European Employers' Institute

Can the EU restrict subcontracting? A legal perspective

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About the study

This legal study examines recent proposed restrictions to subcontracting in EU labour law. In the legal debate, it has, for example, been proposed that subcontracting should be limited to a certain number of tiers and that some sort of direct liability across the entire subcontracting chain should be introduced. Focusing specifically on these two restrictions, this study concludes that restricting subcontracting comes with several legal complexities. First, as subcontracting generally refers to the practice where someone delegates contractual obligations to a third party, subcontracting is such a common practice in the modern economy that it is hard to pinpoint for restriction purposes without unintended effects for business in general. In this part, this legal study concludes that any measure needs to be carefully defined and drafted to avoid negative legal side effects.

Additionally, the legal study concludes that subcontracting is an aspect of the freedom of contract, which is protected as a part of the right to conduct a business under Article 16 of the EU Charter, as well as under the free movement of services and the freedom of establishment. Here, it is noted that subcontracting has been recognised as a possibility for smaller companies to compete. Consequently, restrictions on the use of subcontracting will undermine competition, as restrictions will gain large companies that do not need to subcontract services. That subcontracting is protected under EU primary law means that restrictions cannot be done without carefully balancing their effects on the protected rights.

Mapping existing restrictions and measures that address labour law issues in subcontracting chains, the study finds that EU law takes no consistent approach to restrictions. Among the existing measures that, in one way or another, address labour law issues in subcontracting chains, direct liability, equal treatment of employees, as well as reporting and transparency obligations can be found. Importantly, the study finds that limiting subcontracting to a certain level of tiers is unprecedented in EU law. It is also noted that such national restrictions to subcontracting have repeatedly been found to be inconsistent with EU law.

1. Introduction

1.1. About this legal study

This legal study is written at the request from the European Employers' Institute (EEI). The purpose of the study is to provide a legal analysis of the EU law frameworks surrounding subcontracting, as well as to examine proposed restrictions to subcontracting.

1.2. Background

To fully understand the legal framework surrounding subcontracting, it is essential to first define the concept itself. In general contract law, subcontracting refers to a situation where one party to a contract delegates the performance of some or all of its contractual obligations to a third party. Being an integrated practice in modern business, subcontracting is often utilised to enhance efficiency by using external capacity. In the EU, which is built on a market economy idea, subcontracting and free competition have generally been accepted and supported ideas.

That a contract party delegates obligations to a third party, a subcontractor, is not a new phenomenon. While subcontracting offers economic advantages and flexibility, it can also create challenges. Diverted or diluted labour law liability is one concern that has been raised.[1] Such an issue can, for instance, be that the employees to a subcontractor do not receive remuneration or that health and safety standards are being set aside.

In recent years, labour law issues in subcontracting chains have led to national legislation in several EU member states.[2] Also at the EU level, the issue has been addressed.[3] The problem has been identified to be particularly acute in subcontracting arrangement involving several layers of subcontractors, often referred to as 'subcontracting chains', where ensuring liability becomes increasingly difficult.

To address the labour law issues related to subcontracting, a number of measures have been presented in different legal studies over the last years.[4] In legal studies, limiting the number of subcontracting chains and extending liability to the entire subcontracting chain are pointed out as solutions to the labour law problems.[5]

Limiting the number of subcontracting and introducing direct liability (often referred to as 'joint and several liability') are measures that have also been endorsed by the European Commission. In its report of April 30, 2024, on the implementation of the enforcement directive to the Posted Workers Directive, the Commission recognises national implementation to limit subcontracting to certain levels and extend liability to the full subcontracting chain as a "good practice" for fighting the problems with long subcontracting chains.[6]

[1] For a description of the general labour law issues related to subcontracting, see e.g. David Weil, The Fissured Workplace, 2014, p. 99 ff.
[2] See for instance the German Lieferkettensorgfaltspflichtengesetz (entered into force on 1 January 2023) and the French Loi no. 2019-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et enterprises donneuses d'ordre.
[3] See e.g. Commission report of 30 April 2024 on the application and implementation of Directive (EU) 2018/957 of the European Parliament and of the Council of 28 June 2018 amending Directive 96/71/EC concerning the posting of workers in the framework of the provision of services (COM (2024) 320) p. 12, where the issue is addressed.
[4] See e.g. Borelli, Silvia, Subcontracting: Exploitation by design (study published for GUE/NGL The Left in the European Parliament on December 7, 2022; Cremers, Jan and Houwerzijl, Mijke, Subcontracting and social liability, Syndicat Europeæn Trade Union, September 2021, Bruun, Niklas, Promoting collective bargaining in public procurement – social clauses and the way forward, ETUI Working Paper 2025:04, p. 25.
[5] In addition to the two mentioned measures, also other measures have been proposed.
[6] European Commission, Commission report of 30 April 2024 on the application and implementation of Directive (EU) 2018/957 of the European Parliament and of the Council of 28 June 2018 amending Directive 96/71/EC concerning the posting of workers in the framework of the provision of services (COM (2024) 320) p. 10.

In a parliamentary question of 10 October 2024, the Swedish S&D MEP Johan Danielsson asked the Commission how it would realise the good practice recommendations, as Member States introducing limits on subcontracting have often faced "legal hurdles".[1] Answering the parliamentary question, the European Commission reiterated its good practice recommendations, but clarified that they apply only to situations falling under the scope of the Posted Workers Directive.[2]

On April 9, 2025, the European Trade Union Confederation (ETUC) and the European Federation of Building and Woodworkers (EFBWW) urged the EU to take action to limit subcontracting to fight exploitation, fraud and other labour abuses in subcontracting chains.[3] The proposed limitations to the practice of subcontracting include limiting subcontracting chains to a certain level of tiers, as well as introducing direct liability across the entire subcontracting chain.

Though these two proposed measures remain somewhat vague, this study seeks to investigate the legal aspects of restricting subcontracting, specifically the proposed limits on subcontracting tiers and the introduction of full liability across the entire subcontracting chain.

This study will examine the legality of the proposed restrictions to subcontracting, the potential legal side effects of these measures and how they align with the existing EU law framework that addresses issues of diverted labour law liability in subcontracting relationships. Particularly, the methods used in the Public Procurement Directive (2014/24), Posting of Workers Directive (96/71)[4], Temporary Agency Work Directive (2008/104), Employer Sanctions Directive (2009/52) and the Corporate Sustainability Due Diligence Directive (2024/1760) will be analysed.

1.3. Research questions

With the background presented above, this legal study seeks to investigate aspects of the proposed restrictions to subcontracting in a labour law context. This legal study seeks to identify, define and distinguish the legal concept of subcontracting from related legal concepts and to clarify the legal framework surrounding it by answering the following research questions.

a) To what extent may subcontracting be limited in EU law?
b) What legal side effects may restrictions to subcontracting have?
c) What existing EU law measures address labour law issues related to subcontracting?

1.4. Outline

Chapter 2 presents the key findings of the study. It summarises the main conclusions and insights drawn from the analysis of subcontracting and its legal implications. Chapter 3 focuses on the complexities of legally defining subcontracting. It addresses the difficulties in distinguishing subcontracting from related legal concepts and the implications of such complexities for potential legislative measures. Chapter 4 explores the protection of subcontracting as a part of the right to conduct a business under Article 16 of the Charter. It examines the limitations this protection imposes on potential restrictions to subcontracting within the EU legal framework. Chapter 5 deals with the cross-border aspects of subcontracting. It covers both the protection subcontracting enjoys as part of the free movement of services and the potential risks that restrictions to subcontracting may pose to the internal market. Chapter 6 describes the existing mechanisms within EU law that address labour law issues in subcontracting chains. This includes mechanisms such as direct liability, equal treatment of workers, and reporting requirements, as outlined in existing EU law. In chapter 7, concluding remarks are made.

[1] Question for written answer E-002021/2024 " National attempts to limit long subcontracting chains and the Commission implementation report on the Posting of Workers Directiv" 10.10.2024.
[2] See Answer given by Mr. Schmit on behalf of the European Commission to question E-002021/2024, 28.11.2024.
[3] The press release can be read at https://etuc.org/en/pressrelease/simplification-eu-must-limit-subcontracting-and-promote-direct-employment
[4] Amended by Directive 2018/957.

2. Key findings

1

It is hard to pinpoint subcontracting for legal purposes without risking unintended effects.

2

Subcontracting is part of the freedom of contract, which is safeguarded by EU primary law.

3

The protection of the freedom of contract under EU primary law limits the restrictions that may be imposed on subcontracting in EU secondary law.

4

There are several different types of legislative means that aim to address labour law problems in subcontracting chains in existing EU law.

5

The main legislative means to address labour law problems in subcontracting chains are 1) direct liability, 2) equal treatment of the workers and 3) reporting mechanisms for the use of subcontractors.

6

Limiting subcontracting chains to a certain level of tiers would represent an unprecedented and blunt restriction on subcontracting. It is unprecedented because no similar measures currently exist in EU law. It is blunt because it has the legal side-effect of disadvantaging small and medium-sized enterprises while benefiting larger companies, which could ultimately harm competition within the EU.

3. Definition issues

3.1. Introduction

In this study, subcontracting has so far only been defined as the situation when a contract party delegates parts or all of its contractual obligations to a third party. However, legally, this definition will require further clarification. In the following sections, the complexities of defining the obligations to be delegated, defining who really is to be considered a third party and definition issues related to the distinction between services and products are addressed.

3.2. How is subcontracting legally distinguished from similar legal concepts?

The ever-increasing specialisation and division of labour are likely a result of a more open market economy with lower transaction costs, as well as the matchmaking capabilities of modern technology. Regardless of the underlying economic factors, it is often beneficial for a business to hire external capacity to complete specific tasks. In general business terms, the use of external capacity is commonly referred to as subcontracting or outsourcing.

While subcontracting and outsourcing may be used interchangeably in business practice, legal frameworks addressing subcontracting require a distinction between the two concepts. In EU secondary law, subcontracting is a concept used in, e.g. the Public Procurement Directive (2024/24), the Posting of Workers Enforcement Directive (2014/67) and the Employer Sanctions Directive (2009/52). Of these three directives, only the Employer Sanctions Directive contains an explicit definition of the concept. In Article 2 (f), a subcontractor is defined as "any natural person or any legal entity, to whom the execution of all or part of the obligations of a prior contract is assigned".

By limiting the concept of subcontractor to obligations derived from a specific prior contract, the definition separates subcontracting from outsourcing, where external capacity is hired for a service that otherwise would have been handled internally. Even if the Public Procurement Directive lacks a clear definition of subcontracting, it is obvious from the context of the directive that subcontracting as a notion refers to obligations delegated under the public contract in question.[1] As also posting of workers is dependent on a specific contract, it is likely that the rules on subcontracting in the Posting of Workers Enforcement Directive also refer to obligations delegated from a particular contract.

It is noteworthy that the delegation of contractual obligations is not consistently referred to as subcontracting in EU law. One such example is the use of labour intermediaries, where the actual performance of labour may be delegated to an intermediary temporary work agency. In the EU Temporary Agency Work Directive (2008/103), the use of such labour intermediaries is protected. Without using the notion of subcontracting, the directive defines a temporary work agency as someone who hires employees to assign them to user undertakings.[2] This type of subcontracting is protected under the directive, so that any restriction must be motivated (Article 4 of the Temporary Agency Work Directive).

[1] See e.g. Article 71 of the Public Procurement Directive that relies on the concepts of "main contractor" (the one having entered the public contract) and "subcontractors".
[2] Article 3p. 1 (c) of the Temporary Agency Work Directive.

3.3. What is a subcontracting chain?

If a subcontractor in turn subcontracts obligations to another subcontractor, one can speak of a "subcontracting chain." This concept is being used in e.g. the Public Procurement Directive (2014/24) and must be distinguished from the notions of "chain of activities", "supply chain" and "value chain," which are being used in e.g. the Corporate Sustainability Due Diligence Directive (2024/1760).

Whereas a subcontracting chain seemingly refers to a situation where the contractual obligations are directly subcontracted, supply chains and value chains are more vague and broad terms. In the Corporate Sustainability Due Diligence Directive (2024/1760) (CSDDD), the relevant notion for determining the due diligence responsibility is referred to as the "chain of activities". In article 3.1 (g) of the directive, chain of activities is defined as "activities of a company's upstream business partners related to the production of goods or the provision of services by that company, including the design, extraction, sourcing, manufacture, transport, storage and supply of raw materials, products or parts of products and the development of the product or the service" as well as the "activities of a company's downstream business partners related to distribution, transport and storage of a product of that company, where the business partners carry out those activities for the company or on behalf of that company.

A closely related problem is the definitions of supply chain and value chain in existing EU law. The use of the term supply chain typically involves every chain in the production or transport of a product, whereas the value chain is broader and involves every step that creates value to the product.[1] From a legal certainty perspective, both these concepts are vague. Any restriction must cautiously deal with the scope of the liability it imposes.

To summarize, it seems that when subcontracting chain is being used as a legal concept, it relates to a situation where the contractual obligations can be derived to a specific contract.

> ***While subcontracting and outsourcing may be used interchangeably in business practice, legal frameworks addressing subcontracting require a distinction between the two concepts.***

3.4. Who is the 'third party'?

In a legal context, the simplified notion of subcontracting above has proven difficult to define. A prominent example of this challenge is the so-called Teckal exemption in EU public procurement rules, which illustrates the complexity in defining the 'third party' in a subcontracting relation.

In the judgment Teckal, C-107/98, EU:C:1999:562, the court held that public procurement rules do not apply when a local authority controls a legal person in a manner akin to its own over its internal departments, provided that the controlled entity "carries out the essential part of its activities with the controlling local authority or authorities". This exemption was later codified in Article 12 of the Public Procurement Directive (2014/24). For the purposes of this legal study, the Teckal exemption illustrates the difficulties in defining who constitutes a 'third party'.

Defining subcontracting might also be complex when a company has decided to outsource certain services. For example, a company may outsource custodial services relating to regular maintenance of its office premises. Such custodial services could be handled by a company that in turn chooses to subcontract cleaning to one service provider, watering of plants to another and maintenance of the coffee machine to a third. The more irregularly the employees of the subcontractors appear at the office premises, the more unreasonable it is to call them subcontracted employees or to impose labour law liability for the company having ordered the custodial services. In fact, every hired service can be considered outsourced subcontracting.

[1] As follows from recital 25 of the CSDDD, these concepts may differ in different EU acts.

3.5. Service or product?

Another definitional challenge arises in distinguishing between the purchase of ready-made products and on-site construction. Generally, purchasing ready-made products does not trigger the same liabilities for the purchaser as hiring on-site services. This distinction between products and services is recognised in EU primary law, where the free movement of goods and the free movement of services are treated as separate rights and governed by different provisions.

In Hans & Christophorus Oymanns GbR, Orthopädie Schuhtechnik, C-300/07, EU:C:2009:358, the distinction between products and services was put to the test. The issue in the case was whether tailored shoes were to be considered products or services for public procurement purposes. The ECJ held that, even though the shoes were made-to-measure, they should still be classified as products. Similar problems can occur for several different legal aspects.

As a labour law-related example, one can take modern house construction where houses and buildings often are pre-fabricated and built elsewhere than on-site. If the prefabricated modules are built in another member state, they will be considered products in the EU internal market. Traditional house construction made on-site is undoubtedly considered a service. As it is a service, it will trigger the Posting of Workers Directive (96/71) if an undertaker uses labour from another member state. Self-evidently, these rules are not applicable if the work is being performed in another member state and the result is exported as a product.

3.6. Conclusion

At this stage, it remains unclear how the proposed restrictions to subcontracting will define the concept itself. However, as demonstrated in this section, there is considerable complexity in defining the notion, which would need to be addressed with precision.

Prohibiting subcontracting behind a certain level of tiers would be particularly problematic. If restrictions that prohibit subcontracting to a certain level of tiers would include also products, it goes without saying that it would be impossible to do business. For example, a business might be forced to choose between subcontracting for repairs and purchasing a new product outright, thus affecting not only decision-making processes but also local jobs and sustainability.

From a legal certainty perspective, the complexities in defining the concept of subcontracting must be handled with care. Rules that are uncertain will most likely have a deterring effect for those who could be made liable. As regards subcontracting, that means generally that smaller businesses will be affected whereas large scale companies do not need to bother.

To ensure legal certainty, it is necessary to address on-site subcontracting for services only regardless of what measures that are proposed. If restrictions of subcontracting are extended to apply to all services a company hires, it will affect business negatively.

[1] As follows from recital 25 of the CSDDD, these concepts may differ in different EU acts.

4. The protection of subcontracting under the EU Charter

4.1. Introduction

The practice of subcontracting is principally protected by the freedom of contract as it involves the right to choose whom to do business with. Under EU law, freedom of contract has long been considered a part of the right to conduct a business as well as a part of the freedom of movement. In this chapter, the importance of that protection is being discussed.

4.2. How is subcontracting protected in EU law?

Since the Lisbon Treaty entered into force on December 1, 2009, the Charter has been a part of EU primary law together with the Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU). By gathering fundamental rights that hitherto had been recognised as general principles established in the case-law of the ECJ or parts of the treaties, the Charter has proven to be a powerful and comprehensive legal instrument.

With respect to the legal background described above, some rights in the Charter have clear parallels to the treaties. One such parallel exists between the freedom to provide services (Article 56 of the TFEU) and the freedom of establishment (Article 49 of the TFEU) on the one hand, and the right to conduct a business in Article 16 of the Charter) and the right to property (Article 17 of the Charter).[1]

In old EU law, the right to conduct a business was not codified, but it was already early recognised as a "fundamental right" and a "general principle of law".[2] In the explanations to the Charter, it is made clear that Article 16 was meant to codify the freedom to exercise an economic or commercial activity.[3] With references to a number of old landmark cases, the explanation to the Charter also clarifies that the freedom of contract is included in the right to conduct a business.[4] These historical connections make old case-law relevant for interpreting the right to conduct a business under Article 16 of the Charter.

In its landmark judgment, Sky Österreich, C-283/11, EU:C:2013:28, the ECJ confirmed the freedom of contract as an aspect of the right to conduct a business under Article 16 of the Charter.[5] Also, in later case-law, the freedom of contract as a part of the right to conduct a business has been reiterated.[6]

The exact limits of freedom of contract are not clear.[7] It has, however, been established in case-law that the freedom of contract under the right to conduct a business includes the right to choose with whom to do business.[8]

[1] See the Official Journal of the European Union 2007/C/303/02 at p. 23 for an explanation of the role of the right to conduct a business.
[2] Nold, C-4/73, EU:C:1974:51 p. 13.
[3] See the Official Journal of the European Union 2007/C/303/02 at p. 23.
[4] See the Official Journal of the European Union 2007/C/303/02 at p. 23 with references to Sukkerfabrikken Nykøbing, C-151:78, EU:C:1979:4, p. 19 and Spain v. Commission, C-240/97, EU:C:1999:479 p. 99 as well as reference to Article 119(1) and (3) of the TFEU which recognizes free competition.
[5] Sky Österreich, C-283/11, EU:C:2013:28 p. 42 f.
[6] See e.g. Alemo-Herron, C-426/11, EU:C:2013:521 p. 32, J.K., C-356/21, EU:C:2023:9, p. 74, and Bank Melli Iran, C-124/20, EU:C:2021:1035, p. 79 (with further references).
[7] See e.g. Peers, Steve, 'Article 16' in The EU Charter of Fundamental Rights: A Commentary, Bloomsbury Publishing, 2021,paragraph 16.65 f. where the future evolution of Article 16 is described as still emerging.
[8] Anie, C-798/18 & C-799/18, EU:C:2021:280 p. 57.

As regards the proposed restrictions to subcontracting, it is obvious that the proposal to limit subcontracting to a certain number of tiers will infringe on the right to choose with whom to do business. Introducing direct liability will not necessarily have that effect, as it does not limit the contractual freedom of choosing with whom to do business. Instead, it regulates the consequences of such a choice. Hence, particularly the proposed restriction to limit subcontracting to a certain level of tiers will affect the freedom of contract protected under the right to conduct a business in Article 16 of the Charter.

4.3. What does it mean that subcontracting is protected under the charter?

The protection of freedom of contract under the Charter is relevant in determining the limitations to which it can be subjected. Together with the treaties of the EU, the Charter constitutes EU primary law. Primary law has a constitutional effect in the sense that secondary law, directives and regulations must be compatible with primary law. Consequently, the legislator must comply with primary law when passing a directive or a regulation. If secondary law is not compatible with primary law, it cannot be applied.[1]

The issue in the Sky Österreich case was whether a monetary limitation set out in Article 15 §6 of EU directive 2010/13 for the use of exclusive sports video materials in news production was compatible with the rights to conduct a business in Article 16 and the right to property in Article 17 of the EU Charter. In its judgment, the Court held that the freedom of contract is protected under the right to conduct a business in Article 16 of the Charter.[2]

4.4. How may subcontracting be restricted?

That the freedom of contract is protected under the right to conduct a business does not mean that it cannot be subject to limitations. On the contrary, the right to conduct a business is not an absolute right. [3] Limitations to the freedom of contract exist in EU law, e.g. dominant actors under competition law and in labour law for non-discrimination purposes. Still, a limitation of a fundamental right must be viewed in relation to its social function and fulfil the requirements set out in Article 52 §1 of the Charter.[4]

Pursuant to Article 52 §1, limitations of fundamental rights must follow certain criteria. First, any limitation needs to be provided for by law. Second, the limitation must respect the essence of the right or freedom that it intervenes with. Third, subject to the principle of proportionality, limitations may be made only if they are necessary and genuinely meet objectives of general interest recognised by the Union or the need to protect the rights and freedoms of others.

A potential limitation of the freedom of contract would most likely be made in the form of a directive. Hence, it would be provided for by law and, therefore, fulfil the first criterion. When it comes to the second criterion, it can be questioned whether a limitation of the right to subcontract would respect the essence of the right to conduct a business.

Such a serious restriction of the freedom of contract as a part of the right to conduct a business in a labour law context has been disqualified by the ECJ in Alemo-Herron, C-426/11, EU:C:2013:82.

The issue at stake in Alemo-Herron was whether the rules implementing the Transfer of Undertakings Directive (2001/23) in the UK were compatible with the freedom to conduct a business. The court held that UK legislation was not compatible as it did not give the transferee any chance to participate in the collective bargaining body.[5]

[1] To this effect, see e.g. Digital Rights Ireland, joined cases C-293/12 & C-594/12, EU:C:2014:238, in which the CJEU held that the directive 2006/24 on the retention of data was invalid as it was not proportionate in relation to the right to respect for private and family life in Article 7 of the Charter or to the right to protection of data in Article 8 of the Charter.
[2] Sky Österreich, C-283/11, EU:C:2013:28 p. 42 f.
[3] Sky Österreich, C-283/11, EU:C:2013:28 p. 45.
[4] Sky Österreich, C-283/11, EU:C:2013:28 p. 45 ff.
[5] Alemo-Herron, C-426/11, EU:C:2013:82 p. 34 ff.

Therefore, it was held that this was a breach of EU law. Indeed, a limitation on the use of subcontractors would constitute a particular problem for small and medium-sized enterprises, as those, in contrast to large companies, cannot compete on even terms if they are not allowed to use subcontractors.

Regardless of whether a limitation on the right to subcontract would conflict with the essence of the right to conduct a business, it must also be proportionate in accordance with the third criterion of the test set out in Article 52 §1. The proportionality test under Article 52 requires that the objective intervening in the protected right, here the right to conduct a business, is legitimate under EU law. Not all objectives are legitimate. The ECJ has, e.g. made it clear that the interests of the national economy of a member state cannot serve as justification for obstacles prohibited by the treaty.[1] It seems that the suggested limitations of subcontracting are proposed to ensure the protection of workers. Protection of workers is a legitimate aim that can motivate interventions in fundamental rights.[2]

To assess what is proportionate, the ECJ has set out a test questioning whether the same objective could be achieved with fewer intervening measures.[3] With analogies to the case-law of the ECHR, the ECJ has set out in general that restrictions made by the union legislator to fundamental rights shall be assessed on a number of factors, including "in particular, the area concerned, the nature of the right at issue guaranteed by the Charter, the nature and seriousness of the interference and the object pursued by the interference".[4]

As regards the nature and seriousness of the interference, the proposed measures would interfere with the right to conduct a business differently. Limiting subcontracting to a certain level of tiers will strike out business actors depending on their form and how big they are as well as creating incentives to buy ready-made products instead of having local on-site jobs. It is quite likely that the objective, to protect workers, can just as well be achieved by alternative means than limiting the level of subcontractor tiers.

Compared to limiting subcontracting to a specific number of tiers, introducing direct liability does not necessarily have as negative effects on the right to conduct a business. On the contrary, direct liability could be made business-model neutral and, if cautiously drafted, increase the legal worker protection. However, a direct liability measure can be just as incompatible with the right to conduct a business as a limitation of subcontracting to a certain level of tiers if it is not cautiously drafted.

Whereas limiting subcontracting to a certain level of tiers is incompatible with the core of the contractual freedom and consequently also the right to conduct a business, a direct liability mechanism may be compatible with that right.

Crucial for a direct liability mechanism is the limitation of liability for another legal subject's omissions or violations of law and the foreseeability of the application of such a direct liability measure. It is likely that open-ended liability for every level of subcontracting would make companies risk-averse in using subcontractors at all. Hence, such an open-ended system would not enable for smaller actors to compete as they cannot use subcontractors.

4.5. Conclusion

To summarise the discussion in this section, limitations to subcontracting must be balanced with respect to the interventions they create to the right to conduct a business. As limiting subcontracting to a certain level of tiers is a drastic intervention to this right, it can only be legitimate if there is no less intervening measure available. To protect the employees, less intervening measures are available.

[1] See .e.g. AGET Iraklis, C-201/15, EU:C:2016:972 p. 72.
[2] See .e.g. AGET Iraklis, C-201/15, EU:C:2016:972 p. 73 with further references to Arblade, C-369/96, EU:C:1999:575 p. 36, SEVIC Systems, C-411/03, EU:C:2005:762 p. 28 and ITF and Finnish Seamen's Union, C-438/07, EU:C:2007:772 p. 77. For a list of the justifications recognized by the court, see Barnard, Catherine, The Substantive Law of the EU – The Four Freedoms, 7:th ed., 2022, p. 500 ff.
[3] See e.g Digital Rights Ireland, joined cases C-293/12 and C-594/12, EU:C:2014:238 p. 46.
[4] Digital Rights Ireland, joined cases C-293/12 & C-594/12, EU:C:2014:238 p. 47.

5. Cross-border aspects of subcontracting

5.1. Introduction

There are cross-border aspects of introducing restrictions to subcontracting that need to be considered. Restrictions to subcontracting must be made so that they are justifiable with the free movement for services and freedom of establishment that constitute a significant part for the creation of the internal market. This cross-border aspect is examined in this chapter.

5.2. Subcontracting and the internal market

The EU strives to create an internal market with free movement for services, goods, capital and persons. In EU law, the ideas of free movement enjoy the highest priority by being central to the EU treaties. To create an internal market, the EU legal idea is to prohibit restrictions ('obstacles') to the free movement of goods, persons, services and capital. The free movement for services under Article 49 of the TFEU and the freedom of establishment under Article 56 of the TFEU include the economic rights in Articles 15–17 of the Charter.[1] This means that prohibitions of the economic rights in the Charter can also constitute an unlawful restriction to the free movement.

Just like interventions to the economic rights might be lawful under the Charter, obstacles to the free movement can also be legitimate. The assessment of whether a restriction on free movement is justified is commonly known as the "Gebhard test," named after the case Gebhard, C-55/94, EU:C:1995:194, where the criteria were clearly outlined.[2] Under this test, that much resembles the test under Article 52 of the Charter, a restriction must be 1) applied in a non-discriminatory matter, 2) be justified by overriding reasons of public interest, 3) be suitable for securing the attainment of the objective pursued and 4) not go beyond what is necessary to achieve that objective (it must be proportionate).

Particularly for the free movement of services and the right to establishment, freedom of contract, and the right to conduct a business have been of great importance.[3] An example illustrating the relevance of the freedom of contract is the public procurement judgment Borta UAB, C-298/15, EU:C:2017:266. In this case, the ECJ considered whether Lithuanian legislation that restricted subcontracting in public procurement was compatible with EU law.[4] In this case, the Public Procurement Directive was not applicable. Still, the Court held that "fundamental rules and general principles of the TFEU in particular Articles 49 and 56" may be considered by the Court if there is a "certain cross-border interest".[5]

Taking the general principles of the TFEU into account, the Court held that the Lithuanian limitation of subcontracting was an illegitimate obstacle to the free movement. Even if the limitation of sub-contracting was non-discriminatory, the ECJ recalled that Articles 49 and 56 of the TFEU "preclude any measure which, even if it applies without discrimination as to nationality, prohibits, impedes or renders less attractive the freedom of establishment and/or the freedom to provide services".[6]

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[1] See Cilevičs, C-391/20, EU:C:2022:638 p. 56
[2] Barnard, Catherine, The Substantive Law of the EU – The Four Freedoms, 7:th ed., 2022, p. 500.
[3] See e.g. the labour law related judgment AGET Iraklis, C-201/15, EU:C:2016:972. In this judgment, the CJEU held that national legislation implementing an EU directive must comply with the freedom to conduct a business under the free right to establishement in EU law.
[4] For a similar situation but applying the public procurement directive, see Siemens ARGE, C-314/01, EU:C:2004:159, Wrocław - Miasto na prawach powiatu, C-406/14, EU:C:2016:562 and Vitali, C-63/18, EU:C:2019:787.
[5] Borta UAB, C-298/15, EU:C:2017:266 p. 36
[6] Borta UAB, C-298/15, EU:C:2017:266 p. 47

As regards public contracts, the Court continued that "it is the concern of the European Union to ensure the widest possible participation by tenderers in a call for tenders, including contracts which are not covered by Directive 2004/17". Continuing that argument, the ECJ ruled that "[t]he use of subcontractors, which is likely to facilitate access of small and medium-sized undertakings to public contracts, contributes to that objective."[1]

Based on the arguments above, the ECJ held that the Lithuanian limitation of subcontracting was a restriction on the freedom of establishment and the freedom to provide services.[2] As mentioned above, such a restriction may, however, be legitimate under the "Gebhard test".[3]

In the case at hand, the reason for imposing the restriction on subcontracting was to ensure that the works were properly executed.[4] That was held to be a legitimate objective.[5] According to the Court, "such an objective may justify certain limits on the use of subcontracting".[6] However, assessing the proportionality of the measure, the Court held that the limitation on subcontracting went beyond what was necessary to achieve the objective.[7]

Decisive for the Court's finding that the limitation on subcontracting in Lithuanian law was unproportionate was that the limitation was general and did not allow for assessment on a case-by-case basis.[8] As an alternative means, the Court held that a less restrictive measure that could still have achieved the same objective could have been to order the tenderer to present which parts would be subcontracted.[9]

Limiting subcontracting could have broader consequences for the internal market, particularly for the free movement of services and the right to establishment. As seen in Borta UAB, restrictions to subcontracting can hinder cross-border business operations, particularly for small and medium-sized enterprises, thus counteracting the EU's objectives of promoting competition and economic integration over member states' borders.

A consequence of protecting the internal market is that any rules restricting subcontracting will need to take the free movement principles into consideration. On the other hand, imposing rules that seek to deal with subcontracting to 'third countries' can be formulated without the free movement considerations.

Limiting subcontracting could have broader consequences for the internal market, particularly for the free movement of services and the right to establishment.

5.3. Conclusion

Restrictions to subcontracting may conflict with the principles establishing the internal market. In addition to what was concluded on restrictions of the right to conduct a business in the previous chapter, restricting free movement would undermine cross-border operations. Hence, restrictions could be particularly detrimental to cross-border regions. Careful impact assessment of the effects of restrictions for the free movement would be necessary.

[1] Borta UAB, C-298/15, EU:C:2017:266 p. 48. See also Vitali, C-63/18, EU:C:2019:787 p. 26 and reason 78 for directive 2014/24.
[2] Borta UAB, C-298/15, EU:C:2017:266 p. 50
[3] Borta UAB, C-298/15, EU:C:2017:266 p. 51.
[4] Borta UAB, C-298/15, EU:C:2017:266 p. 52.
[5] Borta UAB, C-298/15, EU:C:2017:266 p. 53.
[6] Borta UAB, C-298/15, EU:C:2017:266 p. 54.
[7] Borta UAB, C-298/15, EU:C:2017:266 p. 54.
[8] Borta UAB, C-298/15, EU:C:2017:266 p. 55. Later, the CJEU has also disqualified Italian law that allowed bidders to only subcontract 30 % as being incompatible with EU law, see Vitali, C-63/18, EU:C:2019:787.
[9] Borta UAB, C-298/15, EU:C:2017:266 p. 57

6. Existing legal mechanisms addressing labour law issues related to subcontracting

6.1. Introduction

As discussed in Chapter 4 of this study, it is important to see every restriction to subcontracting through the lens of Article 52 of the Charter, as it is a restriction of the right to conduct a business. Therefore, it is critical to see which objective each restriction tries to achieve. In the name of proportionality, it is also important to see whether that objective could have been achieved by less interfering means.

Restricting subcontracting cannot be an objective in itself; rather, the aim must be, e.g. to improve labour conditions for workers within subcontracting chains. This distinction should be emphasised from the outset. In the following paragraphs, some existing measures dealing with labour law issues in subcontracting chains will be dealt with.

6.2. Direct liability

A prominent example of direct liability is the Employer Sanctions Directive (2009/52). This directive contains an explicit measure to impose liability in subcontracting relations for illegal workers. The purpose of the directive is to fight illegal immigration by imposing standards on employers (Article 1). In Article 8, the Employer Sanctions Directive imposes a certain liability: contractors, of which an employer is a direct subcontractor, can be held liable in place of the employer. For the purposes of the Employer Sanctions Directive, a subcontractor is defined as 'any natural person or any legal entity, to whom the execution of all or part of the obligations of a prior contract is assigned'.[1]

In the Posting of Workers Enforcement Directive (2014/67), a specific mechanism was introduced in Article 12 to tackle the problem with labour law liability for employees hired by subcontracting service providers. The mechanism set out in the enforcement directive can be described as a direct liability mechanism as it requires member states to enable posted workers to hold the contractor liable for labour law violations committed by its subcontractor. Quite remarkably, it can be noted that the Commission has considered implementing this obligation by limiting subcontracting to a particular number of tiers as a "best practice".

Also, the Public Procurement Directive (2014/24) contains a rule allowing Member States to extend the obligations to subcontractors in Article 71.

6.3. Equal treatment of workers

Treating workers in subcontracting chains equally is a means that is particularly prominent in the Temporary Agency Workers' Directive (2008/104). It is noteworthy that the Temporary Agency Workers' Directive contains no explicit rules for subcontracting nor is that notion used.

[1] Article 2 (f) of the Employer Sanctions Directive (2009/52).

On the other hand, temporary agency work is necessarily a type of subcontracting itself. In fact, the directive was enacted to strike a balance between two conflicting interests (Article 2). As such, the directive seeks both to protect workers hired by temporary agencies, but it protects also the right to use temporary agencies. Therefore, the directive guarantees the use of temporary agencies (Article 4).

To prevent abuse of temporary agency workers, the directive contains several mechanisms that seek to improve the working conditions for the temporary agency workers. Under Article 5 of the directive, temporary agency workers need to be treated equally to the ordinary workers at the "user undertaking" (i.e. the company hiring temporary agency workers from a temporary work agency).

6.4. Reporting and transparency obligations

Reporting obligations for risks related to the use of e.g. subcontractors exist in various places in EU law. Over the last years, it has become particularly debated as one of the prescribed measures of the CSDDD. Under Article 8 of this directive, EU Member States are obliged to 'ensure that companies take appropriate measures to identify and assess actual and potential adverse impacts arising from their own operations or those of their subsidiaries and, where related to their chains of activities, those of their business partners".

The reporting obligations introduced through the CSDDD are not completely new to EU law. Also the Public Procurement Directive contains reporting requirements in the sense that it can be made necessary to map the use of subcontractors when bidding for a public contract according to Article 71. Indirectly, also the conflict minerals regulation (2017/821) imposes a reporting liability for importers of conflict minerals by prescribing management system obligations (Article 4) and risk management obligations (Article 5).

It is noteworthy that the reporting and transparency obligations do not apply to all companies, but only to companies with more than 1 000 employees and a net worldwide turnover of more than 450 000 000 euros (Article 2 p. 1 of the CSDDD). That the rules only apply to big companies can be seen as a proportionality measure as it could be unproportionate to require small and medium sized enterprises to apply the same standards.

6.5. Limitation of subcontracting to a certain number of tiers

There is no example of when EU law prescribes the limitation of subcontracting to a certain number of tiers. Still, such limitations to subcontracting exist in national legislation and even as a means for implementing EU directives. ECJ case-law has consistently taken a negative approach to such national legislation holding it to be contrary to EU law.[1] Given the consistent and clear approach toward subcontracting limitation, it is somewhat surprising that the Commission describes limitation to a certain tier as an example for "best practice".

6.6. Conclusion

In the examined directives, three types of mechanisms that address labour law issues in subcontracting relations exist. Those mechanisms are direct liability, equal treatment of the workers and reporting and transparency obligations. Seen in the light of the existing mechanisms that address the issue of labour law liability in subcontracting relations, restricting subcontracting to a certain level of tiers would be an unprecedented legislative measure, which currently does not exist in EU law. On the other hand, direct liability mechanisms already exist. In contrast to limiting subcontracting chains to certain tiers, direct liability is a legal model that already exists. Also, it does not necessarily restrict the use of subcontractors as bluntly as a strict limitation to the tiers.

[1] See e.g. Borta UAB, C-298/15, EU:C:2017:266 and Vitali, C-63/18, EU:C:2019:787 discussed in section 4 of this legal study.

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7. Concluding remarks

Addressing labour law issues in subcontracting chains means a conflict between the right to conduct a business and the labour law objective of protecting employees. Under the Charter, as well as according to the principle of the free movement of services, this balance requires proportionality. As the nature of subcontracting is complex, legal measures restricting it need to be carefully addressed and limited in their scope of application.

While limiting subcontracting to a certain level of tiers may seem a straightforward solution to combat labour abuses, it presents significant challenges, particularly for smaller businesses and the internal market. Direct liability, on the other hand, can present a more balanced approach, not necessarily infringing EU law. Nonetheless, it must be stressed that also a direct liability mechanism can be just as intrusive as a limitation of the subcontracting tiers and hence also risk not being compatible with EU law.

There is a risk that restrictions to subcontracting will have negative implications for the market economy on which the EU is based, for cross-border EU regions and for the environment. Therefore, it is recommended that any restriction to subcontracting is preceded by a thorough impact assessment.

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