



**ESRC Centre for Analysis of Risk and Regulation**

## Decentralisation of Economic Law – An Oxymoron

Myriam Senn



THE LONDON SCHOOL  
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# Decentralisation of Economic Law – An Oxymoron<sup>\*</sup>

Myriam Senn

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## Abstract

The interest in decentralising governance is increasing worldwide. In Europe too, a policy of decentralisation is being applied. In economic law, notably in both the cases of EC competition and financial services law, new rules are in the process of being introduced. In competition law, the regulation on the implementation of the rules on competition has led to a decentralised model of law enforcement. In financial services law, the directive on markets in financial instruments has proposed the introduction of a four-level rule-making model, which may represent a participative, decentralised approach, but has resulted in a centralisation of that process, while the enforcement remains decentralised. This essay provides a brief overview of these models of regulation. Then, it examines these regulatory structures and focuses on the question of the impact of the decentralisation process in the context of decentred understandings of regulation. It points to the paradox of law being decentralised where it is a centralised function and thus represents an oxymoron. The paper argues that decentralisation results in an oxymoron depending on the function of law considered. The overall purpose of the paper is to contribute to a better understanding of governance through decentralisation.

## 1. Introduction

Within the economy different forms of governance and structures of regulation can be made out depending on the economic sector concerned and the goal pursued. Currently, some areas of economic law in Europe are undergoing a radical transformation process mainly with regard to the aspects of governance and the procedural norms applied. Important rules have recently entered into force or have been revised in the areas of competition and financial services law. From the point of view of governance, they are characterised by the fact that they deal with contradictory questions of centralisation<sup>1</sup> and decentralisation.<sup>2</sup> The

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<sup>1</sup> According to The Oxford English Dictionary, Volume II, p. 1035, centralisation means the action of centralising or the fact of being centralised; gathering to a centre or the concentration of administrative power in the hands of a central authority, to which all inferior departments, local branches, etc. are directly responsible. Centre means the point round which a circle is described; the middle point of a circle or sphere, equally distant from all points on the circumference; a point towards which things tend, move or are attracted or a point from which things, influences, etc. emanate, proceed, or originate. Ibid. p. 1035. Both, centralisation and centre, as well as decentralisation and decentre, see n 2 hereinafter, are used synonymously in this paper.

<sup>2</sup> According to The Oxford English Dictionary, Volume IV, p. 327, decentralisation means the action or fact of decentralising; decentralised condition. In Politics: the weakening of the central authority and distribution of its functions among the branches or local administrative bodies. To decentralise means to undo the centralisation of; to distribute administrative powers, which have been concentrated in a single head or centre.

new Council Regulation on the implementation of the rules on competition<sup>3</sup> and the new directive on markets in financial instruments<sup>4</sup> are two milestones of this development, which most probably will have longstanding and important repercussions. In competition law, the centralised scheme set up by the former regulation implementing the rules on competition<sup>5</sup> had applied for over 35 years without any major change. As a matter of fact, that centralised system proved to be effective and appropriate in order to establish a culture of competition in Europe and to ensure the uniform application of the norms.<sup>6</sup> However, it needed to be modernised and adapted to the changing environment.<sup>7</sup> In the area of financial services regulation it was recognised that the approximately 20-year old attempt to build up a single market for securities and investment services has not been satisfactory in achieving its goal of consistent application of the rules.<sup>8</sup> Consequently, it was generally accepted that the legal structure in this area also needed to be revised.<sup>9</sup> In particular, the application of the rules should be rendered more effective and promote a greater convergence of national approaches. In both cases, the opposite forces of centralisation and decentralisation are at play and the main argument of this essay is to try to cast some light on this debate.

Section 2 describes the institutional arrangements made in the area of competition law in relation to enforcement and arbitration and, in the sector of financial services law, in relation to rule-making and enforcement. The reasons for the introduction of a new institutional structure and new procedural rules in each area are examined. In competition law, the regulation on the implementation of the rules on competition introduces a decentralised system of law enforcement where it is in fact a centralised function. However, the role and treatment of the arbitrators still has to be clearly defined. In financial services law, the directive on markets in financial instruments introduces the application of a four-level rule-making model, which amounts to a centralisation while the enforcement remains decentralised.

Section 3 analyses these regulatory structures of governance mechanisms and focuses on the question of the impact of the decentralisation process mainly from the perspective of decentred understandings of regulation. It is assumed that the models described in Section 2 mainly raise issues in relation to the fragmentation of knowledge, power and control,

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<sup>3</sup> Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty; Official Journal L 1, 04/01/2003 p. 1-25. It applies since 1<sup>st</sup> May 2004.

<sup>4</sup> Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC Official Journal L 145, 30/04/2004 p. 1-44. See also Proposal for a Directive of the European Parliament and of the Council on Investment Services and Regulated Markets, and amending Council Directives 85/611/EEC, Council Directive 93/6/EEC and European Parliament and Council Directive 2000/12/EC, 19.11.2002, COM (2002) 625 final, 2002/0269 (COD).

<sup>5</sup> Council Regulation No 17 of 6 February 1962, First Regulation implementing Articles 81 and 82 of the Treaty, OJ 13, 21.2.1962, p. 204/62. Regulation as last amended by Regulation (EC) No 1216/1999 (OJ L 148, 15.6.1999, p. 5).

<sup>6</sup> White Paper on Modernisation of the Rules Implementing Articles 81 and 82 of the EC Treaty (formerly Article 85 and 86 of the EC Treaty), Commission Programme No 99/027 – (1999/C 132/01) –, Official Journal C 132, 12.5.1999, Executive Summary.

<sup>7</sup> A discussion of this point of view is outside the scope of this essay.

<sup>8</sup> Communication from the Commission – Financial Services: Building a framework for action; COM/98/0625 final. See also Moloney (April 2003), p. 509-510.

<sup>9</sup> A discussion of this point of view is outside the scope of this essay.

complexity, coordination among the different market actors<sup>10</sup> concerned, and self-regulation. It is argued that there is a paradox of law being decentralised where it is necessarily a centralised function and thus represents an oxymoron.

Finally, Section 4 sets out an attempt to assess decentralisation as a regulatory system or governance model based on selected observations. The paper discusses the oxymoron issue and argues that decentralisation results in an oxymoron depending on the function of law considered, enforcement, rule-making, or arbitration. The overall purpose of the essay is to contribute to a better understanding of the policy movement of governance through decentralisation, which can be used for a variety of experiments.<sup>11</sup>

## 2. The models

In general, the institutional arrangements and the structures and policies applied to economic areas or sectors are discussed independently from each other and few comparative analyses exist. The focus of this paper, however, is placed on the institutional arrangements and regulatory structures of both competition law and financial services law and discusses through them (various) aspects of centralisation and decentralisation. Both areas are linked due to the fact that they both play a central role within a functioning economy and both just have or are undergoing radical changes. They also present some common features insofar as they are designed to better meet the challenges of an integrated market and the enlargement of the Union.<sup>12</sup> At the same time, it is suggested that they represent alternatives, because competition law belongs to the horizontal policies of the European Union whereas financial services law is sector-specific. It is therefore possible to get a broader overview with regard to the oxymoron issue.

In this context, it should also be taken into account that although the current transformation process is based in both cases on a long-lasting regulatory experience in applying the former rules, the reasons leading to redefine the norms and introduce a new regulatory model are different in each case. Their previous institutional and regulatory structure as well as their respective goals also differed. Inevitably, this has repercussions on the form of governance applied.<sup>13</sup> In fact, in each case the efforts made to determine and introduce new rules have largely been influenced by the experiences made with the former rules. In particular the advantages and disadvantages of the existing systems of regulation were well known.

In this paper, the different institutional arrangements and the structures introduced in competition law and financial services law are described in the form of models. This is because a simplified presentation of each area is considered which focuses only on their important features. In a way, both cases are put into a 'shape' and are each arranged or classified as a model. This approach focuses the description on the main institutional features of both competition law and financial services law, which refer respectively to

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<sup>10</sup> For the purpose of this paper, the terms actor and participant are used as synonyms. Basically, the following three broad categories of actors with own functions are distinguished: (1) official international and supra-national institutions, authorities and courts, (2) national institutions, authorities and courts, (3) companies – regulated firms and other companies – and individuals. However, more detailed classifications are possible: not at least for the purpose of the enrolment analysis, Black locates an extremely wide range of actors in the financial services area. See Black (October 2003), p. 10-11. If specific actors are addressed in this paper, they will be named explicitly.

<sup>11</sup> Besley, p. 8.

<sup>12</sup> See *supra* n 3, Introduction; Proposal, *supra* n 4, p. 7-8.

<sup>13</sup> See hereinafter points 2.1. and 2.2.

enforcement and arbitration, and rule-making and enforcement. With regard to the oxymoron issue of decentralisation of economic law they are determining. Moreover, a model can also be interpreted as representing a system that both works and is complete. As such, it is not limited to dealing with official rules nor the official institutional framework. Thus, it is also possible to take elements which do not officially belong to the institutional framework, for example arbitration in the case of competition law, which – as will be discussed later – is an important constituent of the model of competition law.

Furthermore, in relation to centralisation and decentralisation of governance, it is also possible to deal solely with the determining features of a model independently.<sup>14</sup> Presently, they encompass questions of enforcement of the law, and the specific question of arbitration in the case of competition law, but do not include the rule-making process in relation to that law. On the contrary, in the case of financial services law, the focus is first placed on the rule-making process and then on the question of enforcement of the rules. These different features, themselves, represent alternatives.

The presentation of the two models concentrates on institutional and structural aspects of regulation and the forms governance may take. It does not deal with the regulatory tools, which may be written norms (legal and non-legal) – eg, in competition law in the form of a regulation and in financial services law a directive, both according to European law – and accompanying sanctions, economic or market-based instruments, social norms and corresponding sanctions, technologies and processes.<sup>15</sup> Neither does it deal with questions of substantive law.

## **2.1. Competition law: enforcement and arbitration**

Under the former competition rules<sup>16</sup> or model of centralised governance, restrictive practices in the system of cartel supervision and abuses of dominant or monopolistic positions affecting trade between Member States had to be notified to the Commission in order to qualify for an exemption. It was the exclusive power of the Commission to either authorise these practices or grant exemptions in accordance with the conditions laid down in the EC Treaty, and to forbid cartels and abuses of dominant or monopolistic positions, which could have distorted competition. This system was characterised by the centralisation of the authorisations for all restrictive practices by the Commission, and thus requiring exemption following prior notification to the Commission by the market participants concerned.<sup>17</sup>

Although the system that emerged from that initial regulation proved to be successful, eventually it began to present some disadvantages, which were due mainly to developments within the environment. Hence, it was generally recognised that there was a need to modernise and adapt the rules. The most important weaknesses of that system can be classified as follows:<sup>18</sup> first, the national competition authorities and the national courts did not have enough competencies to effectively enforce the competition rules themselves. Second, the monopoly of the Commission on notification and exemption appeared to be no longer appropriate. It necessitated a lot of the Commission's resources, which then did not have sufficient resources left to concentrate on the discovery or detection of serious cases of

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<sup>14</sup> See Black, *supra* n 10, p. 10-11; Black (January 2002), p. 2-7.

<sup>15</sup> Black, *supra* n 10, p. 3. To the basic issue of how regulation can be exercised, see Black, *supra* n 14, p. 15.

<sup>16</sup> Regulation No 17 of 1962; see *supra* n 5.

<sup>17</sup> For an introduction see Whish (2003); Furse (2004).

<sup>18</sup> See *supra* n 6, White Paper, Executive Summary and p. 17-20, 23-24 and 27-28.

fraud or infringements against the competition rules. Third, the companies notified large numbers of restrictive practices to the Commission to avoid private action before national courts and national competition authorities - not only to seek legal certainty. This situation created a lot of unnecessary bureaucracy and costs to the companies. Finally, the prospect of future enlargement of the European Union called for a reform of the system. It was generally agreed that it was essential to adapt it to the economic and social changes which had occurred since the introduction of the first regulation.

### *Enforcement*

The new rules<sup>19</sup> – which were described in the White Paper on modernisation of competition law as mainly mapping out the transition from a centralised authorisation model to a decentralised governance model – do not only represent a modernisation or adaptation of competition law with regard to the attainment of its objectives.<sup>20</sup> The main one is that Member States must avoid the monopolisation of certain markets by preventing companies from entering or participating in a market. Any abuses of dominant position among companies have to be avoided. Moreover, Member States' governments should not be allowed to distort the rules by discriminating in favour of public enterprises or by giving aid to chosen private-sector companies. The rules provide the conditions for the development of a decentralised enforcement system. The most important characteristic of this new, decentralised model over the former system of centralised authorisation involved setting up an exemption system for cartels and other abuses of dominant positions, which is entirely implemented by national competition authorities (NCAs) and national courts.

Thus, these norms introduce important changes as far as the regulatory structure and the procedures applied are concerned. An entirely new division of responsibilities and powers among national and supra-national authorities characterises the procedural reform. Within that decentralised system, the Commission has given up its exemption monopoly, but it has the possibility to make ex post controls. The national authorities and national courts have received powers to grant exemptions. They are able to take direct action against private companies to ensure compliance with competition rules as far as their country is concerned. Hence, any administrative or judicial authority called upon to apply the provisions prohibiting agreements which restrict competition according to the EC Treaty can apply the provisions setting out the conditions for exemptions.<sup>21</sup> Practically, this approach offers the possibility to establish a system of general exemption for all agreements and clauses in a given category.<sup>22</sup>

An important objective and challenge of this system is to promote the consistent application of the competition rules among the Member States and not to give rise to differences. Competition should in no way be distorted. Moreover, there should be no legal uncertainty for the companies. To reach this goal, a European framework of consistent application of the competition rules is created through the introduction of new information and cooperation mechanisms. The NCAs have to work closely with the Commission on the one hand and cooperate with the competition authorities of the Member States on the other hand. To that end, the Commission stresses the principle of primacy of Community law. It indicates that

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<sup>19</sup> See *supra* n 3. See also the Proposal for a Council Regulation on the Implementation of the Rules on Competition Laid Down in Articles 81 and 82 of the Treaty and Amending Regulation (EEC) No 1017/68, (EEC) No 2988/74, (EEC) No 4056/86 and (EEC) No 3975/87 COM (2000) 582 final.

<sup>20</sup> See *supra* n 6, p. 3.

<sup>21</sup> Art. 81(3) EC Treaty, see *supra* n 3.

<sup>22</sup> See *supra* n 6, p. 19-20.

the existing information and cooperation mechanisms<sup>23</sup> apply to competition law. It also expresses its readiness to edict explanatory notes to explain its policy and assist national authorities with the application of the rules.<sup>24</sup>

Its Notice on cooperation within the Network of Competition Authorities<sup>25</sup> expressly seeks to ensure effective cooperation of the Commission with the NCAs and vice versa in a network, the European Competition Network. It rules on the exchange of information between the NCAs and the Commission. In particular, an increased cooperation should take place and practices should be brought to the attention of the other parties (the Commission or the NCAs) in all cases. In fact, the new Regulation sets up a system of supervision and control by the Commission. All decisions and practices developed by NCAs must be notified to the Commission. Within this process, the Commission has acquired powers over national regulatory authorities. For example, it can pre-empt the competencies of the NCAs where it initiates an investigation, although it is required to first consult the NCA in such cases. The Commission may also choose to take a case from a NCA and deal with it itself. In other words, it can displace the NCAs and substitute its own proceedings in any case. The consequence of this increased cooperation, which in fact represents the counterpart of the decentralisation process, may well represent a centralisation. Although, it is still too early and no sufficient empirical data exists to judge whether the new regime represents a real shift from a highly centralised system of enforcement to a decentralised regime, and whether decentralisation really took place, it is most probably true that in practice the new regime may well result in an increase of the Commission's power and not a decrease.

As far as the national courts are concerned, they shall consult the European Court of Justice directly on all matters – thus, also on competition law matters – and the Court will give preliminary rulings.<sup>26</sup> Finally, from the point of view of the companies, this system represents a shift to greater reliance on their self-assessment. It introduces a simplification of the procedure and administrative formalities applying to them. The ending of the requirement to notify restrictive practices has positive effects. The companies will stop notifying large numbers of such practices, which was very expensive and consequently be able to better concentrate on their commercial strategy, which should result in a reduction of their compliance costs.

### *Arbitration*

As already stated, the main concern with regard to the introduction of a decentralised enforcement system is to ensure the consistent enforcement of the rules. Thus, as just stated, a whole network has been created within which the Commission coordinates the activities of the NCAs. The role of the courts is clearly defined too. However, it should not be ignored that the decentralisation of competition policy also has important implications for arbitrators. Arbitration has become increasingly common and is still developing as a method of dispute resolution by private justice in the law of business transactions.<sup>27</sup> Due to its specific features and the fact that it belongs neither to the European Competition Network nor to the court system, it must be considered separately, because it is suggested that it represents a factor with a potential to hinder the consistent application of the rules.

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<sup>23</sup> Art. 169 and 177 EC Treaty.

<sup>24</sup> See *supra* n 6, p. 22-26; art. 11-16 Regulation 1/2003, *supra* n 3.

<sup>25</sup> Commission Notice on cooperation within the Network of Competition Authorities, OJ C 101, 27/04/2004, p. 43-53.

<sup>26</sup> Art. 234 EC Treaty.

<sup>27</sup> See for example: Gharawi, p. 185-188. See also Baudenbacher/Higgins, p. 2-3.

Arbitral tribunals may act based on their own judgments only. They are free from the constraints under which other authorities operate. They do not have to take precedents into account and are not concerned with the development of a coherent case law. Their approach is the same, irrespective of the area of law concerned. They are guided by the chances that the parties reach an agreement, in order for them to solve a problem. They may also apply the specific rules designed by the parties and ignore other national or supranational rules.<sup>28</sup> Furthermore, in European law, no constitutional or other duty or specific rules apply to arbitrators. Arbitration is an independent or self-regulated body of law and represents an alternative to any national or supra-national legal system. From the point of view of an arbitrator, European law only constitutes one possible source of legal provision among others claiming application to the merits of a case.<sup>29</sup> However, in the European Union it was generally accepted under the former, centralised system that competition rules were arbitrable and that arbitrators had to apply these rules in the same way as the national courts. This obligation resulted from a statement of the European Court of Justice according to which: "Community law must be observed in its entirety throughout all the territory of all the Member States; parties to a contract are not, therefore, free to create exceptions to it."<sup>30</sup> In such cases, arbitrators could have considered whether an alleged offence fell under an exemption. However, a thorough analysis of the arbitrators' duties and powers by the European Court of Justice does not exist.

The main problem of arbitration certainly is the fact that the assistance mechanisms, which have been introduced for national authorities and courts, have no equivalent with respect to arbitrators. Arbitrators are private actors and although they may be in a position to deal with complex issues in relation to the application of the rules, they are not specialised in dealing with public policy issues. Furthermore, until now the European Court of Justice only recognised certain types of arbitrators as arbitral courts, with a right to request preliminary rulings.<sup>31</sup> Private arbitrators do not have standing to lodge a reference.

However, it is generally admitted that the decentralised enforcement of competition law may only be successful if it can ensure the consistent application of the rules in all the areas, including arbitration proceedings. With a view to this situation, a possible solution could have been to introduce an independent and direct right of reference for arbitrators. As the regulation contains no such right, it should be possible to assist the arbitrators in an informal way in practice if necessary.<sup>32</sup> However, there is a risk not only with regard to the consistent enforcement of the competition rules, but that arbitration can also be perceived as a device allowing the parties to effectively evade the rules.<sup>33</sup>

In summary, this model introduces a new distribution of powers and a genuine network of cooperation among the different authorities. While enforcement is decentralised, the Commission remains the sole authority to be active on the whole territory. It is in charge of

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<sup>28</sup> On arbitration see: Arbitration and alternative dispute resolution; Redfern and Hunter; Hopfe, 263; Born; Cotran and Amisshah; Pryles; International Handbook on Commercial Arbitration; van den Berg; Guide to ICC arbitration; Rubino-Sammartano.

<sup>29</sup> Shelkopyas, p. 570; see also: Gharawi, *supra* n 27, p. 185-188.

<sup>30</sup> See Nordsee Deutsche Hochseefischerei GmbH v. Reederei Mond Hochseefischerei Nordstern AG & Co. KG, Case C-102/81, 1982 E.C.R. 1095, at para. 14. See also Baudenbacher/Higgins, *supra* n 27, p. 3, with further references; Gharawi, *supra* n 27, p. 188-192.

<sup>31</sup> See Baudenbacher/Higgins, *supra* n 27, p. 15-17; Gharawi, *supra* n 27, p. 197-199.

<sup>32</sup> Baudenbacher/Higgins, *supra* n 27, p. 14-18.

<sup>33</sup> See Shelkopyas, *supra* n 29, p. 575.

developing the rules and shaping the competition policy, which remain centralised features of the model. It also has to take adequate measures to prevent decentralisation of competition law, which could allow a re-nationalisation to occur. Thus, the implementation of the decentralisation package may, in fact, result in a centralisation.

## **2.2. Financial services law: rule-making and enforcement**

As for the area of financial services, the following presentation focuses on the directive on markets in financial instruments.<sup>34</sup> The reason for putting the emphasis on that directive is that it might be the most adequate and representative in illustrating the changes within the governance structure currently occurring in financial services law. In this area, the process of integrating capital markets and developing a policy of consistent practice to construct a single financial services market began in 1979. The governance system applied relied on the two pillars of mutual recognition of the respective regulatory exigencies among the Member States and home country control. It was foreseen that it would be possible to operate without any constraint throughout the European Union, with a single regulatory passport.

The seminal investment services directive (ISD) adopted in 1993<sup>35</sup> did precisely that in trying to lay down rules to make the said governance structure concrete. Its main goals were to establish conditions under which authorised investment firms and banks could provide specific services in other Member States on the basis of the home country control and ensure a grade of coordination necessary to secure mutual recognition of authorisation and prudential supervision within the EU. The directive should have created a single passport for investment firms and investment services. The role of the legal instrument was the enforcement of the EC Treaty freedoms as far as investment services and organised trading of financial instruments were concerned.<sup>36</sup> From an historical point of view, the implementation of that directive proved to be unsuccessful<sup>37</sup> and the Commission decided to take measures to address the situation. An important initiative was the Financial Services Action Plan,<sup>38</sup> which proposed the introduction of a strategic programme in order to accelerate the realisation of a single financial market. Once completed, it will have changed the shape of investment services regulation in particular. Therefore, the directive discussed here is an integral part of a coherent programme of legislative measures.<sup>39</sup>

### *Rule-making*

The directive incorporates those provisions of the former ISD, which have proved their worth. It introduces material changes, which take into account the evolution and development of the financial markets. Its broad objectives are to efficiently protect the investors and ensure market integrity, as well as to promote fair, transparent and integrated financial markets. It is expected that once in place it will have a positive effect on the whole economic activity.<sup>40</sup>

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<sup>34</sup> See *supra* n 4.

<sup>35</sup> Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field; OJ L 141, 11.6.1993, p. 27-46; see generally Moloney (2002).

<sup>36</sup> See Proposal, Explanatory Memorandum, *supra* n 4, p. 3.

<sup>37</sup> Building a Framework for Action, COM (1998) 625 final; Moloney, *supra* n 8, p. 509-510 and generally with regard to the development of an integrated market: Hertig and Lee, p. 3-5.

<sup>38</sup> FSAP, COM (1999) 232 final, Implementing the Financial Services Action Plan.

<sup>39</sup> See Proposal, Explanatory Memorandum, *supra* n 4, p. 3-5.

<sup>40</sup> See Proposal, Explanatory Memorandum, *supra* n 4, p. 8-28; critically: Hertig and Lee, *supra* n 37, p. 3-20; and for a positive point of view: McKee, p. 277-283.

From the point of view of centralisation and decentralisation of governance, the most important feature of the directive is the new approach it introduces with regard to the rule-making process. It consists of applying the model of rule-setting advocated by the Committee of Wise Men,<sup>41</sup> which requires that a systematic and rational distinction is made for the high level principles, the technical rules and the implementing measures. These measures should be legally binding, applied consistently, and at the same time they should be easily adaptable.<sup>42</sup> Prima facie, the idea of delegation of some legislative functions and powers is a genuine feature of the model.<sup>43</sup>

More concretely, the Committee has mapped out a legislative structure of four levels: Level 1 consists of framework principles and legislative acts elaborated by the Commission and adopted by the Council and the European Parliament. It provides for powers to be delegated to the Commission. Level 2 is the result of a delegation of legislative procedure.<sup>44</sup> At this level, one finds the technical implementation measures the Commission adopted as a result of the Committee of European Securities Regulators (CESR)'s consultations with market participants and interested parties (CESR was established following the recommendations of the Lamfalussy Report by decision of the European Commission of June 2001 and recognised by the European Parliament<sup>45</sup>). This second tier tries to describe and outline the principles more precisely and defines the detailed measures. At Level 3, the consistent and timely implementation of Levels 1 and 2 should be realised. This level also requires the joint interpretation of recommendations. Hence, the national regulators should cooperate more intensively and CESR may provide assistance through guidelines or by developing common standards. Level 4 concerns the enforcement. In particular, the strengthening of the enforcement of the rules requires the Commission to observe the practices developed by the Member States.<sup>46</sup>

CESR is expected to play a crucial role within this rule-making process, mainly with regard to the third level. The overall goal of its activities is to ensure the consistent and timely day-to-day implementation of the European legislation in the area of financial services. As CESR is composed of national securities regulators who are in direct contact with market participants, it is in a better position than the Commission to appreciate the situation and problems existing among the Member States. When exercising its functions, it can rely on its strong ties with the Commission, national authorities and market participants. CESR can also sort out differences in relation to the proposals and implementation of the rules. It works in a transparent and open manner on the mandates it receives and already has established a detailed procedure for consultations,<sup>47</sup> which should target all interested parties. This approach is in line with the measures proposed with regard to European governance in general. Furthermore, CESR also works through its own Expert Groups with clearly assigned mandates. Thus, the market participants should be able to contribute to all the discussions and submit new ideas. This open-door policy should enhance the democratic character of the rule-making process, which should provide for more acceptances of the European norms as well as ultimately contributing to their consistent implementation.

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<sup>41</sup> See Proposal, *supra* n 4, p. 32-33.

<sup>42</sup> *Ibid.*, p. 32-33.

<sup>43</sup> See critically hereinafter in the text, point 3.

<sup>44</sup> See Moloney, *supra* n 8, p. 511.

<sup>45</sup> See Commission Decision 2001/527/EC.

<sup>46</sup> See Proposal, *supra* n 4, p. 43.

<sup>47</sup> See: European Governance: A White Paper, COM (2001) 428 final, 25.7.2001, p. 11-18. See also Ref. CESR/01-007b.

As described, this model introduces a partly new repartition of the roles among the main categories of actors: the Commission, the national supervisory authorities, CESR and the private market participants. However, it does not introduce a radical new distribution of powers. Only some powers are attributed to other actors. At the institutional level, legislative powers are given to the Commission in relation to the detailed rules. The Commission is the sole authority in charge of approving the detailed rules. The Council and the European Parliament only pass the basic principles, which are laid down in the directives. They do not have any influence on either the formulation or passing of the detailed rules. Thus, within this model, decentralisation only takes place at this institutional level.

With regard to the other participants, this model results in a centralisation around the Commission. It is the sole, responsible authority to have the power to formally approve the detailed rules, which either were laid down in the directives themselves or were passed by the Member States under the former system. In practice, the Commission may be influenced by CESR and the European Securities Committee<sup>48</sup> – which represents the political counterpart of CESR – when it takes its decisions. CESR can prepare technical rules and make proposals, but it does not have any powers to pass them. Formally, contrary to the previous situation, neither CESR nor the Member States have any capabilities.<sup>49</sup>

### *Enforcement*

Moreover, the directive represents an attempt to clarify the attribution of responsibilities among the different actors (mainly the market participants – investors and supervised financial institutes<sup>50</sup> – and the supervisory authorities), not least with the means to create incentives in order to ensure the consistent enforcement of its provisions. The directive largely concentrates on the role and function of the competent national authorities and on supervisory cooperation among these authorities. In particular, the introduction of the four-level model implies the participation of a number of different authorities and some countries may have several competent authorities. Due to this situation and with regard to legal certainty, it is necessary to clearly determine the role and functions of all the authorities concerned. Thus, the directive requires that the Member States publicly designate one competent authority, which has to enforce the individual provisions. This authority should be a public body; independent and avoid conflicts of interest. The directive describes the conditions under which responsibilities may be attributed by the competent authority to other authorities or independent bodies, including self-regulatory ones.<sup>51</sup>

To guarantee the consistent and equivalent intensity of enforcement of the rules, on the one hand, and to further the creation of an integrated financial market, on the other hand, the directive also requires that there should be some convergence within the powers at the disposal of the competent authorities.<sup>52</sup> As a matter of fact, the list of powers (art. 50 of the directive) and provisions for administrative sanctions (art. 51 of the directive) are modelled on similar provisions to the ones, which have been introduced in the Prospectus and Market Abuse Directives. Another important issue raised by the directive is the strengthening of the duties of assistance and cooperation among these authorities. It is generally recognised that

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<sup>48</sup> ESC, see Commission Decision 2001/528/EC.

<sup>49</sup> Moloney (2003), p. 813-817; and: Scott, p. 62, 74-76, in the same sense in relation to governance at the European level. See also European Governance: A White Paper, *supra* n 47.

<sup>50</sup> See Black, *supra* n 10, p. 10-11.

<sup>51</sup> See Proposal, *supra* n 4, p. 31-32 and art. 49 of the Directive.

<sup>52</sup> See Proposal, *supra* n 4, p. 28-32.

the existing provisions on exchange of information are not sufficient. They were adapted to markets in which there were no or only few links.<sup>53</sup> Nowadays, national markets work together and the proportion of cross-border activities is slowly increasing. This requires an efficient cooperation among national supervisors; a good functioning network should be created. It is not only necessary for the effective enforcement of the rules and the pursuit of infringements, but also to sustain the confidence needed and to support reliance on home country supervision.<sup>54</sup> Thus, officially the view is taken that the new approach should ensure a more effective and market-responsive application of the rules. However, as a counterpart, the role and influence of the Commission may increase and it may well work as a centralising force.

### 3. Analysis of decentralisation

It should be noted that the following analysis of some of the structural aspects of the models described should be understood in a broad sense: the most important assumption resides in the fact that the main goal of regulation is welfare economics. Consequently, a functional approach is applied; regulation should be understood to be a factor that contributes to correct market failure and manage risks.<sup>55</sup> As far as the concrete models discussed here are concerned, the current process of introduction and application of new rules follows the premise that previous regulatory models either have been unsuccessful or needed to be redefined. In a way, the introduction of new models can be considered to be a remedy to the weaknesses and regulatory failures of the former ones. Their main point is that some powers should be attributed to the market actors and that these actors should be enabled to participate in and be better integrated in the legislative process. In sum, efforts are made to introduce a market-based approach. This approach of decentring or opening the legislative process is a consequence of the recognition that the use of strict centred procedures, as was the case in competition law, is no longer satisfactory. It is also in line with the White Paper on European Governance, which submits proposals to obtain greater involvement of the general public in the discussion of European issues and makes suggestions to democratise the rule-making process as such.<sup>56</sup>

Moreover, the form or shape decentralisation takes differs according to the area considered and depends on the regulatory objectives or requirements of an area, which have to be fulfilled by the different actors concerned. Decentralisation is not a determined policy concept. There is not one form of decentred regulation. Decentred regulation can take a variety of forms and can cover different policy experiments. Decentred perspectives represent a wide set of techniques too and are rooted in systems theory.<sup>57</sup> Hence, separate models can be outlined for competition law and financial services law, as described in the previous section.

The concept of decentralisation implies that the state does not have the monopoly of shaping and determining the whole regulatory process. The regulatory functions are dispersed or fragmented among the different actors concerned. Consequently, the emphasis is placed on

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<sup>53</sup> See Proposal, *supra* n 4, p. 32.

<sup>54</sup> See Proposal, *supra* n 4, p. 32.

<sup>55</sup> A discussion of the goal of regulation in general is outside the scope of this essay. See for this topic Black, *supra* n 14, p. 7, with further references.

<sup>56</sup> See the White Paper on European Governance, *supra* n 47, p. 11, 20.

<sup>57</sup> See Black (November 2001), p. 103-146. See also Hancher and Moran; Scott (2001); Teubner; Scott (2004), p. 226-245.

complexity; in particular, a whole range of interactions among the state and the other actors concerned take place. In order to work, these interactions have to be coordinated and a working system of co-operation represents an important element of decentralisation. At the same time, this implies a fragmentation of knowledge, power and control among the state and the other actors, who all have to fulfil their own specialised functions, but who do not master the whole regulatory process each on their own. Furthermore, regulation should be understood in a broad sense. It is not produced by the state only, but by a whole range of actors. As a consequence, the central authority of the state is basically weakened and a greater number of actors participate in the regulatory process. Thus, the distribution of power implies that there is also room for the actor's own initiative; an actor who can act autonomously and can express himself in the form of self-regulation too.

The models discussed here are analysed from the perspective of a decentred understanding of regulation. The following – only punctual – observations are made on the basis of four criteria: fragmentation of knowledge, power and control; complexity; coordination; and self-regulation. In fact, in scholarly contributions and in practice, a whole range of criteria have been delimited and discussed in order to define the concept of decentred regulation. However, this paper focuses solely on four criteria because (in the view of the author) they are best suited to characterise the models of governance discussed here. Although, they are inspired or may be similar to Foucauldian notions, as some of them are made concrete and discussed as characteristics of decentred analysis of regulation by Black,<sup>58</sup> they should not be understood strictly in that sense in this paper.

#### *Fragmentation of knowledge, power and control*

Fragmentation<sup>59</sup> constitutes an element of the concept of decentralisation, because the regulatory functions are not concentrated anymore; on the contrary they are distributed among the different actors concerned. Thus, this undoing of a centralised system or the existence of a decentralised system of governance results in a fragmentation, which is an innate part and characteristic of decentralisation. In relation to regulation, the determining elements of knowledge, power and control are not centralised anymore, they are fragmented.

Both models discussed here first introduce a fragmentation of knowledge, which is an inherent feature of decentralisation. It results from the information asymmetry between the different regulators and the regulatees and implies that on the one hand, the Commission knows the rules but does not know the practical situation in the Member States. On the other hand, the national authorities have a good knowledge of both the rules and the situation in their own national markets, though their knowledge is not as detailed as that of the Commission and the markets, each in their own respective field. Regardless of that situation, the national authorities are in a better position to communicate with the institutes they supervise and thus enforce the rules. On the whole, no actor possesses all the information regarding a determined market or area.<sup>60</sup>

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<sup>58</sup> See Black, *supra* n 14, p. 2-7, with further references. Black's decentred understandings of regulation deal with five perspectives or central notions, which serve to seize or analyse decentred systems of regulation: complexity, fragmentation, interdependencies, ungovernability, and the rejection of a clear distinction between public and private.

<sup>59</sup> Basically, the word fragmentation is used. Instead of fragmentation, delegation may be used too, but it is to be understood as an authoritative decision that transfers policy making authority away from established, representative organs to a non-majoritarian institution, whether public or private. Thus, the definition implies that it is largely used as a policy method, which should not always be the case with fragmentation. See Thatcher and Stone Sweet, p. 3; Thatcher, p. 125-131; Shapiro, p. 173-175.

<sup>60</sup> See also in this sense Black, *supra* n 14, p. 3-4, with further references.

The situation is more differentiated in relation to the fragmentation of power and control. In competition law, there is no fragmentation of power and control at the rule-making level, which – as a legislative function of the state – remains an entitlement of the European institutions, and therefore centralised. At the enforcement level, as an executive function of the state, the effective fragmentation of power is the core of the introduction of a decentralised organisation. The national authorities receive clear enforcement powers and corresponding duties as far as their national markets are concerned. In comparison to the former centralised enforcement model, it is a top-down approach. However, due to the enlargement of the European Union, there is an even more important need for them to cooperate with each other and coordinate the policies they apply with the authorities of the other Member States and the Commission. The working of the model largely depends on such cooperation. The Commission still can intervene to a large measure; it remains responsible for the policy-making and is in charge of assisting the national authorities when they carry out their specific administrative functions. Consequently, there is no real fragmentation of control as far as the enforcement is concerned and the national authorities are not entirely independent. Furthermore, it should be noted that the Commission's possibilities to influence arbitration, which reinforces the fragmentation and is significant in that model, are not clear. Arbitration is not the result of any concrete measure taken, but it has the potential to distort or hinder the consistent enforcement of the rules. Indeed, arbitration could be interpreted as a consequence of a model or a regulatory system set up by regulators. If a model does not work satisfactorily or presents severe disadvantages for the companies, they might prefer to turn to arbitration. There is still no empirical evidence on this point, but arbitration can be considered to represent an effective decentralisation in relation to the model as a whole.

In financial services law there is no delegation of power from the Commission to CESR and the national authorities, as far as the rule-making process is concerned. On the contrary, Member States and national authorities have no power to pass detailed rules for their own country, as was the case formerly. As already stated, CESR, national authorities, as well as private market participants or consumers, can participate in the regulatory process and submit proposals, but they cannot decide on the rules to be adopted. This capability belongs now expressly to the Commission. This situation represents a bottom-up approach (rather than top-down) as well as a case of (reverse) delegation where the powers of the principal or Commission increase, while the powers of the agents (CESR and the national authorities) decrease.<sup>61</sup> It can be interpreted as result in a fragmentation or a hybrid form of control – including the participation of governmental and private actors<sup>62</sup> – insofar as within the rule-making process the Commission can attribute mandates to CESR. CESR deals with technical questions and submits regulatory proposals. It works in an open manner and tries to reach as many market participants as possible, all of whom can take their own stance. However, due to the fact that no power is delegated at the moment, it is difficult to determine the extent of the participation of the different market actors in the long run. One cannot exclude the possibility that they will lose interest in Community matters and prefer to concentrate on their own objectives, nor can one forget that the Commission may be even more influential following the institutional decentralisation occurring in her favour. For its part, the enforcement always has been decentralised in the area of financial services, implying that the national supervisory authorities have corresponding powers. This situation is confirmed

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<sup>61</sup> In the same sense: Lastra, p. 62; see to the Principal-Agent Approach: Thatcher and Stone, *supra* n 59, p. 3; Thatcher, *supra* n 59, p. 125-131; Shapiro, *supra* n 59, p. 173-179.

<sup>62</sup> Scott, *supra* n 49, p. 68; Black, *supra* n 14, p. 6.

by the new rules, and the network constituted by these authorities is even reinforced insofar as their role and competencies now are clearly delimited.<sup>63</sup>

### *Complexity*

The next characteristic of decentralisation taken into account is complexity. Complexity belongs to the concept of decentralisation, because that concept implies that the centre is weakened and loses, at least in part, its meaning and function, while other entities emerge. These entities may then assume some agreed responsibilities and functions. A system is constituted, which is not a simple, one-centred system, but one which comprises many different ramifications. Thus, it represents a complex system, which is narrowly linked to, or even depends on, the concept of decentralisation. Both models discussed in this essay are complex or complicated. A key element of their complexity lies in the interactions between the actors involved. These interactions can simultaneously develop their own dynamics, thus rendering the system even more decentralised and complex. These interactions can be classified as constituting intra-organisational as well as external networks of interdependencies and references to factors, subjects and contexts.

Theoretically, intra-organisational relations consist in the linkages existing between one (mother) organisation and its sub-organisations. These organisations are not considered to be autonomous, but interdependent. Although the processes and tasks are similar to the ones of external networks, the question of the integration of these sub-organisations in the main organisation is much more important. This is underpinned by the fact that it is not possible to retire from an organisation without leaving the whole system. Furthermore, the working of the network is linked to a hierarchical structure among the institutions and actors, which constitutes a key element of that network.<sup>64</sup> In relation to the models considered in this paper, a similar situation can be applied to the competition law model and to the financial services law model. Indeed, the Commission represents the basic organisation in both models, while the national authorities and the other markets actors may fulfil the role of the sub-organisations. The working of the whole organisation depends on their interactions and readiness to cooperate with each other. As the roles and functions of the different actors are pre-ordained by the rules governing that area, they are intertwined and it is not possible only to quit a sub-organisation, but the whole organisation.

External networks are characterised by the fact that they represent horizontal systems, which result in horizontal cooperation taking place among the organisations concerned themselves. These organisations can act autonomously, but they may (voluntarily) cooperate as they are dependent on each other and pursue similar interests. Consequently, there is also a possibility to quit a network.<sup>65</sup> Again, applied to the models considered here, these kinds of networks may be encountered, for instance, among the competent national authorities within an area or comparable public or private groups of interests at the national level, etc.

In particular, in the case of competition law, the attribution of enforcement responsibilities to the national authorities constitutes an external network, as such rendering the model more complex. It should, as already stated, motivate these authorities, as well enforce the rules of cooperation amongst them, though more actors have to play an active role in that model, eg, the European Competition Network. As a consequence, the success of its implementation in fact depends largely on the willingness of national authorities and of other actors involved to

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<sup>63</sup> See *supra* point 2.2. at Enforcement.

<sup>64</sup> Willke, p. 112-125.

<sup>65</sup> *Ibid.* p. 112-125.

interact, with a view to applying the rules and working together in a constructive way. Furthermore, the interests pursued by the different categories of actors and the dynamics of their interactions, which are already intricate, might largely influence its realisation too.

In financial services law, both the rule-making and the enforcement processes are more complex in their design than in competition law. The four-level rule-making approach requires interactions among all the market participants, including private ones. At the institutional level, there is now a multiplicity of committees, which renders the situation extremely fragmented and even more complex. Among others, both CESR and the European Securities Committee (ESC) have been created recently.<sup>66</sup> As already stated, the enforcement has always been decentralised in that area. However, the new rules render the decentralisation even more complex. The national authorities have clearly defined powers, but they might be influenced by the private market actors and can act through CESR in order to pursue their own goals. Thus, there is a risk that their way of operating may become impenetrable.

The complexity of both models is further accentuated by the functional approach applied through decentralisation. Both models are fragmented and the goal of the approach or concept of governance applied is to ensure compliance with the rules throughout the European Union, in each area or sector. This implies that they are adapted to the realities of the area or sector concerned, which is likely due to the flexibility offered by decentralised approaches, which can be rapidly adapted to the characteristics of an area. Moreover, the interactions among the participants of a model create a dynamic of its own. This increases the complexity of a model, made already complex by diverse actors and other specific factors which can determine and influence the working of a model.<sup>67</sup> In both models, the enforcement of the norms gives rise to more interdependencies and requires even more coordination and multilateral interactions among the actors concerned, not least because of the enlargement of the Union. In fact, the enlargement process represents a further challenge as far as the integration of the actors is concerned. The characteristics of the interactions with the new Members do not correspond to the ones applying to the former Member States. This again renders the models and form of decentralisation even more complex. These countries not only have another background and no previous experience in implementing the rules, but they are also used to acting according to other principles and applying a different approach and philosophy. This requires the development of new ways of thinking, interacting and cooperating with each other in order to reach common goals.

### *Coordination*

Besides complexity, decentralisation of governance is narrowly linked to the question of coordination and cooperation among the different actors or participants concerned. Coordination probably is the most important characteristic of the models of decentred governance and may be considered to constitute the core of their existence. It is an inherent part of decentralisation and emanates from the existence of a decentralised system itself. In such a system, there is no centralised power or a single head anymore, but a multitude of centres. They have to work together in order to ensure the functioning of the system as a whole, and consequently coordinate their activities.

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<sup>66</sup> See *supra* n 45 and n 48.

<sup>67</sup> See Black, *supra* n 14, p. 3.

In fact, decentralisation represents a dichotomy between autonomy and integration, and coordination constitutes a pivotal condition in order to get them to work. Practically, it is necessary to organise the exchange of information among the actors concerned and ensure their broad integration in the respective rule-making and enforcement processes. In particular, decentred models are characterised by interdependencies among the actors, each playing a determined role. They should work together on the one hand and thus also constitute a reliable basis for the market participants on the other. Depending on the degree of centred and decentred governance introduced or applied in a model or area, different interdependencies can be created or recognised and the kind of interactions among the market actors can differ depending on the situation. Considering the two models discussed here, there may be at least a three-way process of coordination or interactions in the area of competition law, and a four- or even multi-way one in the rule-making process of financial services law.

In the competition area, the regulators - the Commission at the community level and the competition authorities at the national level - as well as the regulatees (market participants), need to coordinate a whole range of activities, functions and experiences with intensified cooperation.<sup>68</sup> On the contrary in the area of financial services, coordination among actors is to be intensified based on the long-standing experiences made within international cooperation in that area.<sup>69</sup> The good working practices of these models largely depends on the recognition that the model's participants constitute a network among themselves, and on the assumption that they are interdependent and willing to interact and cooperate in a fair and constructive way, so as not to compete among each other. Moreover, it should not be forgotten, that in these models the interactions and interdependencies are in no way presumed to be limited territorially.<sup>70</sup> They are international and extend well beyond borders. In this context and as an example, it is interesting to note that the International Organization of Securities Commission (IOSCO) is currently making great efforts to improve international cooperation in the financial services area. It has worked out a Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information that contains basic conditions in order to ensure the good functioning of international cooperation among its members. IOSCO is in the process of assessing its members for their ability to cooperate according to that Memorandum.<sup>71</sup>

Furthermore, these models assume that there are many reasons for reciprocal interests and interactions among the participants. These interactions and linkages, which can take place at different levels, indicate that the models are immanently complex and might concern

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<sup>68</sup> See in this sense Black, *supra* n 14, p. 5-6, with further references.

<sup>69</sup> In this context and with regard to the new governance structures to be introduced both in competition and financial services law, it is interesting to note another important discrepancy between them, which has led to that situation. The fact that a single authority always has governed competition law while the financial services sector does not know any single authority certainly has largely influenced the formulation of new rules and still influences the way the actors concerned interact among each other. In the financial services sector, each country always has had its own, individual organisation of supervision and its own institutions. In that area, the discussion concerning the creation of a single authority has just been launched. On the contrary, in the area of competition, the discussion focuses on the question of attribution of powers to the national competition authorities. See White Paper, *supra* n 6; Regulation No 1/2003, *supra* n 3; also, see among others: Lannoo; Karmel (1999). Similar discussions are going on in the United States regarding the decentralisation of supervision of securities regulation, see Karmel (2003); and regarding the creation of a national corporate law, see Bebchuk, Cohen, and Ferrell; Bebchuk and Ferrell; Karmel (1991).

<sup>70</sup> Black, *supra* n 14, p. 5.

<sup>71</sup> For more details, see: <http://www.iosco.org/pubdocs/pdf/IOSCOPD126-English.pdf>.

different and contrary aspects.<sup>72</sup> An important motivating reason for coordination and cohesion within the models are the advantages to the participants resulting from the interactions of their interdependencies. But, coordination and cohesion also involve risks, like the risk of conflicts of interests. Moreover, it should not be overlooked that the interdependencies themselves may also lead to a subtle dynamic of dependencies and independencies, which characterise decentralisation as such and represent another challenge to be managed.

It should also not be forgotten that coordination represents a genuine contradiction and sets limits to the autonomy and the responsibilities of the different actors concerned. Within the models discussed here, the most important goal of the regulatory approach chosen is to ensure that the norms are applied consistently. A crucial assumption of the models is that a market-based approach is best suited to motivate the market participants. This approach is a consequence of the recognition that by linking the enforcement requirement policy with a market-based approach, there should be an opportunity to convince the market participants that it is worthwhile for them to apply the rules. This should finally have positive repercussions on the consistent enforcement of the rules. It is true that as both models contain a large part of decentralised features their functioning largely depends on the motivation of the different actors and the way they work together. However, it is difficult to judge how the rules will be enforced at this stage of the implementation process, though one can entertain doubts as to the success of these models with regard to the consistent enforcement of the rules. A potential problem, or an important weakness, of both models is that the pivotal and determining powers are not delegated at all, on the contrary, both models finally increase the powers of the principal or the Commission.<sup>73</sup> They are attributed to the Commission and in the case of financial services law even more capabilities are transferred to the Commission.<sup>74</sup> The Commission can take adequate measures if necessary, control the activities of the national authorities and consequently of the market participants. It is the ultimate overseer. As stated before, there is a possibility that national authorities and private market participants may prefer to concentrate on their own goals. Another weakness of the model consists in the integration of the new Members, which accentuates the diversity among the actors concerned and renders the consistent application of the rules definitively more difficult. At the moment it is still unknown whether and how they will apply these rules, take over practices developed by the other Member States in the course of several decades, and be ready to intensively cooperate with the other Members and the Commission. Moreover, it should be mentioned that there are many rivalries among the Member States. Although it is too early to take a position at the moment on the success of these models one can state that, at this point, these models imply that an active or even proactive involvement by all market participants is essential in order to ensure the success of the implementation of their rules; something which was often not the case in the past.

### *Self-regulation*

The next issue considered is self-regulation. Decentralisation raises the issue of self-regulation as it implies that more diversity, or a greater variety of institutions and bodies, may contribute to the shaping of a fixed governance model. This is due to the fact that powers are fragmented and attributed to national authorities, private market participants or other bodies, who play determined roles. Depending on the model, decentralisation may represent a combination of supra-national, governmental and non-governmental or private

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<sup>72</sup> See Willke, p. 112-125.

<sup>73</sup> See Thatcher and Thatcher and Stone, *supra* n 59 and n 61.

<sup>74</sup> See *supra* point 2.2.

actors organised in different ways according to the circumstances. A consequence of that greater diversity is that these actors may develop themselves and act autonomously or exercise their functions in their respective fields in the absence of intervention. In other words, there is room for different kinds of regulation and for self-regulation too, which is linked to the possibility of the actors acting on their own due to decentralisation. Self-regulation may represent a further regulatory ramification within a decentralised system, which is characterised by the fact, that it relies on the private initiative of the actors concerned.<sup>75</sup>

Moreover, it should be taken into account that there is no form of pure self-regulation in the models discussed in this paper, particularly not in the four-level rule-making model to be introduced in financial services law. Self-regulation as, or if, encountered in the models is a form of enforced self-regulation. It depends on the existing rules in an area<sup>76</sup> and there is only space for self-regulation insofar as no regulation or other rules have been already laid down.

As far as the national authorities are concerned, the duty of the Member State is to clearly designate the responsible authority, who in turn introduces an efficient enforcement and supervisory system, as well as providing a definition of the role of these authorities. Its realisation depends on the willingness of the Member States to fulfil their obligations seriously. However, the designated national authorities cannot act in an autonomous way in both cases. They are not self-regulated and not independent insofar as they are expected to take adequate measures in order to ensure that the rules are applied consistently. They also should be ready to cooperate with other authorities which, among other things, implies that they should coordinate their approaches. Furthermore, the Commission exercises a function of control and can intervene.

The situation is different for the private market actors. In financial services law, these actors can organise themselves in groups of interest or self-regulatory bodies. They are expected to participate in the rule-making process and can make proposals or take a position, but as already stated, the Commission is the sole authority to decide on the rules to be adopted. Therefore, the private market actors are not entirely autonomous insofar as their autonomy is limited by regulation, though they still have the possibility to regulate themselves and, for instance, exert control over the members of their groups and set up their own codes of conduct.

In competition law, powers are clearly attributed to the national authorities. These authorities may act autonomously, but they are limited by the regulations too. The Commission can intervene, also on a case-by-case basis, as far as the control of the enforcement of the rules is concerned. Hence, (officially) no space is left for self-regulation in this field. However, private companies confronted with questions of competition can act in an autonomous way in that area and escape the rules through arbitration. Arbitration represents a form of self-regulation and it offers a true alternative to the application of the supra-national rules, which permits working out autonomous solutions depending on the concrete situation. In particular, in such cases, the Commission and the national authorities only have limited possibilities to influence arbitration.

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<sup>75</sup> See in this sense Black, *supra* n 14, p. 4-5, with further references.

<sup>76</sup> See basically to self-regulation: Ayres and Braithwaite, p. 101-131; Baldwin and Cave, p. 125-137; Black (1996), p. 24-55; see also Harrison/Morgan/Verkuil, p. 342-350.

Taking into account that alongside the introduction of the new rules in both areas their consistent implementation should be ensured, the self-regulatory bodies are basically expected to contribute to the enforcement of these rules. In financial services law, through their integration in the rule-making process,<sup>77</sup> they can participate directly and submit proposals. Should they succeed in influencing the outcome of the rule-making process and should their proposals be accepted, the rules passed may be better adapted to their needs and then accepted by these bodies. But it is uncertain whether this will be sufficient to ensure these rules are respected. In particular, it should be mentioned that competition among the national markets might still undermine and hinder the realisation of an internal market. In that regard, the self-regulatory bodies may play a determining role. In competition law by contrast, the arbitrators may act independently and even apply rules other than the existing competition rules, although they represent a factor that may seriously distort the consistent enforcement of the rules. Thus, self-regulation has the potential to increase decentralisation in both cases.

#### **4. Evaluation of decentralisation**

Following the observations on the structure of the models and their analysis, it is now possible to evaluate governance through decentralisation from a theoretical and regulatory perspective. It will be possible to evaluate these models at the operational level within a few years, on the basis of the practical experiences made with enforcement in the interval. The following observations provide a rudimentary assessment of whether the decentralisation process, in fact, results in a reinforcement of centralisation and thus represents an oxymoron, as well as discussing some paradoxical outcomes of decentralisation. In particular, the rules discussed here should be considered first in the context of the current international debate on decentralisation. They are then assessed at the level of the state and, finally, as a method or experiment of delegated legislation.<sup>78</sup>

Given the limits of the focus on these external aspects of the models, it is then necessary to complement them with internal ones. Thus, the issue is addressed within the models, proceeding based on the features characterising each model: enforcement, rule-making and arbitration.

##### *General remarks*

Considered in a broader context the models discussed here pertain to the ongoing debate on decentralisation, which stands for a lot of different policy experiences: not only the theory, but the practical developments too show that there is a clear trend towards decentralised forms of governance worldwide.<sup>79</sup>

While there is a fear of having a predominant national (centralised) government in the United States and though it is recognised that genuine decentralisation of powers is no longer possible,<sup>80</sup> a characteristic of the decentralisation process in Europe is that it is grounded in the idea that the powers are not an exclusive right of the Commission. Rather they are shared with other actors. In a determined area, the situation also depends on the attitude of the authorities concerned, which may prefer to attribute decision-making powers to specialised bodies rather than exercise that authority themselves. Furthermore, the

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<sup>77</sup> See *supra* point 2.2.

<sup>78</sup> See Shapiro, *supra* n 59, p. 173-179 and p. 186-192.

<sup>79</sup> Besley, *supra* n 11, p. 8; Majone (July 2002), p. 375-392, 380.

<sup>80</sup> See Frug, p. 253-258.

adaptation of the institutional framework to the growing volume and complexity of regulatory tasks has proved to be much more difficult than expected. It represents another reason to delegate some powers or tasks depending on the area concerned.

There also is a tendency for Member States to basically continue to oppose centralisation of regulatory powers in all areas, even in areas which are important to the realisation and functioning of the internal market. Rather, they prefer to entrust the task of implementing Community policies to networks of independent national and supra-national regulators and supervisory authorities. In their view, the Commission should coordinate and monitor the activities of the networks in order to ensure the coherence of European regulatory policies. In those kinds of models of governance, the Commission could also, more generally, bring its specific competencies as supra-national organisation into focus. Thereby, it could concentrate on its core business, which consists of ensuring the proper functioning of the single European market. This attitude is essential to the credibility of the integration process.<sup>81</sup> However, the Commission also becomes increasingly dependent on the Member States through decentralisation.<sup>82</sup> It is dependent on the (in its view, indirect) enforcement that takes place via the national authorities, notwithstanding its centralised powers to control and intervene if necessary.

In fact, the question of decentralisation of powers in connection to the governance models discussed in this essay illustrates the discussion on the delegation and exercise of the competencies as a concretisation of the principle of institutional balance.<sup>83</sup> To judge the quality of governance, the European Union applies five principles of good governance, which it has developed itself regarding the conduct of the actors: openness, participation, accountability, effectiveness and coherence.<sup>84</sup> As there still are no, or not enough, practical experiences with the enforcement of the models discussed here, it is not possible to comment on the application of these principles at this time. While certain authors argue that the efforts made to improve the governance and to render it more democratic rather deepening than diluting the role of the institutions and resulting in a centralisation,<sup>85</sup> others opine that they already see a risk, not in excessive centralisation, but in excessive fragmentation of powers, which might dilute the powers and role of the Commission.<sup>86</sup> It might also be that due to the process of decentralisation, the models tend not to denationalise, but rather to renationalise an area or sector of the economy. However, in such cases, the controls performed by the Commission should play a decisive role in ensuring system integrity. They can be interpreted as constituting a kind of corrective. Thus, basically, the main difficulties stem from finding a clear and adequate division of competencies between the Commission and the Member States, national supervisory authorities and markets participants, all of whom have the possibility to act at a national level in their respective area, to varying extents.

From an historical point of view, the new rules introduced in competition and financial services law can be interpreted as representing a pragmatic approach. Limitations of a purely legislative approach to market integration have become increasingly clear since 1992. It

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<sup>81</sup> See Majone, *supra* n 79, p. 375.

<sup>82</sup> *Ibid.*, p. 382-383; Baldwin, p. 273-283; Thatcher and Sweet Stone, *supra* n 59, p. 3-9.

<sup>83</sup> Majone (September 2002), p. 322.

<sup>84</sup> See European Governance: A White Paper, *supra* n 47, p. 10. A discussion of the sense and adequacy of these principles is outside the scope of this essay.

<sup>85</sup> See for example Scott, *supra* n 49, p. 74-76; see also European Governance: A White Paper, *supra* n 47, p. 11-18.

<sup>86</sup> Majone, *supra* n 79, p. 376-377; see also Baldwin, *supra* n 79, p. 277-285.

resulted in no practical integration. Today, there is a greater awareness of the importance of effective enforcement.<sup>87</sup> In particular, the lack of an adequate administrative infrastructure is perceived as a serious obstacle to the completion of a working market. It means that between the supra-national level, the national level and the enforcement, there is an institutional vacuum that is supposed to be filled by the readiness of the national authorities to cooperate with each other and with the Commission.<sup>88</sup> However, it is recognised that a serious problem of credibility with this style of regulation underlies this situation, that is accompanied by a continuous loss of prestige and influence of the institution as such.<sup>89</sup>

Although these remarks apply to both models discussed in this paper, it should be taken into account that the elements of their governance structure (enforcement, arbitration, rule-making), historical development, substantive rules, philosophical approach, appreciation of their future development as their role and function differ.

Furthermore, it should be noted that in financial services law generally, centralisation and decentralisation have not yet been made a subject of discussion in the same way as in competition law.<sup>90</sup> In particular, they have not been made out as a cause of the deficiencies of the former regulatory system.<sup>91</sup> The enforcement of the rules has always been decentralised in this area.<sup>92</sup> It is now reinforced by the requirement to have an unambiguous delimitation of the role, powers and competencies of the responsible authorities. Moreover, there should be a horizontal reinforcement of this structure insofar as a network of cooperation among the national authorities on the one hand, and with the Commission on the other hand, will play a more important role in the future. It is also assumed that a democratisation process should take place through the application of the rule-making model. However, although the model is intended to have a positive effect on the market integration, the result may not be satisfactory, which is due to the fact that in reality a centralisation occurs as responsibilities are transferred back to the Commission.<sup>93</sup>

In competition law, the norms introducing a decentralisation should be better adapted to the environment of an enlarged European Union.<sup>94</sup> The model resulting from the evolution of the rules first implemented in 1962, takes into account that the Commission had already wanted to attribute its powers to the Member States since the Eighties. It should therefore not want to intervene frequently, at least not in the first phase of implementation, although it is responsible for the controls and despite the fact that the judicial review remains centralised. As far as arbitration is concerned, the tensions existing between arbitration and the application of competition law remain, and arbitration unavoidably leads to fragmentation and decentralisation. Practical experiences will show how enforcement will work and how far the Commission will make use of its capacity to increase the process of centralisation.

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<sup>87</sup> See Davies.

<sup>88</sup> See Majone, *supra* n 83, p. 336.

<sup>89</sup> Majone, *supra* n 83, p. 329; see also Baldwin, *supra* n 82, p. 271-285, according to whom the reasons for the weaknesses of the models are due to a problem of legitimation of the institutions.

<sup>90</sup> See to this topic among others Lannoo, *supra* n 69; Hertig and Lee, *supra* n 37, p. 14-16.

<sup>91</sup> Although some authors imply that this is the case; see Hertig and Lee, *supra* n 37, p. 14-16.

<sup>92</sup> See Moloney, *supra* n 8, p. 516-517.

<sup>93</sup> See *supra* point 2.2.

<sup>94</sup> See *supra* point 2.1.

### *Decentralisation within the models*

In relation to a model, it may be interesting to see how its different features work, within the model itself. The following three features are distinguished and discussed: enforcement, arbitration and rule-making.<sup>95</sup>

In the area of competition law, there is an effective decentralisation in favour of the national authorities as far as the enforcement is concerned. The Commission is no longer engaged in the process of granting exemptions. The national authorities are engaged in such a process. However, the main challenge is to ensure the consistent application of the rules and the Commission is in a position to perform controls and intervene in all cases. As the rules have just been introduced, the practice will have to show whether this enforcement system will work and the extent of the Commission's interference.

Regarding the arbitrators, at the moment it is difficult to evaluate their influence on the consistent enforcement of the competition rules in practice. The possibility is not excluded – as the role and treatment of arbitration still is not clearly defined – that it may distort the consistent implementation of the rules. In fact, arbitration represents a real danger, because if it does not only apply to isolated cases it may become even more important over time and could hinder the consistent application of the rules, leaving the Commission and other courts with few possibilities to influence their activities.

The changes of governance decided by the Commission in the area of competition law probably are better adapted to the needs of an enlarged European Union. The model introduced is more fragmented as it includes the participation of a greater variety of actors and is based on the recognition of their abilities, each at their own level.<sup>96</sup> However, the model remains characterised by a hierarchical exercise of powers and still has to prove its worth in practice. In case of conflict between European law and national laws, the former would have predominance over the latter, making the former a powerful centralising force. Furthermore, it is uncertain whether incentives are effectively created for the national authorities through the attribution of the responsibility to act. National authorities may well first want to defend their own national interests and a competitive situation may arise among them. The situation is even more difficult for the authorities of the newly admitted countries. These authorities first must familiarise themselves with the law and then apply it. They have to adopt the practices and precedents developed by the Commission based on the former rules too. They may well decline this methodology and try to develop their own practices. As a result, the Commission may be called to intervene frequently and in this way reinforce the centralisation process.

In financial services law, enforcement remains decentralised and, as already stated,<sup>97</sup> the role and functions of the authorities are even reinforced in that regard.

As far as the rule-making process is concerned, the national supervisory authorities have to participate in that process as independent authorities and as members of CESR, cooperating more intensively. Due to this situation, the rule-making process appears to be the most important and innovative element within that governance model. In order to better assess the model under this aspect, it may be interesting to look at processes of delegated legislation

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<sup>95</sup> As already stated, they are the main characteristics of the models; see *supra* point 2.

<sup>96</sup> See in the same sense in relation to European Governance Scott, *supra* n 49, p. 64.

<sup>97</sup> See *supra* point 2.2.

existing in other jurisdictions. The examples of the UK and Switzerland, which apply similar procedures at the national level, are considered here.

In the UK, the existing rule-making process is characterised by the fact that there are several levels of legislation: the first level or primary legislation is constituted by the passing of the Acts of Parliament. Then, such legislation often delegates the power to regulate administrative details or to adjust the legislation to new circumstances if necessary to ministers or other responsible authorities or agencies. These rules constitute the delegated or secondary legislation.<sup>98</sup> The role of this legislation is to materialise the principles laid down at the primary legislation level. From a practical point of view, it also gives the representatives of Parliament more time to concentrate on important questions. Depending on the case, the Acts of Parliament themselves may provide for direct parliamentary intervention and control over the delegated regulatory measures; Parliament may have the possibility either to confirm or repeal the measures elaborated on through delegation.

The new Financial Services and Markets Act 2000, which has introduced an organisational consolidation of the norms governing financial markets in the UK is an example of that process. With this Act, extensive powers have been attributed to the Financial Services Authority (FSA). Section 138 of Part X of the Act on Rules and Guidance<sup>99</sup> describes the general rule-making powers of the FSA in relation to the definition of regulatory requirements to be applied to persons authorised under the Act.

According to the Act, the FSA can adopt a whole range of secondary legislation. It may make such rules when it deems it necessary or expedient for the purpose of protecting the interests of the consumers.<sup>100</sup> The FSA is independent of the Government, but it can be called to account to the Government and Parliament. It also has to take the interests of all of its stakeholders into account.<sup>101</sup> Its power to make general rules is not limited by any other power. However, in exercising its rule-making powers, the Authority must follow the procedures set out in the Financial Services and Markets Act 2000; there are important consultation requirements, which have been imposed to it.<sup>102</sup> According to the rule on consultation, the Authority must publish a draft of the rules it proposes in such a way as to effectively bring them to the attention of the public. The draft must be accompanied by explanations and other information. Furthermore, the FSA has been given the power to issue formal guidance, which may consist of such information and advice it considers appropriate.<sup>103</sup>

Basically, a similar situation exists in Switzerland, but there, the concept of so-called framework laws is applied. The Stock Exchange and Securities Trading Act of 1995<sup>104</sup> is a typical example, which is specifically designated to be a 'framework' law. The Act contains only the main principles or primary legislation concerning the authorisation of exchanges and securities dealers, the supervision of the markets and the rules on disclosure and takeovers. It expressly attributes powers to the different authorities, designating precisely

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<sup>98</sup> Baldwin, *supra* n 82, p. 59-62; Zander, p. 108-124, with an Anglo-American comparison.

<sup>99</sup> In the whole, see Financial Services and Markets Act 2000 (FSMA 2000), Part X, Rules and Guidance, ss. 138-147.

<sup>100</sup> See also Hutter and Power, p. 1.

<sup>101</sup> See Briault, p. 12.

<sup>102</sup> S. 155 FSMA 2000.

<sup>103</sup> S. 157 FSMA 2000.

<sup>104</sup> SESTA, SR 954.1.

depending on the subject to be regulated in the secondary legislation or ordinances. The Act names the following authorities: the government or Federal Council and the supervisory authority. Moreover, it states in an article called 'Self-Regulation' that stock exchanges are considered to be self-regulated organisations and that they must organise themselves appropriately. In detail, Article 4 states that: (1) The stock exchange must undertake to ensure that it has an organizational structure in respect of its operations, administration and supervision that is appropriate to its activities. (2) A stock exchange must submit its regulation and any amendments thereof to the Supervisory Authority for approval.

Thus, it amounts to enforced self-regulation, which is expressly delegated by the Act. For self-regulated bodies, the Act requires these bodies to first submit the rules they pass to the supervisory authority for control and approval. Furthermore, a tertiary legislation also exists in the form of guidelines or circulars, which can be formulated by different authorities or bodies. Regarding the delegated or secondary legislation and the tertiary legislation, the responsible authorities or bodies apply broad and transparent consultation procedures. Not only supervised institutes, but also individuals have the possibility of participating in these consultations. Regarding the application of the delegated or secondary as well as the tertiary legislation, the Swiss Parliament does not have any power to approve or control it. It cannot declare it void. It is the task of the courts to confirm or invalidate the secondary and tertiary legislation based on practical cases submitted to a court for judgement.

In the two examples of delegated legislation considered, both countries have a long-standing experience with these models, which can be compared to the four-level rule-making model introduced in financial services law. In particular, the actors concerned can actively participate in the rule-making process and as a result the rules generally are, or should be, better adapted to their needs. However, it should be noted that there is a lot of criticism on the use made of delegated legislation, which is considered excessive by some authors.<sup>105</sup> It is bound to a problem of legitimation and recognition by the actors concerned and the courts, which may deviate from that legislation. Thus, a similar situation can be encountered at the European level, which as a result may render the enforcement of the rules even more difficult and questionable.

The introduction of a four-level rule-making model in the financial services area takes the continuous development of that area into account. The model provides for the necessary flexibility to adapt the rules rapidly. However, despite the fact that it seems to introduce a participative approach, which primarily should involve the market participants, lead to the efficient enforcement of the rules and improve the credibility and legitimacy of the measures taken, it represents a centralisation as the Commission is now responsible for passing all the detailed legislation. This could be interpreted as representing only a half-hearted intention of the Commission to democratise the rule-making process. The main problem or even the danger of this model remains the fact that no powers are delegated and thus, the national authorities may not be incentivised to effectively enforce the rules. Therefore, the national authorities, as well as the market participants, may in fact try to find ways of protecting their own national interests.

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<sup>105</sup> See Baldwin, *supra* n 82, p. 85-119, 271-287, for a review of the arguments.

## 5. Conclusion

This paper was intended to offer some observations on the concept of decentralisation in economic law and in particular to explore the oxymoron issue. It focused on the models of competition and financial services law and looked in particular at Europe, notably the European Union. The analysis and evaluation have been carried out from the perspective of a decentred understanding of regulation. At this point, the following conclusions can be drawn:

Decentralisation as a characteristic of governance models can stand for a whole range of policies. While centred models represent rigid systems of regulation, decentred models represent flexible instruments, which offer the possibility of linking enforcement to a market-based approach. At the same time they can be adapted to the characteristics of the area concerned. This is especially important in economic law where the regulatory requirements evolve rapidly due to the internationalisation of business transactions. Thus, decentred models of regulation are appropriate for dynamic, fast-track decision-making structures, while centred models, by contrast, rather stand for stability. However, it should always be taken into account that when discussing one form of governance like decentralisation, the other, opposite force inherently belongs to the discussion too.

Due to the fact that the models discussed in this paper are in the process of being implemented, it is not possible to formulate conclusions based on the practical developments at this stage, but only on the existing legal frameworks. At this time, it can be stated that the models present a mixed figure with regard to decentralisation, which rather appears to be an oxymoron. While some features of the models promote or reinforce decentralisation, others foster centralisation. On the one hand, the rule-making function, which is carried out by the legislative arm of the state, is centralised. On the other hand, the enforcement function, which is carried out by the executive arm of the state, tends to be decentralised. This is not least due to the fact that the enforcement powers can easily be transferred to specialised bodies either of the state or private ones. Furthermore, the issue of decentralisation is linked to an issue of cooperation, insofar as decentralisation requires that the different bodies involved inform each other and cooperate. Arbitration, for its part, remains a decentralised feature and does not present an oxymoron issue as such; it rather reinforces decentralisation. However, it represents a private solution, not included in the legal system of the state, but which can be a consequence of a legal system.

Both models have the potential to dramatically intensify the intervention of the Commission at all levels. This could have far-reaching consequences and doubts are allowed as to the assumption that their working largely relies on the willingness of the national authorities to cooperate. There are also still a number of open issues that will have to be explored in future research, in order to shed more light on governance through decentralisation.

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