Case Notes

No (Cheap) Smoking Allowed – French National Legislation on the Pricing of Cigarettes and EU Law

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Case C-197/08 Commission v. France[1]

I. Facts

The European Commission challenged before the European Court the consistency of a French decree (Article 572 of the '*Code Général des Impôts*', CGI) which adopted and maintained in force a system of minimum prices for the retail sale of cigarettes released for consumption in France, together with a prohibition on selling tobacco products 'at a promotional price which is contrary to public health objectives'. It was thus, in the Commission's view, running afoul of France's obligations under Article 9(1) of Council Directive 95/59/EC of 27 November 1995 on taxes other than turnover taxes which affect the consumption of manufactured tobacco as amended by Council Directive 2002/10/EC of 12 February 2002.

Article 9(1) of Directive 95/59 (which was not amended by Directive 2002/10) provided producers of tobacco with the possibility to freely set maximum retail selling prices ("max RSP"). The French decree undermined the freedom of producers to set prices, since it imposed a minimum retail selling price ("min RSP") in an effort to dissuade consumers from smoking: the retail price of each product, expressed per 1,000 items or 1,000 grammes, was the same throughout the whole territory and was determined freely by the manufacturers and the approved suppliers; the retail price for cigarettes, expressed per 1,000 items, could not however be confirmed if it were below the price obtained by applying to the average price of those products a percentage fixed by decree (a subsequent French decree, 2004-1975, fixed in its Article 1 this percentage at 95 %). This percentage was calculated by taking into account the prices of *all* cigarettes sold in France by *all* producers having access to the French market. Selling cigarettes below this threshold was considered a promotional price contrary to public health objectives and, consequently, against the letter and the spirit of the French decree.

II. Judgment

The Court (Third Chamber), siding with the opinion expressed by the Advocate General J. Kokott, upheld the complaint by pronouncing on the inconsistency of the French decree. In its view, the French decree would eliminate price competition across cigarette producers since the max RSP could not *by statute* be lower than the min RSP, and the end result would be prices converging around the price of the least efficient producer. Thus, the basic objective sought through Article 9(1) of Directive 95/59 (that is, to guarantee that competition across the various producers is preserved) would *ipso facto* be defeated.

III. Comment

Directive 95/59 concerns harmonization of excise taxes across the EU Member States. It provides for several exceptions, none of which is applicable to the present case by any stretch of imagination. (For example, it provides for exceptions having to do with combating inflation). The case thus falls squarely within the basic rule and not the exceptions contained in the Directive. The question is to what ex-

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1 Judgment of 4 March 2010.

tent is the French decree consistent with the possibility allowed to producers to set a max RSP?

The Court had no difficulty in establishing that the French decree was inconsistent with the Directive 95/59: by allowing essentially very little price competition (in light of the 95 % threshold discussed *supra*) the French decree practically amounted to some form of establishing *uniform* retail selling prices for *all* cigarettes sold within France.

Consequently, the interest of this case is in the manner in which the Court constructed the relationship between Directive 95/59 and a host of instances that could, at least in theory, serve as grounds for justifying the French decree. The French argument amounts to stating that, other things being equal, a price hike in the manner imposed through the decree would lead to a lower consumption of cigarettes, at least for those consumers with high(er) opportunity cost for their purchasing decisions (such as younger people).

First of all, the Court stated that a high level of public health protection was very much an objective that the EU Member States had assigned for themselves and was therefore consistent with their integration process. In cases of conflict, the protection of public health should always have priority.

It then went on to review whether there was any inconsistency (conflict) between the French objective (protection of public health) and Directive 95/59. It concluded that this was hardly the case: a system of min RSP for tobacco products could be regarded as compatible with the Directive *provided that* it was structured in such a way as to ensure that the competitive advantage which could result for some producers and importers of those products from lower cost prices would not be impaired through the min RSP established. In the Court's view, the min RSP did not *have to* distort price competition across the various producers in order to achieve the statutory objective (that is, the protection of public health). In other words, there is no need at all to *uniformise* prices in order to achieve protection of public health. This is a rather straightforward point and quite frankly, nothing in the record makes the point persuasively that the opposite should be true. France *could* have argued that a minimum *excessive* price across all cigarettes sold could guarantee *lower* consumption of cigarettes by particular segments of consumers, but it did not.[2] (One cannot *ab initio* exclude that for a very few consumers price is not the dominant variable that explains their purchasing decisions; still, a general measure such as the one under attack in this case aims to influence the behaviour of the critical mass of consumers and not of few outliers. Indeed the success of the measures depends on numbers); As a result, there was no need for the Court to address this argument.

In essence, the Court is implicitly accepting here that something akin to a system which would not opt for a threshold price calculated on the basis of a *producers-wide* average, but instead on a *producer-wide* average *could* be deemed to be consistent with Directive 95/59.

The theoretical foundation for the Court's judgment is probably correct, although empirical analysis was probably necessary to give it the necessary intellectual support. The argument that, other things being equal, the act of increasing prices will lead to lower consumption is true *other things equal*. It depends of course, on the elasticity of the demand and also on the existence of *switching effects*. There is not much one can advance against the Court regarding the first point: although numerous studies have held that smokers are addicted to smoking, there are as many studies that suggest that price hikes lead to less smoking. The second point deserves some discussion. First assume that in a given market there is a duopoly that sells cigarettes at €2 and €2.5 respectively. Now assume that the government wishes to reduce smoking and, to this effect, is contemplating two different interventions: (a) request from each producer to sell at a higher price, say €1 higher; or, (b) request that each producer sells at €3 minimum.[3] In scenario (a) one could observe the effects of switching: (some) consumers of the higher priced brand might be willing to switch to the cheaper brand since they find the requested €3.5 "pricey". *Switching effects* are less probable in the second scenario, although they cannot be excluded altogether. At the end of the day, though, although some consumers will switch from smoking the more-expensive cigarettes to smoking the cheaper ones, while some people (who consumed the cheaper cigarettes) will quit smoking altogether (because of the new higher price). In this vein, the argument of the Court that there is no inconsistency between price competition

2 I am not suggesting that such argument is watertight. I suggest this argument though in order to circumscribe the argument made by France.

3 Option (b) is, of course, much closer to the French decree.

across cigarettes producers and the health objective pursued (smoking less) is reasonable.

The French Republic also contended that the system of minimum prices in question is justified by the objective of protection of health and life of humans under Article 30 ECT. The Court responded that , in order to invoke Article 30 ECT, a transaction must fall within the realm of Article 28 ECT. Since the present case was an infringement case, and since the Commission had not invoked Article 28 ECT, the Court could not step outside the scope of the litigation and rule *ultra petita*. Past case law suggests that the Court would not have accepted recourse to Article 30 ECT as legitimate if the case was not within the scope of Article 28 ECT. In other words, when the harmonisation directive is incomplete, it is possible to argue that, for the part not covered by the directive does in principle come within the scope of Article 28 ECT, and for that part one could conceive that recourse to Article 30 ECT, if warranted, was legitimate; when however, the Court is dealing with directive opting for complete harmonisation, then Article 30 ECT is excluded precisely for that reason (complete harmonisation).

So in a sense the Court's judgment should hardly come as a surprise. Arguably, the Court took the view that Directive 95/59 opts for complete harmonisation.

Of course, it can still be asked whether this case law is sensible, that is, whether Article 30 ECT should be excluded any time the directive is considered to be complete harmonisation. In my view, it is impossible to provide a 'yes' or 'no' answer that would be applicable across transactions. If two conditions are met, that is (a) by complete harmonisation we understand a directive that leaves no room for discretion at all to a Member State, and (b) that there is no doubt when we are in presence of a complete harmonisation directive, then the Court's attitude should be applauded. Is it however always the case? Conversely, if one of the above two conditions is missing, then the answer would depend on the objectives of the directive, its content etc.

But even *assuming arguendo* that the Court has erred in opting for consistency in case law here,[4] the end outcome would in all probability remain unchanged: so let us assume that the Court entertains an Article 30 ECT defence advanced by France. In that case, France would have to state that its measures were necessary to achieve the public policy objective it was pursuing, namely, public health. That is, France would have to demonstrate that *practically* eliminating all price competition across producers of cigarettes was necessary to dissuade consumption (indeed, France had not claimed that it wished to eliminate consumption; if this had been the case, it would most likely have chosen another, more appropriate instrument, e.g., total ban on sales).

This demonstration looks like a quixotic test: since the objective is reduction and not elimination of smoking, other things being equal, a higher price for each packet of cigarettes should lead to lower consumption: a fixed component, say €2 or €3 added to a price individually set by each producer would, in light of the observed elasticity of demand regarding cigarettes across markets, have led to a reduction in smoking anyway. Why then would it have been necessary to also uniformise prices across producers? Remember that the objective is to reduce smoking, not to reduce to a pre-decided level.

France also invoked a WHO Convention (approved via a Council decision) which recognised the right of signatories to take into account their health policy objectives when fixing prices for cigarettes. The Court followed the Advocate General in this respect too, holding that the Convention was not legally binding anyway, and, on substance, it did not prejudge the precise manner in which national taxation schemes should be designed. One can only agree with the Court in this respect in light of the wording and context of the Convention.

What did the Court not say? The Court did not outlaw a measure that would be based on the individual producer's average price: as long as price competition is not impaired, the Court would have no objection in, for example, seeing a fixed amount imposed on prices individually set by various producers. Thus, if France were to suggest that a €2 surcharge, for example, would be imposed on every packet of cigarettes, the Court most probably not raise any objection. In other words, the Court did not deny that onerous prices of cigarettes can have a dissuasive effect on consumption; the Court refused to accept the French claim that the necessary scheme to protect public health is that whereby prices of cigarettes would be rendered symmetrically

4 Consistency might ease transaction costs, but is not in and of itself a value for one could be consistently wrong.

high instead of symmetrically *higher*: all the Court outlawed was elimination of competition in order to advance a public health objective in this case where, in its view, price competition across producers does not bring into question the attainment of the desired objective. This is not unreasonable.

All in all, it is hard to disagree with the Court's judgment. In essence, the Court upheld the argument that the attainment of a social preference need not come at too high a price: as long as it can be attained without overburdening the society, this should be the case.