 20 million units of counterfeit or illegal drugs; 2010/12: In Germany, investigations into the dealings of several pharmaceutical wholesalers are currently underway. They had ostensibly on a large scale imported and sold to pharmacies active ingredients which had no regulatory approval for use in cancer drugs.
3 Krugman and Jones http://ec.elobot.co.uk/apsinuodijimas-svino
understandable that the trademark is identical or confusingly similar to a trademark, which is registered in a foreign country (countries) i.e. from facts there is a reason to believe that the person is aware of using a particular brand because of its fame and evaluation in order to profit without investment to Trademark, resulting in a competitive advantage.

In the most general sense of the scientific doctrine of nullum crimen sine lege (“no crime without law”), the principle is defined as ,,The principle of legality is a core value, a human right but also a fundamental defence in criminal law prosecution according to which no crime or punishment can exist without a legal ground. Nullum crimen, nulla poena sine lege is, in fact, a guarantee of human liberty: it protects individuals from state abuse and unjust interference, it ensures the fairness and transparency of the judicial authority. [...]”

This principle plays an important role in the international and regional human rights instruments. In terms, the Article 11 of the Universal Declaration of Human Rights (UDHR) (1948) gives a very well structured definition of the principle: “No one shall be held guilty of any penal offence on account of any act or omission which did not constitute a penal offence, under national or international law, at the time when it was committed. Nor shall a heavier penalty be imposed than the one that was applicable at the time the penal offense was committed”. The same concept with nearly identical wording is found in several international and regional human rights treaties, including the International Covenant on Civil and Political Rights (ICCPR) (1966), the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR) (1950) and the American Convention on Human Rights (ACHR) (1969).

Developing nullum crimen sine lege (“no crime without law”) in scientific doctrine, in this regard, additional requirements for the clarity, concreteness are raised.

Nullum crimen sine lege (“no crime without law”) principle content is wider than the definition. In legal doctrine, the principle of nullum crimen sine lege (“no crime without law”) has been found to consist of four separate requirements: praevia (“previous law), scripta (“written law”), certa (“definite law”) and stricta (“strict law”). Although the principle of origin was identified only praevia (“previous law), ir mean the Criminal Law of the validity period, the modern doctrine of nullum crimen sine lege (“no crime without law”) interpreted more - additionally emphasizes the Criminal Law of the written form and absoluteness, analogy Insurance and the Law on the wording of accuracy and clarity. 2

In criminal law legislation, in addition to fixed (formal) signs used to being assessed the constituent elements of the offense, which have certain characteristics and are not self-explanatory: their content directly becomes clear from the criminal law or its interpretation. These signs of the content mainly depend on the specific facts and individual legal consciousness in the law. Incriminating the character the content of it is evaluated on ad hoc basis, in addition, it is necessary to specify the criteria according to which it is alleged, also what specific actions of the accused are and how

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they meet the benchmark constituent elements of the offense. For the offense of benchmark features and characteristics of the abundance of relativity their identification and classification is also relatively relative. Almost three-quarters of the Lithuanian Criminal Code of objective assessment are expressed by side features, and most often repeated evaluative serious damage, high-volume, heavy consequences grammatical construction, the clarity, and precision is a priority, but not absolute legal provision in the criminal law. Because of what the authors believes is the possible application of criminal liability for the Well-Known Trademarks violations, but this must be done very cautiously. Nullum crimen sine lege certa ("there is to be no penalty without definite law") functioning narrows various legislative principles - the criminal law must not only be accurate and clear but also, the most concise, logical, without legal loopholes: In ECHR jurisprudence there are established qualitative definitions criteria of terms of availability and predictability; as well the universality of the law enforcement and loopholes to avoid aspiration. Evaluative mental element and nullum crimen sine lege stricta ("there is to be no penalty without strict law") can be compatible with each other only in the event of case-law to form some of their interpretation and evaluation criteria - "fuses", and the court, explaining the character content, takes into account the will of the legislator, objectives, rights system and takes precedent formed by the criteria, and if you dare to depart - it motivates properly. It is visible that to finally assess whether the application of criminal liability for the Well-Known Trademarks violations can only be a detailed analysis of specific countries standards modelled and national case law.

It should be noted that the aspect of the topic, it is important that, under the principle of ultima ratio ("the last resort (as force)") in criminal law should be criminalized only such broad trade violations that can not be removed to less restrictive means or damage removal without law enforcement intervention on the offender's intentional actions have become extremely difficult. Below are two hypothetical situations, which in the author's opinion should be treated as criminal both:

1) The seller does not has a permission to trade in specific non-registered trademarks, but has a permit for intra-commercial activities, including: a) the goods are marked with unregistered trademark are not accounted for; b) the accounting documents for goods bearing the unregistered mark are of false information; c) the accounting documents provide insufficient information.

2) The seller is not authorized to carry out intra-commercial activities, as well as the specific consent of the marketing of an unregistered trademarks.

We see that in the first case, it is not possible to determine what was the extent of trafficking in counterfeit goods, because, for one reason or another it is not possible to determine from the records, concealing an illegal trade is legal; in the second case there is no possibility of an unregistered trademark owner to identify a specific offender and ask him to stop the trade actions.

If the accounting records are properly managed and they are recorded, all the information necessary to identify the goods bearing the trademark is not registered, turnover of the company is authorized to engage in intra-commercial activities, but

1 Veršekys P. (2012) Principle nullum crimen sine lege and evaluative criteria of the body of the criminal act: correlation problem. TEISĖ 85, Vilnius University ISSN 1392–1274
2 More Pranka D. (2012), The conception of marking the line between crime and tort in criminal law of Lithuania, doctoral dissertation, Mykolas Romeris University
there is no permission to use a particular trademark, such violations should not be disposed of criminal legal means.

Also, it should be noted that well-known trademark the criminal law protection could be solved by extending the scope of criminal law. This can be done by pulling liable person for using not only in the offense country (elsewhere) registered, but also for example in EU or in the Paris Convention states members registered trademarks. However, this issue requires additional research, and due to the scope of this article is not analyzed.

For a Well-Known Trademark's infringement as a criminal offense subject, in the author's opinion it is noted that, criminal liability, as a ultimo ratio measure to protect a particular country unregistered trademarks should be used for activities related to goods or services getting in the market. In this regard, it is important to review the material goods and services in the electronic market access and operation within special features:

1) The material goods bearing a registered trademark for actions related to access to the market can be considered for commercial purposes are carried out: trade; transportation; warehousing; goods or parts thereof, when it is obvious that counterfeit is produced, etc.

2) E-product or service bearing a registered trademark can not be counterfeited, an online space for what the territorial trademark for effective application becomes very difficult, because counterfeited goods or services availability becomes infinite. Typically, e-mail. service or product is inseparable from its content, along with the copyright protecting this content. One such example is when the paid online TV services are supplied- channel display, without the same trademark and content owners' consent, whose popularity and profits depend exclusively on offered channels together and brand (eg. Discovery) popularity. (Copyright and trademark rights are not analyzed in this article).

The above-mentioned sequence that criminal responsibility for the Well-Known Trademarks applicability to infringements of the legality *nullum crimen sine lege* (“no crime without law”) principle aspect is determined by the specific domestic regulatory and judicial practice ratio, this work can only be drawn to the conclusion that the right combination of extrinsic and purposeful development of the case law, it could be possible to criminalize the Well-Known Trademarks violations.

**Conclusions**

International law analysis shows that the Well-Known Trademark protection is determined by its value manifests the recognition providing a competitive advantage. Due to the extremely serious damage made counterfeiting both directly distorting the market and refinancing of other offenses, it is concluded that there is a demand to criminalize Well-Known Trademarks violations. Separately exclusive damage is made to consumers by unprotected specialized food products, medicines, children's goods. By the *nullum crimen sine lege* (“no crime without law”) principle meaning, the legislator should ensure the criminal rate clarity and specificity combining specific criminal activities and evaluative elements of criminal activities. In the author's opinion, the offense under criminal signs in national laws (codes) can be expressed as a Well-Known Trademark as an object of the offense. In order to evaluate the characteristics of the object expressed by evaluative compliance *nullum crimen sine lege* (“no crime without law”) is necessary to analyze the specific criminal rate,
together with the case law. Therefore, it is concluded that the Well-Known Trademark rights violations criminalisation in itself would not violate *nullum crimen sine lege* (“no crime without law”) principle.

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The European Commission proposal of 12 July 2005 for a European Parliament and Council directive on criminal measures aimed at ensuring the enforcement of intellectual property rights and proposal for a Council framework decision to strengthen the criminal law framework to combat intellectual property offences (KOM(2005) 276)

APPLICATION OF SOFT LAW INSTRUMENTS IN INTERNATIONAL ECONOMIC LAW: INSIGHTS ON LITHUANIAN PRACTICE ON THE LEGAL REGULATION OF CUSTOMS DUTIES

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Abstract

Purpose – the main aim of this article is to describe the legal status and purpose of soft law sources in international economic law (international customs law, regulating the taxation of international trade) and their relationship with the rules of the European Union (hereinafter EU) and national customs law.

Design/methodology/approach – analysis of relevant issues is based both on theoretical (analysis and synthesis, systematic, comparative) and, in particular, empirical methods (statistical analysis of data, analysis of documents, generalization of professional experience, in particular – practice of the courts of Lithuanian Republic in disputes with customs authorities as well as the practice of the CJEU. The article consists of an introduction, four chapters and conclusions.

Finding – the results of the research points out that currently the national courts of Lithuania, as an EU Member State, aren’t fully following the constantly evolving jurisprudence of the CJEU, in particular, on issues of soft law sources applicable to the tariff classification of goods, customs valuation and their relationship with the EU customs legislation (EU Combined Nomenclature, Community Customs Code).

Research limitations/implications – the analysis is limited to a certain period of time (yrs. 2010 – 2015) and is based on the practice of the Lithuanian Supreme Administrative Court in cases related to the activities of customs authorities and taxation with customs duties in Lithuania as well as the practice of the CJEU, concerning the tariff classification of goods.

Practical implications – as it can be seen from the practice of national (Lithuanian) cases, related to the tariff classification of goods and their customs valuation, there are various obstacles to the efficient functioning of relevant soft law sources in coherence with the EU practice, formulated by the CJEU. These obstacles and problems includes accessibility to the certain soft law sources (HSENs) on the national level, incorrect recognition of their legal value in national judicial proceedings and, in certain cases, granting the direct effect to the WTO soft law sources, while such feature is generally not recognized by the CJEU. This implies the need to modify and adjust the rules of national law, in particular, the Law on Customs of the Republic of Lithuania.

Originality/Value – general questions on the status of soft law sources in the field of international economic law are considered quite widely in the legal doctrine by foreign authors (Lux, 2007; Weerth, 2007; Schaffer, Pollack, 2010; Wolfgang, Kafeero, 2014). However, the national legal doctrine (in Lithuania) examines only the general issues on application of soft law sources, recognizing the importance of the formally legally non-binding legislation, whose purpose is to ensure the uniform application of customs legislation (Medelienė, Sudavičius, 2011). On the other hand, the practical application of these sources of law (the analysis of specific examples of the national case law) is not assessed, described and / or compared to the analogous CJEU practice.

Keywords: international economic law, soft law, customs law, tariff classification of goods, Harmonized System Explanatory Notes (HSENs), World Customs Organization (WCO).

Research type: research paper.
Introduction

The fundamental objective of global development in the modern era, which is targeted by both the international community and individual countries, is to form favorable conditions for the development of the society and its welfare and to create an environment, which would guarantee equal social and economic conditions for sustainable growth. On the other hand, the processes of globalization, as an exclusive feature of modern social and economic system (Hirst, Thompson, 1992; Jusčius, 2006), characterize social relations in the modern world. This process means the creation of a single global economy, when the globally geo-dispersed activities are linked into a coherent complex where the interdependence relations link the entities, participating in it (Linarelli, 2014). Thus, sustainable development, economic growth and development objectives of each country are related to globalization. One of the most important and dynamic global economic factors, which is influencing the globalization, is international trade. Accordingly, it is noticed both at theoretical and practical level, that in the current circumstances, no country can achieve economic growth without being present actively in international trade (Laurinavičiūs et al., 2014).

These processes are also crucial for the evolution of legal systems both on the international and the national levels. Specifically, the most important factor for the changes in international trade and its development in the 20ieth century was the abandonment to apply various national restrictions on foreign trade. After the Second World War, countries of the world have adopted the agreements on the liberalization of international trade and in 1995 established the World Trade Organization (WTO). This led to the transformation of local market specifics in individual states and to the disappearance of many national legal regulatory mechanisms, which created barriers for international trade. As it is noted by legal scholars (Herdegen, 2013) these processes have also formed a special supranational branch of public law, governing international trade, that is international economic law.

Thus, authors, who are exploring evolution of international economic law and its functioning (Folsom, Gordon, Spanogle, 2004; Herdegen, 2013; Laurinavičiūs et al., 2014), emphasizes that although a modern international economic order is regulated by international agreements, conventions and international organizations, such as WTO, WCO and regional international organizations, such as customs unions (to which the EU itself is attributed), that help to balance the interests of the countries concerned. On the other hand, as it is also noticed by the same authors, despite these processes, international trade operators nowadays face different legal regulations of trade relations on the level of domestic (national, internal) law. It is clear that for these reasons, at various international trade tariff regulation levels (unilateral, bilateral / regional and multilateral), both the states and individual international trade operators are faced with complex problems associated with relationship between international and national law, the binding (or non binding) legal force of individual sources of international law and with issues related to the division of competence between national and international institutions. Existing complicated regulatory system of customs duties (GATT and WTO agreements, other international treaties and conventions, such as 1983 Harmonized System Convention), the wide range of soft law sources (explanations, recommendations), which is used for their interpretation and provided by the international organizations (WTO, WCO), other sources: preferential trade agreements between different states and even the legislation of
regional international economic organizations (such as the EU), causes quite a wide range of theoretical and practical problems for the regulation of international trade using tariff regulation measures (customs duties).

Accordingly, the purpose of this article is to describe the legal status and objectives of soft law sources in international economic law (international customs law, regulating the taxation of international trade) and their relationship with the rules of the European Union (hereinafter - EU) and national customs law. In order to achieve it, the following objectives of the article were formulated: (i) to examine how the Republic of Lithuania, as an EU Member State, applies international soft law sources in the area of tariff classification and customs valuation of imported goods for customs purposes and (ii) to compare the relevant judicial practice of national courts with the practice of the Court of Justice of the European Union (hereinafter - the CJEU).

The status soft law instruments in international economic law: general insights and problematics

From a legal point of view, specific public relations, arising from international trade, and regulatory areas of mutual compatibility are addressed by all global trading partners in accordance with the general principles enshrined in the WTO Agreements and, in particular, the General Agreement on Tariffs and Trade (hereinafter - GATT Agreement) and its Annexes (Law of the Lithuanian Republic on the ratification of the agreement, founding the World Trade Organization and its Annexes, 2001), which present a single regulatory framework for the international trade and establishes the generally recognized principles of free international trade and fair competition. As it is emphasized in the scientific literature (Laurinavičius et al., 2014), the direct application of these basic principles simplify negotiations between the states, giving them a clear, purposeful and common procedures for the resolution of trade disputes and resolving other related issues.

However, international trade is inextricably linked with the responsibilities of certain countries (or their groups) to ensure the protection of their internal market, which primarily are related to the establishment and application of customs duties on imported goods of foreign origin. In this respect, the basic provisions of the WTO Agreements, which the Lithuanian Republic has ratified in 2001 (Agreement founding the World Trade Organization, 2001), are the objective basis for the standardization of international trade and defines quite clear rules for its taxation by imposition of customs duties (import taxes), based on the responsibilities of the states not to discriminate goods of foreign origin (Einhorn, 2012). For example, the WTO Agreement on Rules of Origin contains general provisions for determining customs origin of goods, i.e. the state, which is considered the country of origin of goods for customs purposes and which determines what type of customs duties - conventional (regular) or preferential (reduced) should be applicable to the imported goods. Accordingly, the WTO Agreement on the implementation of the Article VII of GATT regulates determination of the customs value of goods which is used as the basis for the calculation of the customs duties, since the absolute majority of the customs duties worldwide are based on the value (ad valorem) duty rate setting (Lux, 2002).

Therefore, according to international customs law, specific customs duty rate is usually determined by three main elements, the price, that is the customs value of
imported goods: customs origin, that is state or region in which goods originated (were produced) and classification (code), i.e. the heading or subheading of the Combined Nomenclature used to identify the goods for customs purposes (Baronaitė, 2010). Globally, the goods are classified for customs purposes under the provisions of Harmonized System, set by the Brussels convention on the tariff classification of goods (1983), to which the Republic of Lithuania joined in 1995 (International Convention on the Harmonized Commodity Description and Coding System (adopted in Brussels on the 14th of June, 1983), 2003: hereinafter - Harmonized System Convention). The EU applies its own Combined Nomenclature (Council Regulation (EEC) No 2658/87 on the tariff and statistical nomenclature and on the Common Customs Tariff, 1987), which is based on the Harmonized System, administered and supervised by the World Customs Organization (WCO).

The examination of relationship between international, EU and national customs law leads to the conclusion that an important issue of modern international economic law is the legal status of the so-called soft law sources (soft law international legal acts). In the doctrine of international public law, "soft law" is generally understood as the landmarks for conduct, which are formulated by international organizations and which are considered neither as strictly binding legal norm, nor a purely political statement (Akehurst, Malanczuk, 2000). It should be noted that the prevalence of so-called "soft law" sources of law, which formally have no binding legal force, but nevertheless may have practical effects, is a common characteristic feature of modern international economic and customs law (Seidl-Hohenveldern, 1979; Schaffer, Pollack, 2010; Wolffgang, Kafeero, 2014). The prevalence of soft law sources of law is most noticeable in the area of regulation of legal relations linked to the tariff classification of goods and the determination customs value (Gurevičienė, 2008; Radžiukynas, Belzus, 2008). For this reason, as a problematic aspect of this question, is the extent to which soft law sources must be taken into account in the process of application of the national and EU customs law, for example, whether, according to the Union Customs Code (Regulation (EU) No 952/2013 of the European Parliament and of the Council laying down the Union Customs Code, 2013), these legal acts would constitute the international law, the application of which cannot be affected by the Union Customs Code (Art. 1, para. 2)?

This problem becomes even more important in the assessment of the fact that the vast majority of international soft law sources are not adopted by the sovereign states (by their consensus or negotiations), but are independently and directly formulated by the relevant legislation of international organizations (WTO, WCO). Individual authors (e.g. A. Medelienė, M. Lux) state that the various international guidelines, explanations, administrative arrangements, advices, recommendations, and other legally non-binding legal acts, which aim is to ensure the uniform application of customs legislation, should also be attributed to the group of customs law sources (Medelienė, Sudavičius, 2011; Lux, 2007). In this regard, it is noted that although their legal effect is only indicative, however, both customs authorities of individual countries, as well as institutions, which settles disputes with them, actually follows them in their practice (Medelienė, Sudavičius, 2011). In order to assess the validity of this position, the article analyzes the practice, followed in the Republic of Lithuania on the practical application of the soft law sources in customs law, and identifies its main trends in the judicial practice.
Application of the soft law instruments for the tariff classification goods: the practice of the CJEU

It should be noted that the use of soft law instruments is especially important for the tariff classification of goods for customs purposes, first of all, for the reason that soft law sources are used to describe proper application of the Harmonized System Convention, which is used to unify and simplify the classification of goods and setting of particular customs tariffs in international trade. It should be emphasized that the Harmonized System Convention itself only provides the general provisions, which provide the basis of Harmonized Commodity Description and Coding System. At the same time, a multipurpose goods nomenclature, where the position of each product (commodity) is encoded in a six-digit format using a special digital code, is described in the Harmonized System Explanatory Notes (hereinafter - HSENs), prepared by the WCO. While these explanations (explanatory notes) are not legally binding, but they are applied by the WTO, as an instrument for the legal interpretation in settling of trade disputes between states. On the other hand, the WCO regularly revises and updates the Harmonized Commodity Description and Coding System, as well as take measures to ensure a uniform interpretation, for example, itself has the right to settle disputes concerning the proper tariff classification of goods (Einhorn, 2012).

This means that although the HSENs, according to their legal nature, are the soft law source, it is generally recognized that they are binding to the countries, according to the Harmonized System Convention, including the EU (Wolfgang, Ovie, 2008). On the other hand, the attention is often drawn to the issue of their compatibility with EU law. In particular, in accordance with the Harmonized System Convention, the EU has set up and is using its own Combined nomenclature of customs tariffs and statistics of foreign trade (hereinafter - Combined Nomenclature), which is enshrined in Council Regulation No. 2658/87 and its subsequent supplements. Although the Combined Nomenclature of the EU was prepared according to the Harmonized System Convention and Harmonized Commodity Description and Coding System, which is based on this Convention, incorporating the rules of the Harmonized System into EU law, but in practical terms there still remains discrepancies between these two systems (Weerth, 2007).

Accordingly, the Court of Justice of the European Union (hereinafter - the CJEU) had to deal with such situations in its practice and has repeatedly pointed out that it is not allowed for the rules of EU Combined Nomenclature to change the content of basic positions for the tariff classification of goods, which are described in the Harmonized System and its explanatory notes (HSENs), whereas the Community is committed to the obligations, enshrined in the Harmonized System Convention (France v. Commission, 1995; Holz Geenen GmbH v. Oberfinanzdirektion Munchen, 2000; Kawasaki Motors Europe NV v. Inspecteur van de Belastingdienst/Douane district Rotterdam, 2006; Hewlett-Packard Europe BV v. Inspecteur van de Belastingdienst/Douane West, kantoor Hoofddorp, 2013). This means that in general the Combined Nomenclature of the EU may not give a different descriptions of commodity items than the descriptions, provided by the HSENs, and, in case of doubt, the provisions of the Combined Nomenclature of the EU should be interpreted according to the rules, established in the HSENs (Kloosterboer Services v. Inspecteur van de Belastingdienst/Douane Rotterdam, 2009; Agroferm A/S v. Ministeriet for Fødevarer, 2013). Consequently, according to the assessments, provided by the CJEU,
HSENs has the interpretative nature and therefore they lack formal binding force (Mineralquelle Zurzach AG v. Hauptzollamt Singen, 2014). On the other hand, despite the interpretative nature of the HSENs and its status as the soft law instrument, the CJEU in parallel has pointed out that, in order to resolve questions concerning the tariff classification of goods, the HSENs, however, must be directly taken into account in the case if Community provisions does not contain any particular rules (Matisa Maschinen GmbH v. Hauptzollamt Berlin Packhof, 1975; ROSE Elektrotechnik GmbH & Co. KG v. Oberfinanzdirektion Köln, 1999; Commissioners of Customs & Excise v SmithKline Beecham plc., 2005 and etc.).

A relevant case law, formulated by the CJEU, leads to the conclusion that although HSENs are not formally recognized as binding source of law, which has the same legal value as other rules of international and EU customs law, but the CJEU applies them in solving the disputes and, what is most important, actually follows them in the specific situations, for example, on order to eliminate regulatory gaps (lacuna legis). This basically means that the tariff classification of goods in the EU Member States, must be guided by the HSENs, which are applicable by national courts of the Member States in individual cases, at least as a general interpretation guidelines (Rovetta, 2010).

**Application of the soft law instruments for the tariff classification goods: the national judicial practice**

In this context, the attention is drawn to the fact that the issues on the application of these rules has been also resolved by the national courts in the Republic of Lithuania (Lithuanian Supreme Administrative Court (hereinafter - the Court) as the highest judicial instance in dealing with this kind of disputes), but the national case law has not yet formulated a clear conclusion on the application of the HSENs, their legal value and status in the national legal system. It should be noted that the case law on the national level remains very controversial and since 2010 can be generalized into three directions of practice: 1) HSENs are directly applicable; 2) in case of conflict between the HSENs and Combined Nomenclature of the EU, the EU law is applicable; 3) in solving the disputes, concerning the tariff classification of goods, the national court is not obliged to give a detailed evaluation of the HSENs at all. It is obvious that such positions (especially the first and the third) are not compatible with each other, as in first case the binding legal force is provided to the HSENs (a soft law source by its nature), and according to the last position the legal value of the HSENs (even as the source of law of recommendatory nature) is questioned in general.

For example, while developing the first direction, the Lithuanian Supreme Administrative Court (in administrative cases No. A142-1156/2013 and No. A261-1408/2010) essentially agreed with the arguments of the court of first instance and the litigants, that the tariff classification of imported goods should be carried out in accordance with the HSENs (The Supreme Administrative Court of Lithuania, 7 October 2013 ruling in the administrative case No. A142-1156/2013, 2013: The Supreme Administrative Court of Lithuania, 4 October 2010 ruling of the panel of judges in the administrative case No. A261-1408/2010, 2010). Specifically, in the abovementioned administrative case No. A261-1408/2010, the Court has analyzed the question of the tariff classification of nuclear reactor components imported by the applicant to the
Republic of Lithuania. The assignment of these goods specifically to the tariff classification subheading No. 8401 40 00, was based directly on the explanations of HSENs, which clarified definition of general heading 8401, as the sole and primary source (see section II, paras. 4-5 and section IV, para. 4, of the Court’s decision). Thus, it can be concluded that the Lithuanian judicial practice has formulated the tendency to apply and recognize the HSENs as directly applicable source of law. It must be noted that this provision is not fully in line with the case law of the CJEU, which was cited above. According to it, the scope and the purpose of the application of the HSENs is to explain the existing sources of the EU law, such as the Combined Nomenclature, while the HSENs itself could be treated as directly applicable only in exceptional cases (when there are no relevant EU law which regulates tariff classification of specific goods). Meanwhile, in the cases cited, the Court has applied the provisions of HSENs and based its final decisions on them altogether without establishing whether there is a relevant EU law, which regulates tariff classification of specific goods (case No. A261-1408/2010), as well as disregarding the fact that the classification of disputed goods were regulated by the EU Combined Nomenclature in detail (case A442-1156/2013).

Secondly, it is debatable on the nature of second direction of the national case law, stating that in case of conflict between the HSENs and the Combined Nomenclature, the EU law is applicable (without any exemptions). For example, in one of the cases (administrative case No. A575-1238/2012), the applicant, who was challenging the tariff classification of disputed goods, which has been set by the customs authorities, raised the question that the content of description of goods (pressed sunflower seed husk briquettes), described in the provisions of HSENs, may be different from the same description, provided in the rules of EU Combined Nomenclature. However, the Court has not applied the HSEN’s, but instead has followed the rules defined in the EU law (descriptions of chapter 23 of the Combined Nomenclature) and hasn’t revealed any details of the relationship between these two sources of law (the Supreme Administrative Court of Lithuania, 3 February 2012 ruling of the panel of judges in the administrative case No. A575-1238/2012, 2012). Thus, it can be concluded that even in giving priority to EU law, Lithuanian national judicial authorities do not analyze all the circumstances, which, according to the practice of the CJEU, are essential in order to make the final decision on the relationship between the HSENs and the Combined Nomenclature of the EU and, finally, to determine the applicable law in a particular case. For example, the Court has declined to investigate whether the content of Combined Nomenclature hasn’t changed the meaning of the tariff classification positions, provided in the HSENs and whether in such situation EU law, defining the position of goods classification, should not be interpreted in a manner that is consistent with the provisions of the HSENs (such practice was formulated by the CJEU in cases British Sky Broadcasting Group plc v. The Commissioners for Her Majesty’s Revenue & Customs and Pace plc v. The Commissioners for Her Majesty’s Revenue & Customs, 2011). In this regard, it should be emphasized that in the present case No. A575-1238/2012, as well as in other cases relating to the tariff classification of goods, which was discussed above, the national court, arguing its position on the interpretation and application of the EU law (the Combined Nomenclature of the EU), generally omitted any reference to the practice of the CJEU and did not follow it1.

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1 As an exception to this general practice of national courts, only one case could be specified in which the Court has analyzed the comparative aspects of the HSENs and the provisions of the EU Combined
The existence of these problems is supported by other examples of national judicial practice, such as for example the practice formulated in the administrative case UAB “Plungės kooperatīvā prekšņa” v. Customs Department under the Ministry of Finance of Lithuanian Republic (the Supreme Administrative Court of Lithuania, 23 May 2013 ruling of the panel of judges in the administrative case No. A261-718/2013, 2013), where the Court has stated that in order to solve the dispute on the tariff classification of goods, the court is not obliged to “investigate the general rules for the interpretation of the CN, including a detailed evaluation of the interpretations of the Harmonized Commodity Description and Coding System Convention (HS)”. Such position is highly debatable with the position of the CJEU to which the court withheld in a number of cases, namely Kloosterboer Services v. Inspecteur van de Belastingdienst/Douane Rotterdam, 2009, and Agroferm A/S v. Ministeriet for Fødevarer, 2013. Finally, such practice of the national court seems as incompatible with the judicial precedents, formulated by the Court himself in other cases, mentioned above, in particular with those, which treated the HSENs as the directly applicable source of law (administrative case No. A261-1408/2010 and administrative case No. A442-1156/2013) and a commitment of the Republic of Lithuania to comply with its international obligations under the Harmonized System Convention (the Article 35, para. 1 of the Law on Customs of the Republic of Lithuania (2004) states that the goods are classified inter alia according to the International Convention on the Harmonized Commodity Description).

The practical examples, which were specified above, support the fact that so far the system for the classification of goods in Lithuania has some unsolved problems, which diminish its efficiency and objectivity. So far, the national courts are not formulated a clear practice on what legal status should be granted to the HSENs, as the main international soft law source, used for the tariff classification of goods, and the existing interpretations are inconsistent, incompatible with each other and do not seem to follow the judicial practice of the CJEU. However at the theoretical level (Laurinavičius et al. 2014) it is noted that advances in technology, appearance of new unknown products, makes it difficult to determine the correct classification code and often requires special expertise, additional laboratory tests, access to manufacturing procedures of goods and their functioning. According to the same authors (Laurinavičius et al. 2014) and official data of the Lithuanian judicial information system "LITEKO" (2016) a number of disputes, concerning the tariff classification of goods, is increasing, for example, over the past five years, their number has grown quite rapidly: if in 2011 Lithuanian Supreme Administrative Court had examined just one case on the tariff classification of goods, in 2015 it examined ten such cases.

Accordingly, in order to ensure the proper application of the HSENs in the Republic of Lithuania and to ensure the uniformity of tariff classification of goods throughout the EU (which is required by the practice and case-law of the CJEU), it is absolutely necessary to solve the above mentioned problems. This may include the legislative review of the rules, entrenched in the Law on Customs of the Republic of Lithuania (2004), in particular the Article 35 (“Classification of goods”), directly describing the possibilities for the application of the HSENs in the national legal system, for example, by stating that products are classified according to the

Nomenclature before reaching a final conclusion on the assignment of tariff classification code (the Supreme Administrative Court of Lithuania, 29 June 2015 ruling of the panel of judges in the administrative case No. A129-442/2015, 2015).
Application of the soft law instruments for the regulation of customs value of goods: comparative aspects

The remaining significant part of soft law sources in international customs law consist of the WTO and the WCO interpretations on the customs valuation methods. In this context, attention is drawn to the fact that, in accordance with the WTO Customs Valuation Agreement, the WTO Customs Valuation Committee adopt the relevant decisions and the WCO Technical Committee on Customs Valuation provides relevant explanations, advice, comments, as well as study materials (Customs valuation. WTO Agreement and texts of the technical committee on customs valuation, 1998). As it is noted in the scientific literature (Radžiukynas, 2003; Gormley, 2009), these sources are taken into account, firstly, in the development of national and EU customs valuation legislation, secondly, while the customs authorities are making decisions on customs valuation in specific import cases (i.e. when the specific types of goods (e.g. used motor vehicles/cars) are imported) or when the customs value of goods couldn’t be set out according to the routine customs valuation methods defined in the legislation.

On the other hand, it may be noted, that the CJEU traditionally takes quite a tough stance on the effect and application of the WTO law within the EU legal system, unlike, for example, applying the Harmonized System Convention and related legislation. Therefore the sources of law, provided by the WTO or included into its legal system (inter alia legal sources on the customs valuation issues), regardless of their nature, such as whether it is a soft law sources or not, aren’t provided with the capability to be directly applied or to have a direct effect in the EU legal system. In this regard it may be noted that already in the case Portugal v. Council, 1999, the CJEU has explained, that the states which are among the most important trading partners of the Community have concluded that the rules of the WTO are not applicable by their judicial organs reviewing the legality of their domestic law. Therefore the WTO agreements are not in principle among the rules in the light of which the Court is to review the legality of measures adopted by the Community institutions (see also case Germany v. Council, 1994). The same cautious approach is applied to the interpretations (commentaries) on the customs value of goods, which, as the sources of soft law, are provided by the WCO: here the decisions of the CJEU are generally not based directly on them and their direct application or the referral to the WCO commentaries is avoided, applying the rules of the EU law instead (Gaston Schul BV v. Staatssecretaris van Financiën, 2010).

It should be noted that the national courts are widely guided by the WTO and the WCO interpretations on the determination of customs value, and, on the practical level, are using them not only in the specific cases of imports, but also to define the general rights and obligations of the participants (importers) of customs legal relations. For example, the Lithuanian Supreme Administrative Court directly on the basis of the decision of WTO Customs Valuation Technical Committee has pointed out that in cases where the customs authorities has a reasonable doubt on the veracity and accuracy of the declared value of imported goods, the burden to prove an exact
customs value is shifted to the importer (the Supreme Administrative Court of Lithuania, 31 December 2008 ruling of the panel of judges in the administrative case No. A756-140/2008, 2008)\(^1\). In other case (No. A442-709/2013) the Court has ruled, that although the WCO guidelines for the determination of the risk on accuracy of the declared value of imported goods are not mandatory in nature, assessing the membership of the EU Member States and the EU membership in the WCO, they can be taken into account (the Supreme Administrative Court of Lithuania, 5 March 2013 ruling of the panel of judges in the administrative case No. A442-709/2013, 2013). Thus, it can be stated that in the area of the determination of the customs value of imported goods, the use of international soft law legal sources (instruments) and the relevant national case law is not coordinated with the position of the CJEU. To address this issue, one of the options to be considered is the opportunity to directly define (specify) rules for the application of these sources in the Law on Customs of the Lithuanian Republic (2004).

**Conclusions**

1. It can be noted that the fundamental feature of modern international economic law (*inter alia* international customs law) is that on the practical level the soft law instruments has become an integral structural part of this law system (WTO and WCO interpretations on tariff classification of goods and customs valuation). Their legal effects at the regional (EU) and on the national level is recognized directly by the CJEU, national case law and the legal doctrine.

2. However currently the national courts of Lithuania, as an EU Member State, aren’t fully following the constantly evolving jurisprudence of the CJEU, in particular, on issues of soft law sources applicable to the tariff classification of goods, customs valuation and their relationship with the EU customs legislation (EU Combined Nomenclature and Community Customs Code).

3. In the practice of the CJEU, soft law sources of international economic law, which are used for the tariff classification of goods, such as HSENs (Harmonized System Explanatory Notes), are not formally recognized as a binding source of law, which has the same legal value as other rules of international and EU customs law. However the CJEU applies them in solving the disputes on the calculation of customs duties and, what is most important, actually follows them in the specific situations, for example, on order to eliminate regulatory gaps (*lacuna legis*). Therefore the tariff classification of goods in the EU Member States must be guided by the HSENs, which should also be applicable by the national courts of the Member States in individual cases, at least as general interpretation guidelines.

4. However, the national case law has not yet formulated a clear conclusion on the application of the HSENs, their legal value and status in the national legal system. The case law on the national level remains very controversial and since 2010 can be generalized into three directions of practice: 1) HSENs are directly applicable; 2) in case of conflict between the HSENs and Combined Nomenclature of the EU, the EU law is applicable; 3) in solving the disputes, concerning the tariff classification of goods, the national court is not obliged to give a detailed evaluation of the HSENs at all.

\(^1\) This practice, citing it literally, was repeated in other subsequent cases in the Supreme Administrative Court of Lithuania, such as administrative cases No. A575-144/2011; Nr. A575-1340/10 and No. A5–1709/2009
5. Under the practice of the CJEU, the sources of law, provided by the World Trade Organization (WTO) or included into its legal system (inter alia legal sources on the customs valuation issues), regardless of their nature, such as whether it is a soft law sources or not, aren’t recognized as having the capability to be directly applied or to have a direct effect in the EU legal system. Notwithstanding the national courts in Lithuania are widely applying the WTO and the WCO interpretations on the determination of customs value, and, on the practical level, are using them not only for solving the questions on the regulation of specific cases of imports, but also to define the general rights and obligations of the subjects of customs legal relations (importers).

6. Solving of these problems on the national level (according to the standards set by the CJEU) may include the legislative review of the rules, entrenched in the Law on Customs of the Republic of Lithuania (2004), in particular the Article 35 (“Classification of goods”), directly describing the possibilities for the application of the HSENs in the national legal system, and direct definition of special rules for the cases of application of the WTO and WCO interpretations on the determination of customs value (establishing specific, exceptional cases of application, such, as for example, determination of customs value of used motor vehicles/cars).

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THE EUROPEAN INVESTIGATION ORDER: ACHIEVEMENTS AND CHALLENGES

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Abstract

**Purpose** – to analyze a new legal measure for international cooperation, i.e. the European Investigation Order, and the prospects.

**Design/methodology/approach** – the document analysis, comparative and critical approach.

**Finding** – regulation of the European Investigation Order and possible interferences, which hinder to cooperate efficiently and smoothly when applying this measure, are disclosed by reviewing them.

**Research limitations/implications** – the review provides a comprehensive view of the European Investigation Order, the perspective of boundaries in its practical application. Thus, it is easier to single out its advantages and disadvantages.

**Practical implications** – it is expected that insights, provided by research, will be useful for the adoption of Directive 2014/41 / EU (European Investigation Order).

**Originality/Value** – Although Directive 2014/41 / EU is already approved, it raises many questions regarding the European Investigation Order application. Thus, this research is original on its insights and observations.

**Keywords:** European Investigation Order, international cooperation, mutual recognition.

**Research type:** general review.

Introduction

When the Member States of the European Union (hereinafter referred to as the "EU") opened their borders, the dimension of criminal activities considerably intensified and expanded. When keeping an eye on such tendencies, the EU had been gradually implementing the "tools"², which would help to cooperate efficiently and
effectively, seeking for successful investigation of criminal offences, which transcend one of EU Member States national borders. Eventually, the implemented measures proved to be too formal and fragmented in practice. Thus, the European Leaders Council adopted the Stockholm Programme\(^1\) on the 11th of December of the year 2009, wherein they expressed their opinion about the necessity to continue development of the comprehensive system, assigned for gathering the evidence in the interstate matters, which would be based on the principle of mutual recognition. Therein, the European Leaders Council stated inter alia that the legal acts, existing in this sphere, do not form an integral and flexible system; thus, an attempt was made to encourage development of a new comprehensive system, which would substitute the existing legal acts.

Soon, i.e. on the 23rd of June of the year 2010, a group of the EU Member States, including Austria, Belgium, Bulgaria, Estonia, Spain, Slovenia and Sweden, presented an initiative to the European Council regarding the European Parliament and Council Directive on the European Investigation Order in criminal matters\(^2\) (hereinafter referred to as the "Initiative"). The innovative provisions were foreseen in this initiative; for example, not only the previously collected evidence, available with the other Member States, can be obtained, but also the actions, aimed at searching, collecting and obtaining the new evidence, can be carried out by means of the European Investigation Order (hereinafter referred to as the "EIO")\(^3\). However, the entirety of the text of the initiative caused broad debates\(^4\) on several issues; firstly, on ensuring the fundamental rights; secondly, on its impact upon the national sovereignty. The Member States\(^5\), EU institutions\(^6\) and the other interested entities\(^1\)


expressed their opinion about the text of the initiative. And finally, with taking into consideration the comments, submitted by the mentioned entities, on the 03rd of April of the year 2014 the European Parliament and Council adopted Directive 2014/41/EU on the European Investigation Order in criminal matters (hereinafter referred to as "Directive 2014/41/EU"). Despite the fact that Directive 2014/41/EU is already adopted, the discussions are going on not only on the mentioned issues, related to ensuring the human rights and to the impact upon the Member States' sovereignty, but also on the dilemma, spontaneously arising from these issues, on the proper implementation of the Directive in the national legislations. Thus, this article is aimed at reviewing the EIO in the three-dimensional plane, i.e. in the plane of the national sovereignty, fundamental rights and perspectives of the EIO implementation.

Parallel between the national sovereignty of the States and supremacy of the European Union's law

Criminal justice is a specific and unique field of law in each State. It remains very different up to now: therefore, regulation of the international cooperation in this area at the EU level is extremely complicated and requires a lot of effort. All the more so, the negative attitude of the EU Member States towards the unconditional cooperation in criminal matters is still envisaged. And it is indeed an understandable position because the States, protecting their sovereignty, authenticity and independence, avoid unambiguous supporting of the aspiration, declared by the EU, on mutual recognition of the evidence, on which the EIO is also based. Of course, on the one hand, the Member States are aware of the significance of recognition of the mutual principle of international cooperation, on the other hand, some EU Member States perceive this principle in a certain sense as the dictatorship, which limited the autonomy of the domestic law 3.

It seems that such apprehension is reasonable. Here, the European Court of Justice (hereinafter referred to as the "ECJ") had an opportunity to speak out on Council Framework Decision 2002/584/JHA, dated the 13th of June of the year 2002

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on the European arrest warrant and the surrender procedures between Member States, which is practically related to the EIO.

The talk is about the Radu case and about the Melloni case, which was examined immediately after it: the both cases are discussed in the context of fundamental rights and mutual recognition. Thus, without going deep into the circumstances of the examined cases, the essential moments, stated by the ECJ when commenting the ratio between the Member State's constitutional provisions and international obligations, must be noted. Namely, first of all, the ECJ stated that the guarantees, foreseen in the national Constitutions of the Member States, have no influence upon the definite case though they foresee a softer regulation towards the convicted person. Thus, the ECJ points to the supremacy of the European Union's law against the national legislation. The ECJ adds in this context that article 53 of the European Union's Charter on Fundamental Rights (hereinafter referred to as the "Charter") in this regard does not formulate the principle of the favourable law. Secondly, the ECJ states that the legislation, underlying the European Arrest Warrant, was (and still is) the framework decision, which is not attributed to the supranational lawmakering. Also the ECJ notes that the Framework Decision, as the instrument of the former European Union's third pillar, in the intergovernmental cooperation in the fields of police and judicial cooperation, in essence, is being implemented via the obligation, based on the international law, which is accepted by the Member States themselves. Thirdly, the ECJ, when construing the European Arrest Warrant in the context of the executing State's refusal to surrender a person, emphasized the need for efficiency and simplification of prosecution in the EU space: this is what the Member States sought when adopting this Framework Decision. Moreover, the ECJ made it clear that the list, foreseen in the Framework Decision, i.e. when the Member States must or can refuse to execute the Arrest Warrant, in principle, is finite. As a consequence, a Member State, when making the decision on the handover, can not rely on the other aspects of fundamental rights.

It must be held that the mentioned ECJ rulings became the inspiration for correction of the text of the initiative in order to increase the value of the Member States' national rights, particularly of the constitutional provisions, when applying the EIO. All the more so, the EIO is applied in the criminal matters, which undoubtedly constrain the legal situation of individuals involved. Thus, the long-lasting debates resulted in the explicit consolidation of significance of the national legislation in the text of Directive 2014/41/ES. Namely, as is consolidated in paragraph 39 of the preamble, "This Directive respects the fundamental rights and observes the principles, recognized by Article 6 of the TEU and in the Charter, notably Title VI thereof, by international law and international agreements to which the Union or all the Member States are party, including the European Convention for the Protection of Human Rights and Fundamental Freedoms, and in Member States' constitutions in their respective fields of application. <...>". This provision allows stating that, if a conflict between the constitutional provisions of the issuing State (the one, which is applying for the investigative measure) and of the executing State (the one, which is executing the investigative measure) arises, the executing State could invoke the

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1 Decision, dated the 29th of January of the year 2013 – case C-396/11 Radu.
2 Decision, dated the 26th of February of the year 2013 – case C-399/11 Melloni.
constitutional values of the national law when executing or refusing to execute the EIO. Thus, this must be considered the reasoned motive for refusal.

It must be noted that, in addition to the above-mentioned reference to the Member States’ national constitutions, Directive 2014/41/ES is full of provisions, allowing the Parties themselves to evaluate on the basis of their national regulation, whether they are to apply the measure of the requested type or the other investigative measure; besides there are a lot of provisions therein, stating that the executing State can refuse to execute the EIO. Some of them are discussed further.

Behold, it is stated in paragraph 10 of the preamble of Directive 2014/41/ES that "<...> However, the executing authority should, wherever possible, use another type of investigative measure, if the indicated measure does not exist under its national law or would not be available in a similar domestic case. <...>". Thus, in such a case, the issuing State can choose, at its sole discretion, what type of investigation to choose in a particular case (article 9 of Directive 2014/41/ES). However, the problem arises herein, i.e. one of the problems, which had to be solved by Directive 2014/41/ES, ─ the issue on admissibility of evidence. After all, as is foreseen in paragraph e of part 1 of article 5 of Directive 2014/41/ES, inter alia the description of the requested investigative measure(s) and the evidence to be obtained must be stated in the EIO. Thus, it goes without saying that the issuing State specifies such measures and methods for searching or collecting the evidence, which will ensure that such evidence will be considered admissible. Whereas when the executing authority self-dependently takes to perform the corresponding investigative actions under its own legal regulation, then the obtained evidence will loose sense for the issuing State, if it is not acknowledged as the admissible one under the national law. Certainly, the executing State is obligated to inform the issuing State about the made decisions; also formalities of execution of the other investigative measure must be discussed, seeking for resolving the differences in the national law. However, this would require the initiative and goodwill from the both Parties.

Also attention must be drawn towards the grounds for refusal to execute the EIO. Eight of them are stated in article 11 of Directive 2014/41/ES; moreover, two grounds are stated in article 10, when it is possible to apply the alternative investigative measure. Some of the grounds, stated in these articles, are sufficiently ambiguous, leaving a considerable space for the subjective assessment. Here, for example, the grounds for application of the alternative investigative measure ─ "The executing authority shall have, wherever possible, recourse to an investigative measure other than that provided for in the EIO where: <...> (b) the investigative measure, indicated in the EIO, would not be available in a similar domestic case." It follows from this provision that, if the executing State itself does not apply the investigative measure, which is requested, in this case, it is empowered to apply the alternative measure at its sole discretion. Moreover, if the alternative measure, which is requested, is not available with the executing State, then it may refuse to provide the assistance, which is requested (part 5 of article 10 of Directive 2014/41/ES). Certainly, in both cases, the executing State must inform the issuing State about its decision and must allow it to decide whether to cancel or to supplement the EIO (part 4 of article 10 of Directive 2014/41/ES).

It is true that this confrontation, as if, settled by references to the principle of mutual recognition; however, it is also not absolute. Because, in accordance of article 19 of the preamble of Directive 2014/41/ES, it is rebuttable, if there are the substantial
grounds for believing that execution of the investigative measure, indicated in the EIO, would result in a breach of the fundamental right of the person concerned and that the executing State would disregard its obligations concerning the protection of fundamental rights, recognized in the Charter, the execution of the EIO should be refused. Thus, even the principle of mutual recognition will not solve the situation, if the executing Member State discerns the committed or non-committed violations of fundamental rights.

After having reviewed the text of Directive 2014/41/ES and having found therein a number of the provisions that can be manipulated, it must be noted that this fact causes sufficiently many doubts about the smooth and effective cooperation, which was a cornerstone of this Directive. However, this issue needs to be separately and more broadly investigated. Meanwhile, when generalising the discussed issue on sovereignty of the Member States, insofar as it relates to independence, and when evaluating and making the decision on execution of the issued EIO, the conclusion is to be drawn that Directive 2014/41/ES contains a sufficient number of provisions, ensuring availability of the tools with the Member States for making an adequate decision in the particular situation.

**Protection of fundamental rights by applying the European investigation order**

EIO is aimed at ensuring fast, effective and consistent cooperation between the Member States in criminal matters. This objective, as if, presupposes the importance to foresee the appropriate procedure (when regulating application of the EIO) for issuing the EIO, collecting and transferring the data (evidence), seeking for the prompt disclose of offenses and for punishment of the guilty persons. However, the issue on the appropriate ensuring of fundamental rights naturally arises in this context.

No matter how important it would be to cherish and to improve the efficiency of international cooperation, probably, in this situation we should not follow the adage “the objective justifies all means”. Thus, it is necessary to draw attention to the extent, to which human rights are protected, i.e. the rights not only of the individuals under investigation, but also of the other individuals, who will be included into this process (for example, witnesses). There is a lot of anxiety about the insufficient ensuring of the procedural rights of individuals. All the more so, nothing is directly said about the aggrieved parties in Directive 2014/41/ES. Thus, still it is important to look at the safeguards for protection of human rights, which are consolidated in Directive 2014/41/ES itself.

The provisions for protection of human rights are notable in the preamble of the Directive under consideration; they can be grouped according to the principle, i.e. what measures for protection of human rights must be taken by the issuing State and what measures — by the executing State. When talking about the necessary preliminary steps to be taken by the issuing State so as to ensure the prevention of abuse of this

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measure and, at the same time, so as to avoid violation of the fundamental right, it is stated that "The EIO should be chosen where the execution of an investigative measure seems proportionate, adequate and applicable to the case in hand. <...>". Among other things, the issuing State is obliged to ensure the EIO full compliance with the rights, laid down in article 48 of the Charter: the presumption of innocence and the right towards defence in the criminal proceedings must be ensured because they are acknowledged, under the Charter, as fundamental rights in the sphere of criminal justice. It means that the State must objectively evaluate whether the issue of the EIO in this case is necessary, justifiable by goals of the general interest and complies with the principle of proportionality. As follows from the text of Directive 2014/41/ES, the EIO in the context of the mentioned principles must be accepted or approved namely by the judicial authorities. It must be agreed that in this case objectivity would be ensured, when evaluating the need for issuing the EIO. However, the other provision of Directive 2014/41/ES looks a bit unusual: it is therein consolidated that the prosecutor himself/herself can approve the EIO (paragraph c of article 2 of Directive 2014/41/ES). It goes without saying that thereby the longer procedure is avoided, alerts when the prosecutor issues the EIO and approves it. However, there is a serious doubt that such procedure would sufficiently ensure protection of fundamental rights. All the more so, it is exactly the issuing State, which has to evaluate whether the EIO complies with two compulsory conditions, i.e. whether issuance of the EIO is necessary and proportionate to the purpose of execution of the investigation, with taking into consideration the suspected or accused person’s rights, and whether it would be possible to execute the measure, stated in the EIO, under the same conditions in the similar national case.

When assessing the executing State's role in the EIO context, it is no less significant. Though the issuing State should recognize the EIO, transferred under this Directive, and should not insist on any additional formalities, but, as is already mentioned above, it retained the right to rebut the presumption, i.e. that the issuing State kept to the fundamental rights, acknowledged in the Directive under consideration, including the ne bis in idem principle, foreseen therein. Thus, if doubts arise in the mentioned scope, it has all the legal preconditions for refuse to satisfy the EIO submitted request for investigative actions. An important role of the executing State is being revealed, when evaluating, inter alia, whether to execute the requested actions or still to apply the alternative investigative actions: no doubt, it is based not only on the formal discrepancies of procedural actions, but also on the aspiration to ensure the smaller restriction of fundamental rights. Moreover, the executing State, as if, itself becomes naturally liable for ensuring procedural rights of the persons by executing one or other actions. It is exactly this aspect, to which much more attention is devoted.

The definite provisions, ensuring the appropriate implementation of the measure, are foreseen for separate investigative measures. There, the executing State can reject the application on handover of the temporarily detained person to the issuing State for the purpose of execution of the investigative measure not only on the grounds, foreseen in article 11 of Directive 2014/41/ES under consideration, but also in case when the detainees does not agree to it or the time for detention of the detainee may lengthen through such handover. In such a situation, it becomes clear that it will be impossible to execute the requested investigation because the detainee’s consent is necessary for this. It must be noted that the Directive does not foresee any form for
the consent to be expressed; however, it is to be considered that still it must be expressed in writing in order to avoid further irregularities in the process.

The situation with the interrogation by video-conference or by applying the other audio and video communication means is similar. Namely, if the suspect or the accused person does not agree and if execution of the investigative measure in a particular case is contrary to the fundamental principles of the executing State’s law. Besides, when applying the mentioned investigative measure, the executing State is liable for the appropriate notification of the witness or of the expert about the interrogation, for the appropriate delivery of the summons to the suspect or to the accused person by giving him/her time for the appropriate preparation for his/her defence as well as for the proper identification of the identity of interrogated persons. It is not defined what is included in the term "appropriate"; therefore, it is to be assumed that the conditions of delivery should be discussed in advance. However, the issuing State conducts the interrogation in accordance with the rules of its national law: unless, as is noted above, the executing State would notice that the fundamental principles of its law are infringed in the course of interrogation. In such a case, the executing State should take steps so that its fundamental principles would be respected. It is also important to note that, if a person refuses to testify when he must testify or gives the false evidence, so, according to the right of the State, in which the interrogation is held, the national law must be applied, as if, the interrogation would be held in accordance with the national law.

When talking about the other investigative measures, such as the information about the bank accounts and the other financial information, the information about the banking and other financial transactions, two aspects must be investigated. Firstly, these investigative measures can be taken not only against suspects or accused persons, but also against the persons, whose data are necessary when carrying out the criminal proceedings. Secondly, the executing State must be provided with the exclusively detailed and clear information, related to the desired investigative action to be performed; the reasons, justifying that the requested information is important for the respective criminal proceedings, must be stated. These provisions, as if, allow feeling a bit stricter tone and provide the executing State with the right to insist on the more precise information so that it could evaluate the adequacy of requested actions. The analogous provisions are also applied towards the investigative measures, according to which the evidence must be collected in real time, continuously and within a certain period of time.

The exclusive regulation of the covert investigation is observed. The executing State may refuse to execute these actions only on the grounds, foreseen in article 11 of Directive 2014/41/EU, which were more than once mentioned, as well as the assumption that it would not be allowed to carry out the covert investigation in the similar national case. The failure to agree on the procedure, applicable towards the covert investigation, could serve as one more ground for refusal, as the covert investigative actions must be executed in accordance with the national law and procedures of the Member State, on the territory of which they are being executed. Thus, the problem of differences in the national laws also arises in this context: the problem may cause an essential barrier for the Member States to cooperate when executing the investigative measure under consideration due to the different treatment of mentioned actions and their regulations.
It must be added to the foregoing statements that both the issuing and the executing States must ensure that the legal remedies, which can be applied when rebutting the EIO, must be at least equivalent to the legal remedies, which can be applied in the national case, when rebutting the corresponding investigative measure. The Member States together must provide the opportunity to make use of these defensive measures properly by providing such information. In such a case, though execution of the investigative measure will not be stopped, transfer of the evidence may be stopped unless the important reasons, why it is necessary to hand over the evidence immediately, would be stated in the EIO. Attention is to be drawn exclusively to the fact that the suspect or the accused person (or a lawyer on their behalf), making use of the rights, applicable to the defence under the national criminal proceedings, may apply for issuance of the EIO. It is an important provision, which allows talking about the equal rights in the proceedings. Attention is to be drawn to one more provision, which guarantees the right to rebut the EIO material basis and simultaneously limits it. Namely, the material grounds for issuing the EIO can be rebutted only after having brought an action in the issuing State, without affecting the guarantees of fundamental rights in the executing State. Thus, the implementation of such right would require an extra effort and resources from the person, when defending his/her interests.

However, it mustn’t be forgotten that one of the key provisions, guaranteeing fundamental rights, is inclusion of the earlier adopted Directives into the text of Directive 2014/41/EU as the basis, ensuring fundamental rights. Namely - Directive 2010/64/EU on the right to interpretation and translation in criminal proceedings; Directive 2012/13 / EU on the right to information in criminal proceedings; Directive 2013/48/EU on the right of access to a lawyer and the right to communicate when deprived of liberty.

As is apparent from the review of the rights, foreseen in Directive 2014/41/EU, the close mutual cooperation between the Member States is absolutely necessary, seeking for ensuring fundamental rights, when issuing and executing the investigative measures and when afterwards using them in criminal proceedings. The issuing State, when issuing the investigation order, must state how the investigative actions must be executed so as to comply with the provisions of the national law. Meanwhile, the executing State, after having detected the discrepancies with the national law, should take steps, seeking for adapting it to the legal regulation of the issuing State, so that the harm, which may be caused to protection of fundamental rights, would be avoided.

**Implementation of the European investigation order**

As the Directive under consideration must be moved into the national laws until the 22nd of May of the year 2017, it is difficult to determine how the provisions, foreseen in Directive 2014/441/EU under consideration, will be settled. However, it can be stated with certainty that the Directive contains sufficiently flexible provisions, which, unfortunately, may be interpreted by the Member States differently and, certainly, transferred.

As is stated in the Directive, one evidence obtaining system is determined under the EIO, but, despite this, it is necessary to foresee additional rules for certain types of investigative measures, such as the temporary transfer of detainees, the interrogation via the video or telephone conference.
The situation with the investigation measures, which are applied in the EIO for gathering the evidence in real time, continuously and within a certain period of time, is similar. Practical arrangements, which must be coordinated with the differences, existing between the issuing and the executing States, are inevitably necessary for such investigative measure. Particular attention must be devoted to definitions of the definite concepts because the further stage of cooperation regarding the EIO will depend exactly on their content. For example, it should be clearly defined what is considered to be “the account data” in the national law, what the scope of “the data” is. Though the content of this concept in Directive 2014/41/EU is recommendatory, they must be precisely defined in the national law.

However, attention is to be drawn to the grounds for non-recognition or non-enforcement of the EIO, which are foreseen in article 11 of Directive 2014/41/EU: actually, the Member States themselves must envisage them. Namely, the use of the investigative measure, indicated in the EIO, is restricted under the law of the executing State to a list or category of offences or to the offences, punishable by a certain threshold, which does not include the offence, covered by the EIO. It should be noted that this provision is not in conflict with Directive 2014/41/EU in Annex D, which indicates the category of offenses for which the issued EIO is to be executed. It should be noted that this provision must not be in conflict with the Annex D to Directive 2014/41/EU, in which the categories of offenses for which the issued EIO should be executed, are stated. Despite this, the Member States themselves have the possibility to foresee the circle of offenses, for which the EIO can be issued. This, in a certain sense, allows the Member States to preserve their independence and to make the decision on what offences it is still possible to cooperate under the EIO. However, apparently, the future will show whether this will not become a formal obstacle in cooperation under the EIO.

Besides, Directive 2014/41/EU obliges the Member States to appoint a competent institution(s) that would be responsible for issuing or executing the EIO as well as the central authority that would assist the competent institution and at the same time would be the body to which the EIO could be forwarded in case the issuing State wishes to make use of exactly this method of transfer. Besides, each Member State must state the language, in which the EIO would be acceptable.

Finally, the Member States should foresee what costs for execution of the EIO are considered to be extremely high. This requirement follows from the fact that each executing State bears all the costs of execution of the EIO. However, if the costs are extremely high, the executing State must inform the issuing State about it and must align the issue of coverage of the costs. Thus, the proper implementation of this rule is also significant.

It is obvious that the Member States have to lay a lot of effort in order to implement the text of Directive 2014/41/EU properly. All the more so, efficiency and effectiveness of this new form of cooperation, i.e. of the EIO, will depend exactly on this.

Conclusions

The European Investigation Order is undoubtedly an advanced international cooperation tool that provides extensive possibilities for searching, collecting and transferring the evidence, which is significant when investigating the criminal matter,
involving an international element. However, after having got familiar with the text of Directive 2014/41/ EU, still the interference, which, probably, will not allow achieving the set objectives, i.e. to cooperate efficiently and effectively without formal restrictions, is discerned in application of the European Investigation Order.

The text of Directive 2014/41/EU clearly shows what provisions have caused anxiety of the Member States about the excessive limitation of the national law’s value because a wider possibility for independent assessing of these provisions is left for the Member States. Of course, the sufficiently drastic statements of the ECJ in the mentioned Radu and Milloni cases on application of the EU law, despite more favourable regulation of fundamental rights, which exists in the Member States, produced a considerable impact upon consolidation of such provisions. This proves that the criminal justice remains an extremely sensitive sphere for the Member States.

The similar situation is also discerned with ensuring fundamental rights. Still the possibility to evaluate, whether the EIO serves as a proportionate measure and whether the issuing State has not violated the fundamental rights, is left for the executing State. Meanwhile, when taking one or another measure, the State reserves the right for itself to take measures so as not to violate its own principles when realising the investigative action. Thus, on the one hand, the investigative actions, as if, should be executed according to the rules of the issuing State, on the other hand, the taken measures will inevitably have to be adapted to the executing State’s law regulation. So, the issue, whether the sufficient protection of fundamental rights will be preserved as a result of such adaptation, remains open.

Despite the above mentioned concerns, it is necessary to adapt precisely the provisions of Directive 2014/41/EU in the national legal systems by foreseeing the precise and clear EIO regulation. It must be noted in this context that, probably, the Member States must foresee at the EU level at least the recommendatory provisions, acceptable for the Parties, which would help to avoid the problems due to differences in the national legal systems, when cooperating under the EIO.

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IDENTIFICATION OF THE SCOPE OF EXPECTED CHANGES IN NATIONAL STRATEGY DOCUMENTS: CASE STUDY OF LITHUANIA INNOVATION STRATEGY 2010-2020

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Abstract

**Purpose.** The article deals with the problems of identifying the future that is decoded in national strategic documents. Due to complexity of their writing process often public sector strategies include abstract and vague goals and objectives. They represent different, sometimes conflicting interpretations and do not indicate precisely desired changes in future. In order to understand what kind of future is presented in strategic document, the document should be analyzed through lens of different perceptions.

**Design/methodology/approach.** The main research problem is the multiplicity and ambiguity of public strategic documents, in this particular study case – "Lithuanian Innovation Strategy 2010-2020". The article attempts to identify the scope of desired changes in "Lithuanian Innovation Strategy 2010-2020" by using method – Causal layered analysis (supported by narrative foresight).

**Research limitations/implications.** The Causal layered analysis has its own drawbacks. During implementation of this method there is a need to identify and create idealistic definitions of problems and solutions for each perceptional layer in order to be able to assign tasks and objectives of the strategy to the proper layer. Preparation of those idealistic definitions depends on the procedure, by which those layers are described. Therefore, in order to have a higher degree of objectivity, those layers have to be identified at least by the several experts in that field.

**Findings.** Analysis of Lithuanian Innovation Strategy for 2010-2020 showed that the Causal layered analysis can be used to identify scope of expected changes. This method of analysis overcomes the ambiguity of public strategy documents by attaching goals and tasks to different layers of perception. Such breakdown of the goals into different layers of perception enables research to evaluate and measure the scope of envisioned changes.

**Practical implications.** The Causal layered analysis gives an instrument for the examination of political documents that are aimed at the future. It gives a theoretical structure, which can decode political documents and give insights about the scope of expected changes.

**Originality/Value.** This research gives not only insights about the scope of desired changes that are anticipated in objectives and tasks of Innovation strategy of Lithuania, but it is one of the first attempts to use Causal layered analysis in Lithuanian context.

**Keywords:** Causal layered analysis; innovation strategy; strategic documents; goal ambiguity.

**Research type:** case study.
Introduction

Each strategic document is an important planning tool for government to govern the development of the nation. All documents that are directed at the future, give a certain vision of desired or expected changes. If vision usually should be that element of strategy gives a view of the desired changes. Abstract visions as "being competitive or innovative nation" or visions based on comparisons as "being better than other nations" cannot explain how radical that goal is, the scope of radicality can be detailed through the strategic objectives and tasks, which are later used to achieve or at least to move towards the vision. Strategic documents in public sector has to cope with even high degree of multiplicity and abstractions, which are a result of several interconnected elements: the longer time horizon, the uniqueness of public sector, the impossibility to translate outcome and/or output into a single parameter (like a profit, which is used in the private sector) and variety of stakeholders (with sometimes conflicting interests).

Innovation development becomes increasingly important for Lithuania, because Lithuania is becoming less able to compete by lower wages. Strategic planning of innovational development becomes essential. Strategy documents used in the innovational development face greater uncertainty compared to other state policies: innovations include elements that do not have a numerical expression, their value can might be seen only in the future; they belong to the different economic sectors with different innovation potential. This uncertainty weakens possibilities to create universal innovation strategies, complicates the selection of objectives and leads to a creation of ambiguous goals and objectives. The same challenges are met in "Lithuanian Innovation Strategy 2010-2020": what kind of future does Lithuanian innovation strategy with its numerous and different objectives and tasks presents? Is it incremental, evolutional strategy or it is aimed at more radical and revolutionary goals?

The aim of research is to identify the scope of desired changes that are coded in "Lithuanian Innovation Strategy 2010-2020".

The research problem is the multiplicity and vagueness of public sector strategic documents that does not allow identifying the scope of changes.


Steps of the research:
1. Analysis of strategy-making in public sector.
2. Preparation of research methodology on how to identify the scope of desired changes that are encoded in innovation strategy.
3. Case study of "Lithuanian Innovation Strategy 2010-2020".
   Case study follows such methodological logic:
   1. Grouping objectives and tasks of innovation strategy according to layers of perception (Causal layered analysis);
   2. Identification of the most dominant layers of perception that innovation strategy is based on;
   3. Presenting narrative of the scope of desired changes.

The theoretical grounds for strategy assessment

First of all innovation strategy is a document that is created by public institution and usually public documents are mostly written by people low in hierarch (at least
first input) for people high in hierarchy. In order to achieve a higher position, the writer has to make sure that he never compromises his superiors (Janssen, 2001). Transparent documents with controversial statements (for example, evident support to one social group and marginalization of others) can provoke marginalized groups and put their superiors or members of government in negative light. Therefore documents go through numerous checks in the hierarchy. At every level, chefs, supervisors, managers and directors add little things, cut out other, make small amendments or suggest major changes. After few weeks and months of the document recycling nobody would recognize the original text (Janssen, 2001). Moreover each institution has its own writing style and writer is required to follow the house style of the institution (J. Renkema, 2001). There are codes, wordings that are used and in some case understandable only in the context of institution. In the end, it is created an impersonal, specific (from style point of view) document for which no particular writer could feel any personal commitment or responsibility.

The main reader of public documents is elected representatives in case of democracy or ruling regime in general. The request or initiative to create such document comes from them. In order to be successful in this field, the writer needs to have ability to write lengthy complex and rather "vague" texts that contain compromises, especially because all the members – of different political persuasion – have to find something of their liking somewhere in the document (Janssen, 2001). It especially relevant in case of democracy as parliaments or city councils can represent broad scope of political ideologies while public institution has to maintain its neutrality.

Vagueness in legal document is usually seen in negative light as it contradicts the very idea of legal normativity. However, vagueness seems to be an intrinsic element of the legal field, because it can be used to express extremely generic concepts and therefore be applied to many different situations (G. S. di Carlo 2013). Indeterminacy and vagueness are seen as inherent characteristics of law for reasons of efficiency and in order to achieve a maximum degree of all-inclusiveness. Thus, interpretation is necessarily a part of the rule of law, and necessarily involves someone interpreting – hence the dilemma: it will be the rule of men, not strictly of law. (Bhatia, J. Engberg, M. Gotti, D. Heller, 2005). Therefore a relative level of vagueness (depending of sphere of regulation) in public documents should be not only accepted, but welcomed.

Because of the combination of these elements: institution context, hierarchy, neutrality requirement and intersection with democratically elected representatives and field of impact, the public document can not avoid vagueness (especially when its field of impact is so broad as in case of future orientated strategy document). There a lot of different types how to analyse the public documents, but typically it is possible to reduce it to communication model (sender-text-receiver). It is a convenient model, but has its own drawbacks. (1) many text analyses are still fairly unsystematic and get no further than vague criteria for text quality; (2) it often unclear how readers would would have responded in reality; (3) Research results can often not directly be applied to communication management (J. Renkema, 2001). Usually conclusions of such research are suggestions to improve writing quality of text itself. The problem of vagueness is not related to the writers' ability to write properly, but to earlier mentioned institutional constrains. Therefore answer lies in receiver's (reader's) ability to decode ambiguous and vague text.
The assessment of public sector strategies is a complex process: the results of strategy can be seen only in the future, the specifics of public sector makes assessment more difficult, because its success cannot be measured purely in terms of financial benefit, as it is done in most cases of the private sector. There are several main differences between the public and private sector in field of strategy-making:

- Objectives, targets in public organizations are defined less than in their equivalents from private sector.
- Relatively greater openness in decision-making in the public sector creates bigger constraints and time losses than in private sector.
- Strategies in public sector are generally exposed to a larger number of interest groups in a comparison with private sector.
- Strategies in public sectors are affected by political cycles (elections).
- The strategy supporting coalitions in public organizations are not so stable and can disintegrate during its implementation (Baile, 1998).

Because of these differences, assessment of the strategies in public sector is a far more complicated process than ones from private sector. Strategy assessment can sort out according to certain elements: quality of written content, quality of selected measures, quality of allocated resources and et cetera. According to R. P. Rumelt (1979) the assessment of strategy can be carried out with the use of four tests: goals' consistency test (Strategy should be rejected, if the goals and objectives are not consistent with each other); guidance test (strategy must be rejected if it is not directed at the problem areas that are relevant to a given context); competence test (strategy must be rejected if the problems that it covers, cannot be solved on the basis of available resources or competencies); practicality test (strategy must be rejected if the selected policy measures cannot be implemented due to the inaccessibility of resources or available knowledge indicates that the objectives cannot be achieved by a selected set of policy measures). Identification of the scope of expected changes can be in part attributed to tests of goals' consistency and guidance.

Creating a consistent and well-targeted strategy is a difficult, because strategy often tries to fulfill expectations of the different interest groups, the coalition partners and various other social groups. This leads to such strategy formulation, which satisfies several interested groups at once, but it leaves room for different interpretations of the strategy. This variety of possible ways to understand the strategy means that there can exist competing and conflicting interpretations. Goals of the strategy lose their clear meaning and become ambiguous when strategy begins to encompass different interpretations. There are several dimensions of strategy ambiguity:

- **Mission (vision) comprehension ambiguity** refers to the level of interpretive leeway that an organizational mission allows in comprehending, explaining, and communicating the organizational mission. Organizational leaders often promulgate mission statements to enhance the organization's legitimacy, and in turn to enhance members' commitment and "sense of mission". The level of mission comprehension ambiguity depends on understandability of mission formulation. When the mission statements are easier to understand, explain, and communicate, there will be less leeway for interpretation and more shared agreement about its meaning (Chun, Rainey, 2005).
- **Directive goal ambiguity** refers to the amount of interpretive leeway available in translating an organization's mission or general goals into directives and guidelines
for specific actions that should be taken to accomplish the mission. This uncertainty often comes from the ambiguity of mission (vision).

- **Evaluative goal ambiguity** refers to the level of interpretive leeway that strategy allows in evaluation of the achievements. Some organizations can express their performance targets in an objective and measurable manner that allows a minimal level of interpretive leeway. Other organizations, especially in public sector, often have no choice other than to describe their performance targets in a subjective and descriptive manner, which leaves a lot of room for interpretations in evaluation, whether or not the performance targets are achieved. Without objective and quantitative performance indicators organizations may try to use workload or output indicators (how many working hours were used and similar indicators) rather than outcome indicators in performance evaluation.

- **Priority goal ambiguity** refers to the level of interpretive leeway in decisions on priorities among multiple goals of the strategy. Indication of priorities usually means to be able to make decisions about which goals should take precedence over others at a given time, or to form a hierarchy in which goals are vertically arranged through means-ends relationships. The existence of multiple goals without any hierarchical arrangement and prioritization leaves much room for interpretation about which goals should have priority (Chun, Rainey, 2005).

Consistency and purposefulness of strategy objectives can be identified only after reducing strategy vagueness and ambiguity and. Objectives in strategy documents usually are different in scale, depth and complexity, but can be presented in text as equal, thereby it increases uncertainty and questions about what strategy aims at. As it was demonstrated above strategy writing (as almost in all cases of preparation of bigger public policy documents) goes through several levels of hierarchy and has to comply with several, in some case conflicting interests. The one of possible ways to deals with these challenges is to split strategy elements according to the scope of expected change. By doing this, it is possible to identify the main underlying guidelines of the projected development in strategy. Causal layered Analysis is the method that is able to reduce this uncertainty and give insights about the scope of expected changes embodied in strategy document.

**Methodology for identifying the scope of desired change**

The method, which is used for identification of the level of the desired change and for reduction of ambiguity, is causal layered analysis (CLA). Causal layered analysis for its focus on the future is usually assigned to methods of future studies. The scope of desired change depends on identification and description of the (social) problem/phenomenon and way to solve it. The (social) problems and their solutions within the CLA theoretical framework are identified through 4 levels of perception (table 1 gives a practical example of the use of CLA in case of traffic jams):

- First level is called "litany". This level refers to the quantitative trends, problems, which usually can be easily identified in the media and is often used for political purposes. In this level of perception problems are treated separately, usually isolated from other phenomena.

- The second level is associated with social causes, economic and political factors. Level is used for quantitative data and academic analysis. The data might be
questioned, but the paradigm that frames understanding of the phenomenon is not challenged.

- The third level is related to analysis of worldview/discourse grounded in society. At this level the social, linguistic and cultural structures (discourses) independent from the actors are analyzed. Based on different discourses different it can be created different possible stories, scenarios about the causes of the problem. This calls into question the foundation, which determines how the problem is understood and by which variables it is described.

- The fourth layer deals with a metaphor or myth. It is the collective archetypes, the subconsciousness, and emotional dimensions. The goal at this level is to question the fundamental images of phenomena (Inayatullah, 2005).

### Table 1. Causes of traffic jam and air pollution according to air pollution

<table>
<thead>
<tr>
<th>CLA levels</th>
<th>Causes for traffic jam and air pollution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Litany</td>
<td>Lack of roads and buses.</td>
</tr>
<tr>
<td>Social causes</td>
<td>Inappropriate urban planning and underdeveloped public transport system.</td>
</tr>
<tr>
<td>Culture/ discourse</td>
<td>Cause for traffic jam and air pollution – discourse about modernist centralized city and its dwellers (usual elements of city discourse: &quot;speed of city life&quot; – car as a mean to cope with it; &quot;wealth accumulation and competition&quot; – car as symbol of success and independence).</td>
</tr>
<tr>
<td>Myth</td>
<td>Cause for traffic jam and air pollution – the belief that the bigger the city, the better chances (it encourages people to move to the big cities and the increase the population of residents and the number of cars).</td>
</tr>
</tbody>
</table>

Source: Inayatullah, 2008

Causal layered analysis of allows researchers to get out of the traditional and conventional scientific frames while investigating the causes of social phenomena. This method can change the levels of analysis and opens different approaches to the same phenomenon herewith enriches the analysis of the phenomenon. It can be also used in analysis of policy documents, because they deal with one or other social phenomenon (social problem) and gives measures and instruments how to solve the phenomenon. By doing that, political document gives a certain view of phenomenon that can be reduced into CLA levels of perception. If document is based on higher levels of CLA perceptions, the scope of that is more fundamental than in case of solutions, which are based on levels of litany or social causes.

In case of strategies there is presented the phenomenon (in this case, innovation), the desired change (vision, goals) and actions (tasks), which would lead to desired changes. There is a risk that the actions and the expected change are on different perceptual levels: strategy offers solutions of evolutionary nature (1-2 levels), but the desired changes are revolutionary (3-4 levels). In order to identify the level of desired changes, strategy goals and actions will be split in accordance with CLA levels of perception. The ideal types of problems and solutions regarding innovation are created so as goals and objectives could be assigned to the proper level of CLA:

1. Litany. The problem – the lack of investment in innovative activities. Solution – to increase size of investments in R&D and provide financial support for innovative companies.
2. Social (systemic) causes. The problem – the lack of effective innovation network. Solution – creation of national innovation system and strengthening competence of participants in network.

3. Culture (discourse). The problem – ideological division between the science and business. The solution – a promotion of new approach to scientific-innovative activities.

4. Myth. The problem – the attitude that only business can innovate. Solutions – promoting overall creativity in society.

This will allow identifying dominant sets of goals and actions and determining the level of desired changes. The study will be carried out according to the scheme (Fig. 1). The result will be given in percentages (Total and separately between goals and tasks/actions) of used levels of perception in document.

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**Figure 1. Method for identifying the scope of desired change in innovation strategy of Lithuania**

CLA is impacted by the new tendencies in foresight analysis called as narrative foresight. Narrative foresight moves futures thinking from a focus on new technologies and generally to the question of what’s next, to an exploration of the worldviews and myths that underlie possible, probable and preferred futures (Milojevic, S. Inayatullaha, 2015). While CLA includes and treats equally several levels of perception, the narrative foresight aims at the deepest levels. Narrative foresight consists of: (1) the deconstruction of outdated narratives, including the used futures of gender relationships; (2) the writing of new endings - of as many novel alternatives as possible; (3) dialogue about many possibilities and personal and group decision as to which alternative is desired and prefered; and lastly (4) actions in the present that are oriented toward the creation of preferred futures (Milojevic, S. Inayatullaha, 2015). The aim of article is to identify the scope of expected changes that are encoded in strategy document (not create a new one), therefore only deconstruction part (1) will be covered in analysis of Innovation strategy of Lithuania 2010-2020. Deconstruction will be based on evaluation part of strategy, because it frames narrative and describes what is success and failure.
Analysis of Innovation strategy of Lithuania 2010-2020

While performing content analysis, it is necessary to distinguish the main strategy aims. Lithuanian Innovation Strategy 2010-2020 vision – "the basis of the Lithuanian economy is the production of high added value products and services; its competitiveness in the global market will be determined by environment favorable for innovative business; the system of education, science, research and development, interaction with business will help to educate a creative society and will create high-level knowledge base for novelties" (Lietuvos Respublikos Vyriausybė, 2010). The objective of the strategy is "to build a creative society and create the conditions for the development of entrepreneurship and innovation" (Lietuvos Respublikos Vyriausybė, 2010). It is worth noting that both the strategy's vision and objective distinguishes creation of creative society, which shows a deeper approach to the innovative development. Creative society formation as a response to the lack of innovation is related to changes in the worldview level, since innovation is no longer regarded only as economic activity, but also as a part of broader phenomenon - creativity. The second element is – the formation of the appropriate environment for the development of entrepreneurship and innovation. Solution for lack of innovative activities through improvement of conditions for innovation and entrepreneurship should be regarded as 2 level of CLA, because it is based on the perception that innovation is a dependent variable of the environment. By ensuring appropriate environment (appropriate taxes, investments, cooperation in the system), innovation growth can be expected.

Solutions and problems of strategy were divided according to the PSA ideal levels of perception (Table 2). Problem field is composed of elements that were identified as a weakness in the analysis of strengths, weaknesses, opportunities, threats (SWOT hereinafter) and the problems that were identified separately in the other parts of strategy (they are bolded in the table). Threats from SWOT analysis were not included in the research, because they are related to external factors, so solutions to these threats can be only indirect.

Table 2. Matrix of problems and solutions presented in Innovation strategy of Lithuania 2010-2020 according to causal layered analysis

<table>
<thead>
<tr>
<th>Ideal descriptions of problems according to CLA levels</th>
<th>Ideal descriptions of solutions according to CLA levels</th>
<th>Problems identified Lithuanian Innovation Strategy (Lietuvos Respublikos Vyriausybė, 2010), Nutarimas dėl Lietuvos inovacijų 2010–2020 metų strategijos</th>
<th>Solutions proposed in Lithuanian Innovation Strategy (Lietuvos Respublikos Vyriausybė, 2010), Nutarimas dėl Lietuvos inovacijų 2010–2020 metų strategijos</th>
</tr>
</thead>
<tbody>
<tr>
<td>the lack of investment in innovative activities (level 1)</td>
<td>The increase of investments in R&amp;D and financial support for innovative companies.</td>
<td>• Too low quality of human resources and material facilities: Lithuania lags behind the average of EU countries According to security indicators of industrial property: There are too few R&amp;D employees in business, especially in high-technology industry: Business sector invests in R&amp;D too little: Few companies develop innovation; their research and abilities of (technological) development and innovation are not sufficient.</td>
<td>• to establish conditions to commercialize research: to create necessary infrastructure (technology transfer center) and legal mechanisms: to increase access of small and medium-sized enterprises to various funding sources: to promote innovation oriented towards demand and consumers’ needs: to encourage enterprises, having considerable growth potential: to promote foreign direct investment in high added value products and services:</td>
</tr>
<tr>
<td>Ideal descriptions of problems according to CLA levels</td>
<td>Ideal descriptions of solutions according to CLA levels</td>
<td>Problems identified Lithuanian Innovation Strategy (Lietuvos Respublikos Vyriausybė (2010), Nutarimas dėl Lietuvos inovacijų 2010–2020 metų strategijos)</td>
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</table>
| the lack of effective innovation network (level 2)    | Creation of national innovation system and strengthening competence of participants in network. | • Innovation system is fragmented: internal relations among participants of innovation system are poor.   
• Hierarchical closeness of higher education and research institutions, unattractive structure of salaries and few career possibilities do not allow talented people to join these institutions and encourage brain drain.   
• Education system (secondary schools and universities) is fragmented and quality of studies does not correspond to economy and society needs of today.   
• Inter-institutional activities aimed at development of science and business cooperation and implementation of purposeful innovation policy are poorly coordinated; there is no institution that is directly responsible for development of science and business cooperation. | • to strengthen knowledge base and develop integrated science, studies and business centers (valleys) of the international level;   
• to establish Agency for Science, Innovation and Technology, the institutional structure, responsible for business and science cooperation;   
• to ensure inter-institutional coordination when implementing the state innovation strategy;   
• to participate in the implementation of international initiatives (Strategy for the Baltic Sea Region, Knowledge and Innovation Communities created by European Institute of Innovation and Technology, activities of European Space Agency and others);   
• to promote business networking and joining international innovation networks;   
• to participate actively in the creation of the European Research Area;   
• to develop export of high added value products and services and business internationalisation;   
• to ensure periodic (every two years) international assessment of Lithuanian innovation system and management reforms of public sector. |
| ideological division between the science and business (level 3) | Promotion of new approach to scientific-innovative activities. | • A lack of systematic approach to innovation, poor culture of inter-institutional cooperation and a lack of cooperation traditions between business and science. | • to promote entrepreneurship of education of various levels and private sectors;   
• having reorganized research institutes, strengthen their cooperation with business;   
• to strengthen interaction among science, studies and business;   
• to develop effective mechanisms of business and science cooperation and schemes for support of joint business and science projects; |
| the attitude that only business can innovate (level 4) | Promotion of overall creativity in society. | • A lack of creativity and entrepreneurship in private and public sectors. | • create education and higher education system which promotes creativity and innovation;   
• to promote life-long learning;   
• to promote technological, non-technological, social and public innovation; |
According to the quantitative analysis, goals and actions can be divided in such order: systemic causes (35%), litany (30%), discourse (20%) and myth (15%). The first two elements that make up to 65% of the Lithuanian strategy are related to the exploitation of current conditions, resources and structures in order to accelerate the innovation progress. When state sets and implements such objectives, it complies with existing perceptual frames of innovation process. Such solutions are characterized by the evolutionary nature, copying of good practice copying and using quantitative indicators for measurement of success. Cultural and perceptual elements that make up to 35% of the tasks and objectives are related to the more radical and more fundamental changes. When State chooses to realize such strategy, it aims at revolutionary change of situation, which is based on a new reinterpretation of situation. It is difficult to assess the success of implementation of such type goals in quantitative terms, as they are related to qualitative changes, which cannot be captured by quantitative indicators.

Narrative of Lithuanian innovational development can be extracted from the assessment criteria, because it frames our understanding and gives measurements for success or failure. Evaluation of the strategy is not based on measurable goals (as it is given above goals are quite vague and complicated – example of the vision). The main source for evaluation is European Union Innovation Scoreboard and it is sought that Lithuanian summary innovation index would reach the European average in 2020 (Lietuvos Respublikos Vyriausybė, 2010). The use of this criterion shows several things: relativistic and quantitative approach based on a view from outside. Success can be measured in comparison with other countries and by the outside source. Narrative behind that is an understanding of Lithuania as lagging behind the more developed EU countries and goal for Lithuania according to chosen assessment is to become at least a "normal", average EU country in sphere of innovation. What is important, the chosen assessment shows that this pursuit for this "averageness" is not pursuit of innovativeness in the strict sense, because Lithuania can achieve goal (average score in Scoreboard) not only by the growth of Lithuanian innovation capacities, but the decline of these capacities in other EU countries. The "average result" does not necessary show if country is innovative, it can highly be dependent on results in EU major innovators. The "average result" shows that country is in "normal" state in comparison to other EU countries. To sum up the main principal of developmental narrative is becoming a "normal" EU country, which "normality" is recognized by other countries.

Conclusions

Innovation Strategy of Lithuania 2010-2020 has the same challenges as other policy documents. Elements of strategy are vague and in some cases too intricate. However the use of causal layered analysis of Innovation Strategy of Lithuania 2010-2020 showed that it can be used to identify the level of desired change. This method of analysis overcomes the multiplicity and ambiguity of strategy text by reducing goals and tasks into the perceptual groups of casual layered. Such breakdown of goals allows to identify the scope of changes that was envisioned strategy. The most tasks and goals that are described in strategy can be assigned to first (litany) or second (systemic causes) levels of causal layered analysis. Tasks and goals related to more radical perceptual levels (discourse and myth) create a smaller fraction of the text.
Therefore, the desired changes of Lithuanian innovation strategy can be described as evolutionary, based on the exploitation of existing resources and realization of the standard ideas about innovation. Such evolutionary approach to innovation development is supported by narrative that can be extracted from the choice of assessment criteria. Firstly, assessment uses EU innovation scorecards with sophisticated statistical indicators, but they are based on the current understanding of innovation processes. Secondly, success in assessment is described as achievement of an average result in summary innovation index. It highlights the narrative importance to be considered by others as "normal" EU nations.

The method has some drawbacks. During research, it was found that there is a need to identify ideal definitions of problems and solutions in order to be able to assign objectives and tasks from strategy to the proper levels of CLA. Despite clear frames of the analysis, the creation of those ideal elements is not sufficiently protected from subjective evaluation. In order to achieve the higher degree of objectivity, these ideal solutions and problems should be identified with the inclusion of the substantial number of the experts.

References


SOCIAL ENTERPRISES: DOES THE LEGAL FORM MATTER?

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Abstract

**Purpose.** The purpose of this paper is to try to answer the question what are the main legal approaches to facilitate the creation of social enterprises? What kind of advantages or disadvantages have these models?

**Design/methodology/approach.** Research focuses on the analytical review of the legal acts and previous insights of researchers. Theoretically this paper employs the philosophical doctrine of the realism. In the social world objects have varying probabilities of coming into existence and causing new objects, which connect into identifiable structures. We investigate the social world in its context, which counts as evidence, concepts, measures, etc. (Letherby et all, 2013). This research also uses the qualitative research methods, such as textual analysis (Lockyer, 2008), comparative method (Vogt, 2005), and generalization (Williams, 2004).

**Findings.** The main scenarios in creating the legal framework for social enterprises are whether the adaptation of existing legal forms or creation of new legal forms taking into account the specific features of social enterprises. Some law makers react in different way by creating the so called social enterprise legal status, or legal qualification. However, the ultimate European legal form of social enterprise is particularly difficult to develop considering very different traditions of the development of social entrepreneurship in different countries.

**Research limitations/implications.** This is a general review of the EU legislation regulating this area, and of social entrepreneurship legal regulation in the selected EU Member States and the USA, which possibly could stimulate the further research and discussion.

**Practical implications.** This research will contribute to the deeper analysis of the legislation in this area and more defined legal categories and positioning of social entrepreneurship in the legal systems of the EU Member States. The results of the research can be useful improving the national legal framework on social entrepreneurship, which is clearly insufficient in nowadays stage of rapid popularization of social entrepreneurship in Lithuania.

**Originality/Value.** This research looks for the legal preconditions of social entrepreneurship in the EU legislation and uses the comparative method to identify and examine the most common legal framework for social enterprises in the EU Member States.

**Keywords:** social enterprise; social enterprise law; corporate form; certification.

**Research type:** general review.
Introduction

Social enterprises (or social entrepreneurship in general) aims to be the nowadays alternative for the traditional business models or the corporate social responsibility in pursue of social mission and sustainable profit-generating activity. Moreover, social entrepreneurship is not only about to facilitate its social mission, but its initiatives create new forms of business and society partnership, from which benefit not only target social groups, but also the whole society.

In order to use the opportunities of social entrepreneurship, particular countries in the European Union have created, and some are just developing, the legal frameworks for this form of economic activity. Though, the existing legal forms of social enterprises in the EU member states vary from state to state. The current EU legislation also doesn’t form any legal framework for social enterprises.

The justification of the concept of social entrepreneurship and definition of its legal framework and regulatory characteristics are important for every state individually. Lithuania is also starting its way toward the national definition of the social entrepreneurship and its legal framework. In this step different legal approaches should be considered to define what kind of legal forms are available to facilitate the legal concept of social enterprises.

However, many countries still lack an enabling framework for encouraging the creation and development of social enterprises. However, there is no, and can’t be the ideal type of social enterprise.

The European Commission defines a social enterprise as an operator in the social economy whose main objective is to have a social impact rather than make a profit for its owners or shareholders. It operates by providing goods and services for the market in an entrepreneurial and innovative fashion and uses its profits primarily to achieve social objectives. It is managed in an open and responsible manner and, in particular, involves employees, consumers and stakeholders affected by its commercial activities.¹

It should be noted that the Communication of the Commission doesn’t emphasize any specific form of legal entity as a social enterprise.

In the EU Member States situation differs from state to state. But some patterns can be distinguished. The researchers who concentrate on the investigation of social enterprises all over the Europe and beyond highlight that social enterprise may take a number of different organizational forms: non-profits, partnerships, foundations and other (Kerlin, 2006).

So far it is up to the particular country to decide whether the social enterprise is supposed to obtain special legal form or not. The main goal of this research is to define what are the main legal approaches to facilitate the creation of social enterprises? What kind of advantages or disadvantages have these models? In order to answer these questions, we investigate some recent legal initiatives in the selected EU countries and the United States of America.

The researchers usually deal with the problems of social entrepreneurship through the prism of economics. Individually it can be mentioned such authors as Austin et al (2006), Lasprogata and Cotten (2003), Baq and Janssen (2011), etc., whose insights can be valuable for the further research of this topic.

¹ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Social Business Initiative. COM (2011) 682 final.
The Main Concepts of Legal Framework

We already mentioned that the European Commission doesn’t emphasize any specific form of legal entity as a social enterprise. However, some countries have chosen to adopt the legislation defining specific legal form of the social enterprise. We have to mention that here we speak about the social enterprises in broader sense of their definition in contrary to the social enterprises that in some countries are linked only to employment of disadvantaged people or people from specific socially vulnerable groups (so called work integration social enterprises). For example, this kind of social enterprises is defined by the Law on Social Enterprises of the Republic of Lithuania.¹

But recently some progress was done also in Lithuanian national legislation defining the social entrepreneurship. In 2015 Lithuanian Ministry of Economy adopted the Concept of the Social Entrepreneurship, which aims to define the main principles of the social entrepreneurship, identify the problematic areas and determine general tasks to foster the development of the social entrepreneurship. The document doesn’t define any specific legal form of the social enterprise yet, but it aims to evaluate the best practices of other European countries in legislation of the social entrepreneurship.²

Lithuanian model of the legal framework for the social enterprises is yet to be defined. Some other countries have more advanced legal frameworks that basically can be divided in the two broad categories (EC, 2015). The main models are:

1. Adaptation of existing legal forms or creation of new legal forms taking into account the specific features of social enterprises;
2. Creation of a social enterprise legal status, or legal qualification.

In the first category some countries have created new legal forms for social enterprise by adapting or modifying existing legal forms. In some Member States of the EU a separate new legal form for social enterprise has been created by adapting the cooperative legal form (e. g. in France, Greece, Italy, and Poland). Some other countries recognize social cooperatives in their existing legal form covering cooperatives in general (e. g. in Portugal, Spain, etc.). The United Kingdom developed a legal form (Community Interest Company) for use by social enterprises only (EC, 2015).

In the second category some countries have introduced the so called social enterprise legal status. The idea of this concept is that the legal status of social enterprise can be adopted by different types of organizations, but these organizations have to meet the pre-defined criteria (e. g. in Denmark, Belgium, etc.). The legal status can be obtained by the most of traditional organizations: cooperatives (traditional and social), investor-owned companies (share companies), associations, or foundations (EC, 2015).

To be more objective, it is useful for this research to have a comparison with some beyond-EU legislation. Recently many states of the USA have introduced three new

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¹ The Law on Social Enterprises of the Republic of Lithuania links social enterprises only with the employment of persons from specific social groups who have lost their professional and general capacity for work, are economically inactive and are unable to compete in the labor market under equal conditions, to promote the return of these persons to the labor market, their social integration as well as to reduce social exclusion. See: Law on Social Enterprises of the Republic of Lithuania. Official Gazette. 2004, No. 96-3519.
² Concept of the Social Entrepreneurship adopted by the order of the Minister of Economy of the Republic of Lithuania. 2015, No. 4-207.
legal structures: the low-income limited liability company, the benefit corporation and the flexible purpose corporation.

As emphasized by some researchers (Urich, 2013), the low-income limited liability company offers changes to the limited liability company format in an effort to create small business interested in social good. The benefit corporation and flexible purpose corporation offer changes to corporate law shifting the primary purpose of the business to serve the needs of shareholders and permitting social and environmental objectives.

Some authors stress that social entrepreneurship can be defined as the so called for-profit charity and point out that historically philanthropic activities and legal structures are largely unrecognized by the legal literature. Today's social changes influence development of the legal environment. It leads to development of new legal entities like for-profit charitable enterprises. The science has to provide adequate attention to the investigation of this phenomenon (Rana, 2013).

Bacq and Janssen emphasize that the social entrepreneurship organization can adopt either a non-profit or a for-profit organizational form and should not be limited to any specific legal form. This perspective results in the emergence of various hybrid organizational forms: independent, they can generate profit, employ people and hire volunteers. This new legal form represents a hybrid organizational type, partly non-profit and partly limited company (Bacq and Janssen, 2011). Many European countries have introduced such special legal entities, but despite all these newly created legal forms across Europe, there are legal forms that have existed for a long time, namely associations, co-operatives or traditional business forms (some examples are investigated in this paper later on).

Dedicated Forms of Legal Entities or a Social Enterprise Legal Status: Who Really Wins?

Whether it is a dedicated legal form, or a legal status, it can be noticed that in any way the legal recognition of social enterprises is essential in every country. The legal forms or statuses allow to recognize the specificity of social enterprise and contributes to giving them a clear identity. Moreover, the definition of the identity of social enterprise allows policy makers to design and implement specific public policies for social enterprises, such as measures under tax and public procurement law. It also helps to prevent misuse of the social enterprise status and allows for social investors to identify the potential investees (EC, 2015).

But which way (legal form or legal status) is more beneficial for social enterprises and society? A new corporate form can be introduced as an entirely new form, unconnected with existing company law, or as new category within the existing regulation with a few special rules or exemptions. If the new corporate form is launched, there will be inevitable costs for companies that would like to switch to new legal form. Such situation could be avoided or minimized by introducing a new category of existing corporate forms without launching a new legal form (Sorensen and Neville, 2014).

This approach has been used in the United States for the benefit corporations, and in the United Kingdom by the community interest companies. The benefit corporation in the US is a class of corporation which legally requires companies to provide a general benefit to society and stakeholders (employees, communities and the
environment). It is a for-profit business, that aims to create a material positive impact on society and the environment.

Urich (2013) emphasizes that as the society modifies its values, the legal system must adapt and accommodate the new perspectives and the American legal system responds to these changes. In the United Kingdom the community interest company is a limited company, which activities are being carried on for the benefit of the community.\textsuperscript{1} In both cases, if this option is chosen, undertakings of an existing legal form can be re-registered as a social enterprise without incurring significant costs.

France in 2014 provided a combined model, allowing traditional corporate entities and new enterprises to become social enterprises. The French Law on Social and Solidarity Economy (2014) acknowledges both the historical social economy entities (cooperatives, associations, mutuals and foundations) and the newly created enterprises with a social goal (Kolosy, 2014).

Another method how a company can obtain a social enterprise status is through a dedicated certification scheme. In Denmark a law on registered social enterprises was adopted by the Government in June 2014. The law aims to introduce a registration system for social enterprises that can provide the basis for a common identity. The registration system will allow enterprises that meet certain standards for their operation and transparency to demonstrate their social characteristics to authorities, business partners and customers through an exclusive right to use the term “registered social enterprise”. More than 14 different legal forms are currently being used by social enterprises in Denmark. The majority of social enterprises are established as associations, foundations or companies limited by shares. All of them will be able to apply for a registered social enterprise status (EC, 2014).

Quite similar example can be presented from Belgium social enterprise legal framework. The Belgian Parliament approved a law creating the legal status of a “social purpose company” back in 1995. The Law sets out the conditions that an organization must meet in order to obtain this status. But there is no specific legal form designed exclusively for social enterprise. Social enterprises adopt a variety of legal forms in Belgium, the most common being a non-profit organization (EC, 2014).

From the point of view of the legal realism, such situation illustrates that the social world objects have varying probabilities of coming into existence and causing new objects. As the assumption of realism we understand the idea that things in the world happen regardless of whether we observe them, or even know them. The starting point of the realist account of law is its critique of a purely doctrinal understanding of law. In the above mentioned examples we see that law is a going institution (or set of institutions) caused by the tensions: between power and reason, and tradition and progress and a social process is not something that can happen at a certain date (Dagan, 2015).

It is clear that legal frameworks of social entrepreneurship develop in many countries responding to the needs of society in new ways to practically facilitate the ideas of social entrepreneurship. The law makers react in different ways, but the common patterns in pursue of this mission can be spotted. Because otherwise in different countries laws on associations, foundations, non-profit corporations and charities would have limited or no ability at all to carry out business activities, since the mentioned legal forms were originally dedicated for the development of donative or redistributive activities, rather than for business activities. Company law was

\textsuperscript{1} Companies (Audit, Investigations and Community Enterprise) Act 2004.
designed to maximize shareholder value. Therefore, the pure legal forms of the non-profit sector and the pure forms of the for-profit sector are inadequate to accommodate the phenomenon of a social enterprise (Fici, 2015).

It has to be stressed that the social enterprises influence the theoretical concept of enterprise in general: the conception of enterprises as organizations promoting the exclusive interests of their owners is questioned by the emergence of enterprises supplying general-interest services and goods in which profit maximization is no longer an essential condition (Galera and Borzaga, 2009).

Legislators may, and probably have to promote the role of social enterprises by defining organizational models. These models, first of all should be set to maximize the effectiveness of enterprises. Legislation should be based on default rules for social enterprises, allowing a reasonable amount of self-regulation. So, in this way we speak about the framing the main principles of the governance of social enterprises (Cafaggi and Iamiceli, 2009). Drawing the line between for-profit and social enterprises, it can be emphasized that both legal entities are created and governed under the state law, have organizational structure, governing rules and capital formed by shareholders. However, social enterprises can and often earn a profit, but they are not permitted to distribute those earnings to their shareholders. This restriction supposed to be included in the articles of incorporation of such social enterprise (Lasprogata and Cotten, 2003).

The international research on the legal forms of the social enterprise distinguished three main models of legislation on social enterprise: the cooperative model, the company model, and a model based on a freedom of choice of legal forms (Fici, 2015).

The last mentioned case covers the certification schemes. Now it can be noticed that certification schemes have some visible advantages. All corporate forms can use them if the companies’ legislation allows the pursuit of social purposes. One of the most important advantages is that certification doesn’t require reincorporation as a new form of company, because reincorporation can lead to significant costs.

Because certification usually would be administered by a public authority, which would supervise and apply sanctions, the misuse of the certificate could be avoided. Regarding the sanctions, it could be simpler implemented with a certification scheme than with a new corporate form. In the case of failure, it would be easier to revoke the certification, while a similar action applied to a new corporate form requires the company either to be converted into other form, or wound up (Sorensen and Neville, 2014).

In any way, all above mentioned examples have a common attribute – the countries have introduced legal framework, acknowledging the importance of legal certainty in the field of social enterprise. It should be emphasized one more time that mostly social entrepreneurship is not defined by legal form, as it can be pursued through various vehicles and examples of social entrepreneurship that can be found within non-profit, business or even governmental sector. The authors define social entrepreneurship as innovative, social value creating activity that can occur within or across the non-profit, business or government sectors. Despite the distinguishing of social entrepreneurship by its social purpose and through multiple organizational forms, there is still significant heterogeneity in its definition (Austin et al, 2006).

Probably the biggest challenge in the countries seeking further development of the social entrepreneurship is to develop company law rules that ensure that social
enterprises actually pursue their social purposes, avoiding the misuse of the status of social enterprise on one hand and ensure sufficient flexibility in their regulation on the other, eliminating obstacles in further development of social entrepreneurship sector in general.

The Common EU Legal Framework: Does it Exist?

The question, whether the common EU legal framework for social enterprises exist, can be answered positively. We have mentioned the Commissions Communication on Social Business Initiative. The Communication is a not binding document, so the Member States can define their own legal status and general legal framework for the social enterprise. However, there are several cases where the social entrepreneurship is mentioned in the obligatory EU legislation.

The EU included the definition of the social enterprise into the Regulation on a European Union Programme for Employment and Social Innovation.\(^1\) The definition in the Regulation doesn’t differ much from the one defined in the above mentioned Social Business Initiative. Of course, this definition shall be used only for the purposes of this Regulation – defining the subjects who can benefit from the measures set in the Regulation.

The other example is the Directive 2014/24/EU on public procurement. This Directive establishes rules on the procedures for procurement across the EU.\(^2\) It also allows the Member States to include the provision on so called “reserved contracts” in national legislation, to create better conditions for the economic operators whose main aim is the social and professional integration of disabled or disadvantaged persons to participate in public procurements.

For the moment there are no more binding legal acts at the EU level defining some sort of obligations for the Member States regarding the legal status for social enterprise. Even the above mentioned legal acts cannot be called legal binding in the strict way of sense, because the specific legal regime for the social enterprise is applied only in the context of the purposes of particular Regulation and Directive. Coming back to the question raised in the beginning of this chapter, supposedly we should raise it another way: is the common EU legal framework for social enterprises really necessary?

Considering the interruption to the work on the Statute for a European foundation the perspectives of a potential European social enterprise might look unclear and unpredictable. The Proposal on the Statute for a European Foundation was presented in 2012. The main purpose of the Proposal was to create new European legal form intended to facilitate foundations' establishment and operation in the single market. It would allow foundations to more efficiently channel private funds to public benefit purposes on a cross-border basis in the EU. After the unsuccessful negotiations the Proposal was withdrawn from the EU legislative agenda in December 2014.\(^3\)

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The ultimate form is particularly difficult to develop given the diversity of approaches among EU member states (Fici, 2015). In any way, poor understanding of the concept of social enterprise could be defined as one of the most important aspects for the future development of this sector.

It was mentioned in this paper that the legal framework didn’t necessarily have to include the creation of the specific legal form of social enterprise in every Member State. Considering very different traditions of the development of social entrepreneurship in different countries, the unified European legal form of the social enterprise wouldn’t help either. However, some legal frameworks at national level are necessary to provide legitimacy and visibility to social enterprises; attract tax incentives related to furthering a social purpose; and to allow the social enterprises to undertake unlimited economic activity (EC, 2015).

From the scientific point of view, continuing research and evaluation in this field will be needed, given the complexity and variation across Member States. Future evolution of different types of social enterprises is inevitable. The future research of different practices in different countries would help moving barriers and looking for solutions that would suit in different cultural environment of social entrepreneurship in different states.

Conclusions

Legal frameworks are important tools for establishing social enterprises. It can provide clarity by defining which entities can be considered as social enterprises, what are their duties, main objectives, and fiscal aspects of their operation. In any way such legal regulation shouldn’t be too strict, to avoid the over-regulation and allow to use more flexible legal tools.

Social entrepreneurship legal frameworks develop in many countries responding to the needs of society in new ways to practically facilitate the ideas of social entrepreneurship. The main scenarios in creating the legal framework for social enterprises are whether the adaptation of existing legal forms or creation of new legal forms taking into account the specific features of social enterprises. Some law makers react in different way by creating the so called social enterprise legal status, or legal qualification.

Some common patterns of the above mentioned forms can be spotted. If the new corporate form is launched, there will be inevitable costs for companies that would like to switch to new legal form. Such situation could be avoided or minimized by introducing a new category of existing corporate forms without launching a new legal form. This approach has been used in the United States for the benefit corporations, and in the United Kingdom.

A dedicated certification scheme that was recently introduced in Denmark and earlier in Belgium is based on a freedom of choice of legal forms and has some visible advantages. All corporate forms can use them if the companies’ legislation allows the pursuit of social purposes. One of the most important advantages is that certification doesn’t require reincorporation as a new form of company, because reincorporation can lead to significant costs.

Probably the biggest challenge in the countries seeking further development of the social entrepreneurship is to develop company law rules that ensure that social enterprises actually pursue their social purposes, avoiding the misuse of the status of
social enterprise on one hand and ensure sufficient flexibility in their regulation on
the other.

The ultimate European legal form of social enterprise is particularly difficult to
develop considering very different traditions of the development of social
entrepreneurship in different countries. Therefore, it could be recommended to
continue the research on different practices in different countries, which would help
moving barriers and looking for solutions that would suit in different cultural
environment of social entrepreneurship in different states.

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TOWARDS CIRCULAR ECONOMY: ANALYSIS OF INDICATORS IN THE CONTEXT OF SUSTAINABLE DEVELOPMENT

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Abstract

Purpose – Circular economy is quite new approach in European Union in dealing with main global challenges. Circular economy evaluation system should show results that could be used by decision makers: it could be used at national, local or enterprise level. This paper analyzes how circular economy evaluation systems reflect basic circular economy principals and sustainable development components.

Design/methodology/approach – analysis based on assessment whether circular economy evaluation systems do or do not include indicators of basic circular economy principles and sustainable development components.

Findings – at micro and meso levels circular economy evaluation systems do not include social component indicators of sustainable development approach, even there are some systems that even do not include all basic circular economy principles. At macro level there are two evaluation systems that covers both circular economy principles and sustainable development component, but statistical data availability should be analyzed in further studies.

Research limitations/implications – In European Union circular economy evaluation systems and their methodology are still developing. In Eastern Asia these evaluation systems are broadly implemented but there is a risk, that not all circular economy evaluations systems are analyzed, because of language barrier: not all Asian evaluation systems are translated into English. The analysis does not go into deep details of circular economy evaluation systems methodology.

Practical implications – the findings of the research can be used in further studies and also applied by national authorities to determine actions that could be funded in order to develop more complex circular economy evaluation system that could give more holistic approach.

Originality/Value – Analysis is important and valuable as circular economy evaluation systems are not analyzed by researches in a context of sustainable development. This approach to evaluation systems could lead to new and more complex evaluations systems, that could give information for decisions makers on further strategy formation.

Keywords: circular economy, sustainable development, circular economy evaluation systems.

Research type (choose one): research paper
Introduction

Sustainable development is not a new concept, it was developed over few decades and its implementation is a complex task requiring long term and continuous governmental efforts. Circular economy (CE) is a kind of new economy form and economic-environmental development model. CE model is an approach of sustainable manufacturing that focuses on a broader, innovation-based methodology for products over multiple life-cycles (Jawahir, Bradley, 2016). As the concrete form which reflects sustainable development strategy, circular economy is becoming main development strategy in more and more regions and countries. It is important to combine these two approaches developing evaluation systems in order to get full view of performance and make right decisions, so setting right and complex indicators to evaluate circular economy is first and the most important step in creating effective evaluation system.

Evolution of circular economy

The concept of a circular economy, introduced by the late Pearce and Turner in 1989, addresses the interlinkages of four economic functions of the environment:

1. Amenity values - the pleasures from natural beauty of nature and existence value of particular species. These pleasures environment provides directly without interference from economy;

2. A resource base for the economy – as an input, economy needs resources, both renewable and non-renewable, that provides environment. Renewable resources usually are biological and can be harvested for economic purposes with no or limited impact, as long as the harvest does not exceed the annual yield.

3. A waste bin for residual flows – for the residuals (waterborne, airborne or solid emissions) after economic activity the environment functions as a waste bin and once the assimilative capacity, that environment can receive, is exceeded, environmental damage begins to surface;

4. A life-support system - for humans and non-humans, the environment functions as a life-support system, that acknowledges the inherent biological character of the environment and that the life-support function can be influenced as a result of economic activities (Andersen, 2007).

From the perspective of environmental economics, the circular economy is based on a material balance principle (Kneese et al. 1970), which implies that all material flows in order to guide their management need to be accounted in economic values, not the physical flows. In industrial ecology, the circular economy is beneficial to society and to the economy as a whole. Benefits can be obtained, not only by minimizing use of the environment as a waste bin for residuals but also more important by minimizing the use of virgin materials for economic activity (Andersen, 2007).

Concepts such as Cradle-to-Cradle or Biomimicry (1997), which were inspired by nature as well, also had an influence on the development of the Circular Economy concept (Sherwin 2013). It is also a mixture of several other schools of thoughts, such as Performance Economy (1976), Industrial Ecology (1989) and Blue Economy (2010) (Ostojic, 2016).

Basic circular economy principles have been formulated based on waste hierarchy and 3R principles: reduce, reuse and recovery. The first principle – reduce, means
achieving the objectives set for production and consumption by using minimal raw materials and energy and by cutting pollution at the very outset of economic activity. The second principle – reuse, refers to a reuse of a product at other economic activities or facilities after its initial consumption. Recovery means recycling and use of a product many times in its primary state rather than one-off use (Zhijun, Nailing, 2007). These three principles lead economy to resources circularity and minimization of extraction of raw materials. Evaluating circular economy just as 3R principles may lead to economic and social ineffective actions proposed by decision makers. CE evaluation system should be more complex and integrating those aspects of sustainability that are missing in basic circular economy principles.

**Circular economy and Sustainable development**

Basically, circular economy model is model of sustainable production and consumption, and it is fundamentally different from the linear economy model. The linear economy is based on linear process: extract – produce - consume – dispose, which does not ensure future generations the same level of welfare as now. In linear economy model there is little or no attention to the pollution generated at each step (Figure 1), and some limitations appear, such as:

- lost value of materials and products;
- scarcity of resources, volatile prices;
- waste generated, environmental degradation & climate change.

Circular economy approach is natural consequence of linear production limitation of limited natural resources, high pollution and energy consumption rates. Wastes generated in linear economy model through extraction and production of the goods and the post-consumption products come around to haunt us as pollution as they eventually end up either in a landfill or are dispersed in ways that contaminate our environment.

![Figure 1. Contrasting the linear and circular economy concepts](source)

Source: Sauvé et al, 2016
Circular economy is the outcome of over a decade's efforts to practice sustainable development by the international communities, and is the detailed approach towards sustainable development (Moriguchi, 2007). Considering circular economy only as an approach to more appropriate waste management is very limited and may lead CE to fail. Just seeing circular economy only in reduce, reuse or recovery options and not in the view of sustainability, may either be not appropriate (Ghisellini et al, 2016).

Sustainable development, defined by the UN's World Commission, is a trajectory where future generations are secured the same level of welfare as present living generations (Andersen, 2007) and circular economy is helping to fulfill this goal.

Successful evaluation of CE leads to successful and sustainable development of a circular economy. This goal requires to set key indicators, that would meet both circular economy and sustainable development approaches.

**Analysis of circular economy evaluation systems**

Analysis of research papers showed, that circular economy can be implemented at three different levels (see Figure 2). Different implementation levels of the CE and different characteristics of enterprises, industries or regions require different assessment indicators. All evaluation systems can be divided into three groups (see Figure 2) with different evaluation systems. The first step of good evaluation systems is to set appropriate indicators at each implementation level.

**Figure 2. Classification of Circular economy development evaluation systems**

**CE evaluation at micro level**

Micro level means implementing circular economy principles to single company, so evaluating circular economy at this level, each enterprise needs to set specific indicators according to companies characteristics, condition, and existing problems. Thus, setting very unified and only one standard of indicators may fail to capture the full development of the circular economy in different enterprise (Su et al., 2013). The adoption of a circular economy principles entail that a company carries out different strategies to improve the circularity of its production system. Production companies
have to cooperate with other companies over the supply chain for the achievement of a more effective circular pattern (Wrinkler, 2011).

Analysis of research papers showed, that circular economy evaluation at micro level is based on cleaner production, green consumption what is not full CE approach. These evaluation systems contain indicators that mostly are based on 3R principles, but not CE in general (see Table 1).

**CE evaluation at meso level**

China is one of the biggest producer in the world and have production plants, industry parks and industry networks. China is the second-largest energy producer in the world and also the second largest energy consumer. Country’s energy consumption per unit GDP is two times greater than the world average. The high-energy consumption in process industries gives a lot of severe environmental problems. Production plants, industry parks and industry networks is mostly China’s production specifics, these production derivatives are evaluated at meso level. These derivatives usually are equipped deficiency and they lag in technology (Li et al, 2010).

Applying the concept of industrial symbiosis, have production plants, industry parks and industry networks utilize common infrastructure and services. This enables these derivatives to cooperatively manage resource flows, trade industrial by products which decrease environmental problems and reduce both firms’ and the nation’s dependency on resources. Reduction of production cost raises industrial productivity and competitiveness (Heshmati, 2015). By applying circular economy and sustainable development concepts, measuring indicators will help to control these parks and plants performance and to take appropriate decisions.

**CE evaluation at macro level**

At macro level sustainability and circular economy indicators are necessary for evaluating, monitoring, and improving upon various policies and programs. Policy makers have to have information so they could select specific indicators to fully cover the strategic goal of circular economy development and sustainability. Circular economy evaluation system creation is most popular and have most challenges. Table 1 shows analyzed evaluation systems and just few have all aspects of CE and sustainable development, and most of them concentrates on pollution reduction and other environmental issues.
### Table 1. Circular economy evaluation systems at different levels

<table>
<thead>
<tr>
<th>Circular economy evaluation system</th>
<th>Author</th>
<th>Categories</th>
<th>Individual indicators</th>
<th>Circular economy principles</th>
<th>Sustainable development components</th>
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<td>Reduce</td>
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<td>Indicators for iron and steel enterprise</td>
<td>Chen et al., 2009</td>
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<td>Factor analysis based on ESCC and CE-targeted performance indicators</td>
<td>Zhu Q. et al., 2010</td>
<td>7</td>
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<td>Quantitative Evaluation of Circular Economy Based on Waste Input-Output Analysis</td>
<td>Li S., 2012</td>
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<td><strong>Circular economy evaluation systems at meso level</strong></td>
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<td>Material flow analysis (MFA) to evaluate Circular economy</td>
<td>Geng Y. et al., 2012</td>
<td>4</td>
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<tr>
<td>National Development and Reform Commission’s (NDRC’s) CE indicator system</td>
<td>Su B. W. et al., 2013</td>
<td>4</td>
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<td>Ministry of Environmental Protection (MEP’s) CE indicator system</td>
<td>Su B. W. et al., 2013</td>
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<td>Regional Circular Economy</td>
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<td>Development index</td>
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<td>Super-efficiency DEA model</td>
<td>Wu H. et al., 2014</td>
<td>3</td>
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<tr>
<td>Evaluation of Regional Circular</td>
<td>Chun-ron J. and Jun Z., 2011</td>
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<td>Economy Based on Matter Element</td>
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<td>An indicator framework for the</td>
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<td>Multi-objective evaluation system</td>
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<td>of the economy–environment–ecology for high efficient utilization of resources (The Institute of Process Engineering, Chinese Academy of Sciences)</td>
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Conclusions

My review results show that current CE evaluation indicators are being carried out at the micro, meso and macro levels.

At the micro (enterprise) level, indicators are tailored to individual firms or an industry’s characteristics and not focuses on both circular economy and sustainable development principles and components. The review shows, that aside from indicators evaluating 3R principles or the environmental aspect, a more systematic evaluation system should be established by adding indicators of economic development and social aspects.

There are no social indicator’s in reviewed CE evaluation systems at the meso level. Also it should be paid more attention to economic indicators, because all indicators mostly focus on resource reduction and recycling.

At the macro level, where the research studies are the most abundant, the indicator systems are generally based on 3R principles and just some integrate all sustainable development components. In this level sustainable indicators are essential. For policy-makers it is important to know countries situation so indicators and indices are increasingly accepted as useful tools because they convey information on a country’s performance towards their specific goals within the three major divisions of sustainability (social equity, economic welfare, environmental quality).

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THE IMPORTANCE OF RESPONSIBLE PRODUCTION AND CONSUMPTION TO OVERCOME THE PLASTIC PARADOX

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Abstract

Purpose – to reveal the importance of responsible production and consumption to overcome the plastic paradox.

Design/methodology/approach – analysis and synthesis of scientific literature, comparative analysis of good practices in different countries.

Findings – The business and society should take care not only for “today” but for “tomorrow” too. As a result, both business and society need to be encouraged or even forced to behave socially responsible more actively to contribute to overcoming plastic paradox in the world. The aspiration of socially responsible production and consumption is still increasing in Lithuania.

Practical implications – it is necessary to learn the good practices of other countries in order to encourage the business and society to behave socially responsible in the processes of production and consumption and in this way to contribute to the overcoming the plastic paradox in the world.

Originality/Value – the importance of responsible production and consumption is disclosed. Only actively acting responsible business and society can contribute to overcome the plastic paradox.

Keywords: responsible production and consumption, business, society, plastic paradox.

Research type: case study.

Introduction

Plastic has become a part of our lives. The usage volumes while at the same time and waste volumes of plastics are growing significantly. It is ironic, but the plastic (polyethylene) bags were invented just little more than fifty years ago and started to be used instead of paper bags as an effective mean to save trees. The plastic bags are significantly less expensive than paper bags, are stronger, and since they require less energy and use less resources for manufacture, actually have a smaller carbon footprint than paper. Unfortunately, after plastic bags replaced paper ones, the scientists faced the another problem: the world’s landfills were clogged by plastic products, but the worst fact is that no one can say for sure that is their real disintegration time. Traditionally, it is speculated that plastic bags are often used only for short, however they last in the environment for hundreds or even thousands of years, but researchers suppose that it is more presumption and the way of saying that
this process takes a “very very long” (over the 500-1000 years). Since the plastic bags were invented quite not long ago, there is no practical possibility to check how long actually takes the degradation process.

This situation could be called as the plastic paradox.

The business and society cannot behave apathetic anymore! So the goal of this article is to reveal the importance of responsible production and consumption to overcome the plastic paradox. It should be emphasized, that the impact of plastic production process on the environment, which is self-evident, in this article will not be deeply discussed.

**Plastic Paradox? Only a Fiction or Already a Result?**

Plastic bags have butchered their way into pop culture as a symbol of carelessness, frivolity and consumerism (Gamba, 2012). Society meet plastic every day:

- While shopping (shopping bags, which allow customers to transport their goods from the stores to their home: small disposable (sometimes are called “single-use” ones as they are used only once; mostly are given free of charge) plastic bags are used to put-in not only non-packaged fresh food products (vegetables, fruits, berries, fish, meat and their products, bakery products, pastries and etc.) or hot-food-to-go, for reasons of food safety and hygiene, but and other goods, like clothes or other small objects) (Lyons, 2013; Temsamani, 2014);
- At home and work (furniture, tools and instruments from plastic become dominant);
- Travelling (packing clothes or footwear into plastic bags);
- Picnicking (using plastic boxes and (disposable) dishes; revellers do not usually clean up the environment after picnics and others are assumed to find a mess) and etc.

The plastic bags do not take place and are light but highly functional (they are able to bear thousand times their own mass), hygienic and waterproof, protect products from damage and their use had grown over the years (PlasticsEurope, 2014/02).

As new uses for plastic was developed, the quantity and variety of plastic items found in the environment all around the world has increased dramatically: plastic bags are swirling around on streets, hanging from trees in parks and forests, floating in rivers, seas and oceans (can endanger the marine wildlife, which might eat them or become entangled in them) (Gamba, 2012; UNEP, 2014). The another one serious aspect of plastics is their persistency in the environment: when plastics fragment, they do not completely biodegrade; instead of this it splits up into smaller and smaller pieces that might have long-term effects on water and soil quality (Gamba, 2012).

Disposable plastic bags are widespread, often free of charge as they are inexpensive for retailers (Lyons, 2013). Plastic bags are hard to recycle (because of rapid contamination) and only a small part is recovered (as not all countries have waste incineration plants). Even when they are kept for reuse (e.g. for new purchases: for storage purposes; as liners for trash bins; or to clean after the family dog), they are usually accumulated (virtually any household has a bulging “bag of bags”) much faster than they are reutilised (Gamba, 2012; Temsamani, 2014). In general, plastic is served for a very specific purpose, while also provides many practical advantages.
But mostly plastic bags are not reused! As a result, plastic paradox has become a major environmental and social problems caused by previous and today societies for today and future. This could be explained according different reasons (look Table 1).

### Table 1. Causes of the plastic bags usage

<table>
<thead>
<tr>
<th>Causes</th>
<th>Explanation</th>
</tr>
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<tbody>
<tr>
<td>Changing consumer behaviour</td>
<td>Trends towards eating at education or work places or, eating away from the home and greater use of public spaces increase the demand for light weight, low (or zero) cost and convenient plastic carrier bags.</td>
</tr>
<tr>
<td>Low consumer awareness</td>
<td>Low consumer awareness of the problem of litter and the overall environmental benefits of reusing plastic bags and switching to multiple-use plastic or cloth carrier bags is still low (especially in Member States that do not yet have strong policies in this area).</td>
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<tr>
<td>Established retail practices</td>
<td>Retailers are not encouraged (by policy in this area) to limit the use of disposable plastic bags because they are quite inexpensive and provide a service to their customers (according to some, unilaterally reducing such a service might have a negative impact on their sales).</td>
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<tr>
<td>Low prices and non-internalisation of external costs</td>
<td>The use of plastic carrier bags also provokes negative environmental consequences that are not included in the prices paid by retailers and consumers.</td>
</tr>
<tr>
<td>Low level of plastic recycling</td>
<td>Even though plastic bags are recyclable, the thinness and light weight of them mean they do not have a high recycling value. Collection and transportation is not very profitable even if the bags are compacted and washing them requires large volumes of water.</td>
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*Source:* prepared according to Lyons, 2013

“Society as a whole – and the economic sectors in particular – are well aware of the problem and are looking for ways to address and help solve it” (PlasticsEurope, 2014/02).

Globally are produced about 280 million tonnes of different plastics each year and only a very small part is recycled (UNEP, 2014). The European plastics industry of about 62 thousand companies employs more than 1.45 million people in the European Union (by the number of plastics industry companies dominate France, UK, Poland, Romania and Hungary (the last one is known for the largest number of employees in the plastics industry)) and creates a turnover in excess of 350 billion EUR per year. It is discussed, that regulation in Europe is becoming critical for plastics industry to create high-quality employment opportunities, drive economic growth and optimise their contribution to European welfare (PlasticsEurope, 2014; PlasticsEurope, 2015).

It is estimated, that worldwide nearly two million single-use plastic bags are used each minute and it is about one trillion each year (Larsen and Venkova, 2014; PlasticsEurope, 2015). Around 90 billion single-use plastic bags were used in the EU in 2010.
More than 90 billion plastic carrier bags were placed on the EU market in 2010 (European Commission, 2015/0123 final) and the amounts are quite stable. Every European citizen use an average of 200 plastic bags per year, of which 90% are single-use lightweight bags (it means that they are used only once) (Environment News Service, 2014) (see Figure 1).

Source: European Commission, 2013/0444 final; Temsamani, 2014

**Figure 1. Plastic bags used per person in EU Member States**

For sure, the consumption of single-use plastic bags contrasts widely among different countries: it ranges from just four a year for people in Denmark (as has introduced a charge in 1993 and consumers commonly pay 0.21–0.37 euro per bag) and Finland (despite the fact, that country have no national legislation on the matter, just voluntary activities of retailers work fluently there) and to over 400 a year for most East Europeans (Barbière, 2015; BBC News, 2014; Larsen and Venkova, 2014; Environment News Service, 2014). The worst performing (the consumption as well as the littering rates of plastic bags per capita is still considered high) countries are Portugal, Slovenia, Slovakia, Hungary, Poland, and the Baltic states: Estonia, Latvia and Lithuania (Kasidoni et al, 2013; Larsen and Venkova, 2014; Environment News Service, 2014). More than eight billion plastic bags end up as litter in Europe every year (Environment News Service, 2014).

The goal to overcome the plastic paradox and minimise its negative impact on the environment and society could be achieved by strengthening the responsible production and consumption.

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1 2010 or latest available data. Croatia was not included.
Responsible Production and Consumption. Plastic Bag Regulations Worldwide and Guidelines by EU

One of the opportunities to avoid and resolve the damage caused by plastic bags, and the costs of undoing the harm (which is mostly impossible), and to promote reusable bags instead of throwing them away would be to educate the society (Lenguyen, 2011; Lyons, 2013). So, the retailers need to encourage customers more actively to reuse their plastic bags (if they decide to buy them) as more times as it is possible and only then to recycle and do it correctly.

Consumers become more and more responsible to make their environment safer and healthier to live in. As a result, they become more conscious about their purchasing in respect with all the products that they use in their daily life. That is why consumers prefer the products which are not harmful and eco-friendly for themselves and environment (Chaudhary et al, 2011). The minimisation of plastic bag use contributes to realization of this ideology.

As it was already mentioned, the consumers can reuse plastic bags. Another is that they could switch to alternative types of reusable bags (include biodegradable plastic bag, qualified cotton bags and etc.), or to cardboard boxes (preferably of recyclable paper) (Sherrington et al, 2012; Lyons, 2013; Xing, 2009). Nevertheless, switching back to paper or using biodegradable or compostable plastic bags does not guarantee clearly to be the solution in all situations. The best determination depends on life-cycle assessments, and local behaviour and waste management facilities (Lyons, 2013).

Some manufacturers incorporate the specific additives into conventional plastics as these additives force plastic fragment over time into small fractions. Such plastic is marked as “oxo-biodegradable” or “oxo-degradable”. Unfortunately, this note can be misleading as such “specific” bags may not be a solution to littering and on the contrary may increase pollution. The European Commission should examine such “oxo” plastics and present a report including a set of measures to limit their consumption or to reduce any harmful impacts of the use on the environment and society (Directive (EU) 2015/720).

The totally biodegradable plastic bags are less competitive than the partially biodegradable or non-biodegradable ones for their green and high-tech, high production cost and small scale. Despite this fact, more qualified substitutes must be designed and popularized as soon as possible, as to plastic bags which don’t meet particular standards, especially the single-use plastic bags, supervisions and even punishment must be strengthened until the product is standardized. To add, the national authorities should prepare the relevant policy to encourage and stimulate the research and produce of the totally biodegradable plastic bag as more as possible and in time to replace the usual plastic bags fully (Xing, 2009).

There are some countries where food products are already packaged in a way that does not require additional thin plastic disposable bags, e.g. fruits and vegetables are packed in mesh bags. But it should be emphasised that thus limits the customer freedom of choice, is uncomfortable as in that packaging could be added too much as is demanded by consumer or it may contain any damaged products inside. In this situation the packaging is destroyed and thrown out and the new one is used to pack...
the products. Moreover, the customers would like to keep the opportunity to choose the products which they want and how much they need their own.

Generally, plastic bags help to prevent waste of food, since it allows customers to buy the amount they demand rather than fixed packaged quantities. Because of the specific characteristics and benefits (e.g. visual control at checkout, food protection) of plastic bags there is very few alternatives to their use (Temsamani, 2014).

It is considered, that there is a causal link between usage and waste of plastic bags and that a reduction in usage will automatically reduce the waste too. The plastic bags are not a problem anymore, since they are successfully being used as a resource for energy production, in line with the waste hierarchy (remove/eliminate, reduce, resource (change materials or sources), reuse, recycle/compost, recover/energy-from-waste (heating and electricity), dispose/landfill) in Member States where EU legislation is already implemented and enforced. The countries should try to achieve zero land-filling of plastic carrier bags (PlasticsEurope, 2014/02).

It is a pity, that most often plastic bags are still excluded from recycling schemes (Lyons, 2013). However, there are some (78) countries around the world which have initiatives to reduce usage of plastic bags (see Figure 2) and examples in European Union Member States are discussed in the following section.

![Figure 2. Plastic Bag Regulations Worldwide](image)

Source: Earth Policy Institute, 2016

Many possible policy approaches to minimise the usage and waste of plastic bags are available: from soft policies like encouraging voluntary initiatives from retailers, to more strict regulations starting with charges on plastic bags and finishing with a complete bans of single-use bags (Gamba, 2012).

Until 2013, European Union Member States and separate companies had taken various measures (e.g. retailers’ voluntarily decisions not to serve plastic bags for free-of-charge; different anti-littering campaigns; charges for and even bans of specific plastic bags) to minimise the usage of plastic bags. A plenty of possible options were
presented: the question was remained: which ones would have the most effect to reduce plastic waste? (PlasticsEurope, 2014/02).

The preference will depend on the specific circumstances: access to alternatives; current recycling practices and waste management; social norms and attitude towards the environment; supporters and opponents of the initiative and their relative influence, and many others (Gamba, 2012).

Although the European Union countries were and are still trying to minimise the usage of plastic bags on their own, plastic waste is still problematic enough, that the European Commission (EC) decided to strive imposing a Europe-wide law (Larsen and Venkova, 2014). As a result, the draft rules amending the EC’s Packaging and Packaging Waste Directive (PPWD) were approved by the European Parliament in April 2014 (the latest revision of the PPWD occurred on 29 April 2015 with the adoption of Directive (EU) 2015/720) and there were aimed to decrease plastic bag use in the EU by 50% by 2017 and by 80% by 2019 comparing the EU average in 2010 (Chatain, 2014; European Commission, 2016; Larsen and Venkova, 2014).

It should be emphasized that only Croatia voted against a proposal to reduce the use of plastic carrier bags (as around 60 companies employing a total of around 1,500 people in this country were aimed to protect jobs), but the Council of the European Union has adopted a Commission proposal for a directive to reduce the usage of plastic carrier bags (CroatiaWeek, 2014).

While an 80% reduction may seem quite easy to achieve for some countries, but at the same time for others this means a reduction of over 90%. Due to this huge disparity (from 4 to 400 per person a year) among the Member States, there is no “one size fits all” solution. This goal can be tackled through national measures, including national reduction targets in one hand and an EU-wide awareness-raising campaign on the value of carrier bags and the need to reuse them in order to save resources on the other hand. Of course, one could argue that the funds should be used to finance the collection and recovery at their end-of-life (PlasticsEurope, 2014/02).

The PPWD agreement is obligatory in all EU countries and gives national authorities of Member States two ways to implement it. The measures shall include either or both of the following (European Parliament, 2014; EUROOPEN, 2014; EU: Committee on the Environment, Public Health and Food Safety, 2014):

(a) the adoption of measures ensuring that the annual consumption level does not exceed 90 lightweight plastic carrier bags per person by the end of 2019 and 40 lightweight plastic carrier bags per person by the end of 2025, or equivalent targets set in weight (compared with an average of 176 bags per person in 2010). Very lightweight plastic carrier bags may be excluded from national consumption objectives:

(b) the adoption of instruments introducing a charge on single-use lightweight plastic carrier bags by the end of 2018, unless equally effective instruments are implemented. Very lightweight plastic carrier bags may be excluded from those measures (Directive (EU) 2015/720).

Even Committee on the Environment, Public Health and Food Safety of EU (2014) in their report had stated, that “making consumers pay for plastic bags can reduce consumption dramatically almost overnight”. However, it should not be applied to bags which are necessary for food hygiene. Member States which have established a
separate bio-waste collection system should be allowed to reduce the price for the bio-based and compostable lightweight carrier bags.

As a result, a proper implementation of EU waste legislation should remain a priority, especially in those countries which are “leading” in plastic use and waste (PlasticsEurope, 2014/02). It should be noted, that choosing the optimal measures requires careful consideration in order to achieve a positive outcome. It is expected that a successful initiative might create momentum for other environmentally-friendly initiatives by effectively reducing the stream of plastic waste. However, a wrong campaign (badly organized, lacking participation or information, ill-suited to circumstances, etc.) could not only be rejected by society but also fail its specific targets (Gamba, 2012).

It is encouraging that in countries and regions that have introduced strong policies to reduce single-use plastic carrier bag use, such initiatives have proved popular (Lyons, 2013). Some countries ban, or charge for plastic and paper bags at the grocer rather than encouraging recycling.

Not less important is to raise awareness amongst society on the impact of littering behaviour and encourage socially responsible behaviour (PlasticsEurope, 2014/02).

It should be recognized that volunteer initiatives seem to address the issue of plastic bags effectively in certain European Union Member States. More specifically, Austria, Germany, Finland and France have reached lower consumption of single-use plastic bags and at the same time lower littering rates of single-use bags than other EU MS with no volunteer initiatives. On the other hand, there are MS where some voluntary initiatives have taken place but were rather isolated (Kasidoni et al, 2013).

The good practices of these and other countries are examined in the next section of this article.

Charges for or Ban on the Plastic Bags? Practices of European Union Member States

It is not a secret that most plastic carrier bags minimisation strategies have necessity and merit, but it should be recognized that some are more effective than others. Business and society prefer and accept more easily voluntary initiatives, but this takes more time to get the results and the effectiveness depends on the number of retail establishments participating. At the beginning such initiatives as charges or even bans cause some inconvenience for consumers but they give the fastest results (Lyons, 2013).

Realising the socio-environmental problem associated with plastic bags, many countries around the world have already tried to free the societies from their addictions by implementing different initiatives. Below are given practices of EU Member States in reducing the use of plastic bags.

Charges for some plastic bags are applied in Denmark (since 1993); Ireland (since 1994, since 2002 bag levy introduced to both biodegradable and non-biodegradable bags), Malta (started in 2005 and again in 2009), Belgium (federal environmental tax on single-use plastic carrier bags since 2007), Latvia (since 2008), Romania (since 2009), Bulgaria (since 2011), Czech Republic (since 2011), United Kingdom (in Wales - compulsory since 2011 and entered into force in 2013; in England introduced in 2015)
and France (since 2014). Most often the plastic bag tax is set for bag manufacturers and is based on the bag’s weight. Manufacturers pass the cost to retailers; the stores are allowed to relinquish and transfer the cost to consumers in bag charges. The charges have the effect on drop in plastic bag use and increased use of reusable bags (European Commission, 2013/0444 final; Earth Policy Institute, 2016; European Environment Agency, 2014; Erbach, 2014; Larsen and Venkova, 2014).

The tax (earmarked to cover administration costs and for an environmental fund used to support waste management, litter cleanup and other environmental initiatives) was so successful in reducing the use of plastic carrier bags in Ireland that annual revenues from the tax were only around one tenth of the amount initially expected. Administration costs were very low, at about 3% of revenues, because reporting and collection are integrated into the existing VAT system (Erbach, 2014).

Additionally in Belgium works voluntary agreement, plastics collection and recycling organisations collect fees charged to end-users. However there is no national scheme for recycling plastic bags separately (European Commission, 2013/0444 final).

Some supermarkets (mostly food stores) have voluntarily chosen to charge for plastic bags – mostly around 0.10 euro per bag – in Sweden (tax is 0.17 – 0.30 euro, by the way, the plastic bag was invented in Sweden), Germany, Finland, Hungary, Slovakia, Estonia, Spain, Portugal, France and the Netherlands (European Commission, 2013/0444 final; Erbach, 2014; Earth Policy Institute, 2016). To add, in the Netherlands in many shops there are “bag bins” where used-bags can be deposited and used again by other customers. In addition, bag manufacturers are responsible for arranging the recovery or recycling of their product. If recycling or material recovery targets are missed, producers must pay a tax based on the shortfall amount (European Commission, 2013/0444 final).

In Germany a system called Packaging Ordinance was introduced in 1991, which stated that packaging manufacturers and distributors are financially responsible for the packaging waste they created (it was set on the amount of packaging waste that manufacturers and distributors had to take back and recover, and these requirements increased gradually). This led to the fact, that in 1993 was created the Dual System Deutschland (DSD), an organisation that collects and manages packaging waste according to the requirements on behalf of fillers and retailers (is well known as the "Green Dot" system (named for the symbol found on recyclable packaging)). Companies pay a fee to the DSD which reflects the collection and recovery costs of the individual materials thus providing them with an incentive to reduce or minimise the packaging materials used. Moreover, all stores that provide plastic bags must pay a recycling tax. Most supermarkets voluntarily charge 5–10 euro cents per bag. Commendable the fact that, almost all plastic bags consumed in the country are recycled, almost three quarters of consumers use carrier bags multiple times, and only about a tenth of groceries are taken home in a new plastic bag (Erbach, 2014; Kasidoni et al, 2013; Larsen and Venkova, 2014).

Some Austrian supermarkets have stopped offering single-use plastic bags, and others provide plastic bags containing more than 80% recycling material. From 2018, the use of plastic carrier bags would be stopped completely in Spain, except for plastic bags for meat, fish and freezer products (with a high water content) (European Commission, 2013/0444 final; Earth Policy Institute, 2016).
In Croatia are applied the combination of a tax (since 2009) on plastic bag producers, a voluntary fee charged by retailers, and a voluntary bag reduction initiative by the retail sector (Earth Policy Institute, 2016).

No measures are applied in Cyprus and proposals to make all bags biodegradable and to require supermarkets charging customers for plastic carrier bags failed in 2008. In Slovenia proposals are being considered for a tax of 0.50 euro for plastic bags and 0.40 euro for biodegradable bags (it should be noted that the price difference is relatively small, but it aims to reduce the consumption of plastic bags in general) (European Commission, 2013/0444 final; Earth Policy Institute, 2016).

Since 1988 in Italy was applied a law taxing importers and producers of non-biodegradable bags, but it did not last or appear effective. In 2007 began a national pilot program aiming to reduce gradually the consumption of non-biodegradable shopping bags and in 2011 there were banned the distribution of plastic bags that are not from biodegradable sources. Unfortunately, the ban has not been fully carried out or enforced because of unresolved legal disputes over EU trade laws (Nastu, 2011).

The national ban on single-use plastic bags are set in France from the beginning of this year. Moreover, the ban on plastic carrier bags will come into effect in two stages: on July 1, 2016 for “lightweight” shopping bags (only bags thicker than 50 microns will still be allowed on the basis they are reusable) and from the beginning of 2017 are planned to ban the packaging bags for fruit and vegetables (The Local, 2015; EuroNews, 2016; Barbière, 2015).

By European Commission (2013/0444 final) is stated that no specific legislation are applied in Luxembourg, Greece and Poland. But in Luxembourg reusable long-life bags were introduced on a voluntary basis since 2004 and in Greece some supermarkets have made reusable shopping bags available but with limited success because thin plastic carrier bags are still distributed without charge since 2008. In Poland the tax was considered but eventually dropped in 2010 (Erbach, 2014; Pilarczyk and Grzesiuk, 2012).

In 2013, European Commission in their report stated that “in Lithuania, there is no legislation or planned legislation to ban plastic carrier bags” and added that “most distributors voluntarily do not use plastic carrier bags” (European Commission, 2013/0444 final). Lithuania started actively working on the implementation of the Directive (EU) 2015/720 in the beginning of 2016. It is planned to ban the single use plastic bags since 2019 (Seimas of the Republic of Lithuania, 2016).

Expecting to reach the bigger reductions in the number of plastic carrier bags use and waste, the charges for plastic bags should be passed on to the consumers in full. The price should be high enough (even a low price can have a big impact if customers see a payment as a hassle or if use of plastic carrier bags becomes socially undesirable) to cover the environmental and social costs generated over the life cycle of a plastic carrier bag (including producing, using, collecting and waste management). It is important to set an appropriate level of price: to start with adequate price and over time it needs to be increased little by little to avoid re-growth of plastic bag use. To sum up, the primary goal is to reduce the consumption of single-use plastic carrier bags by influencing consumer behaviour, rather than to raise revenue. Revenues could be used to enhance the environmental benefit, for waste collecting and recycling and other environmental projects (Lyons, 2013).
To sum up, the oldest (passed in 1993) existing plastic bag tax is in Denmark. Charging consumers for plastic bags appears to be effective in most countries. As well, many societies were and are seeking ways and means to minimise the plastic use and waste hoping to compete the Irish success. Germany was the first country (in 1991) which had introduced a system, which stated that manufacturers (fillers) and distributors (retailers) are financially responsible for the packaging waste they created. Moreover, other countries could learn from the Netherlands and suggest more alternatives of voluntary indicatives. Maximum efforts should be taken by Lithuania, as the set deadline is close.

The good practices of examined countries prove that applied charges demonstrably encourage more and more people to reuse single-use plastic carrier bags or use alternative kind (multiple-use) carrier bags made of plastic or other materials (e.g. linen, cotton, polyester and etc.) more actively and in this way to minimise littering. In the nearest future the free-of-charge plastic bags to customers should not be provided in EU and it is likely that most Member States will be able to take measures to reduce plastic bag use 80% by 2019.

Socially responsible business (producers, retailers) should voluntary participate in the voluntary activities to reduce the plastic bags use and waste. Socially responsible customers already carries their old plastic or cloth shopping bags. Hopefully, this will be not only the fashion but a lifestyle too in the nearest future.

Conclusions

The business and society should take care not only for “today” but for “tomorrow” too. As a result, it is necessary to learn the good practices of other countries in order to encourage or even force both business and society to behave socially responsible in the processes of production and consumption more actively to contribute to overcoming plastic paradox in the world.

Charges for the plastic bags demonstrably encourage society to reuse plastic carrier bags or use alternative kind multiple-use carrier bags more actively. For sure, at the beginning charges cause some inconvenience for consumers but they give the fastest results. Voluntary initiatives to minimise the usage and waste of plastics are not less important, despite the fact that these take more time to get the positive results. The bans on non-degradable plastic carrier bags must be applied in all the countries.

References


Is world really changing as fast as we think? Or is it event changing at all? Social transformations is a delicate topic for researchers. We invited young researchers to look at processes which cause social transformations (or prove the static of societal tradition) in their country and share it with us.