EUROPEAN CONTRACT LAW

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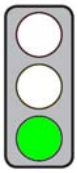
MAIN ISSUES

Objective of the Green Paper: The Commission presents policy options for the development and design of an EU contract law.

Parties Affected: All consumers and enterprises.



Pros: (1) EU-wide harmonised contract rules strengthen the internal market and reduce transaction costs in the medium and long term.

(2) An optional comprehensive EU contract law is appropriate and renders any imponderables that might occur during application of the law acceptable.

(3) The legal form of a regulation ensures uniform implementation throughout the EU.

Cons: –

CONTENT

Title

Green Paper COM(2010) 348 of 1 July 2010: **Policy options for progress towards a European Contract Law for consumers and businesses**

Brief Summary

- **Background and objective**
  - The Commission believes that consumers and businesses are "reluctant" to engage in cross-border transactions due to the differences between national contract laws, which "in turn hinders cross-border competition to the detriment of societal welfare" (p. 2).
  - The existing minimum harmonisation of national rules (e.g. in consumer protection) leaves room for different national approaches.
  - Different national contract laws can prevent in particular small and medium-sized enterprises (SMEs) from operating at cross-border level, as they "raise obstacles to pursuing a uniform commercial policy across the Union" and increase transaction costs for legal counselling. In e-commerce, for instance, in 61% of cases test shoppers were unable to place orders between April and July 2009 because suppliers would not deliver to their countries (Psychonomics Study "Evaluation of Cross-Border E-Commerce in the EU").
  - An EU-wide uniform set of contract rules could provide a reliable legal framework to cross-border business as long as it provides a neutral, user-friendly alternative to national contract law that draws "on the common national law traditions" (p. 7).
  - The aim of this Green Paper is to outline options for developing a European contract law (available in all official languages). To this end, the Commission presents for discussion various options for an "instrument of European contract law". By this it means a construct of EU contract laws which needs further developing in particular with regard to:
    - the degree of its legally binding nature (legal form),
    - the regulation radius (material scope) and
    - the applicability to contract relations that do not cross borders.
  - Civil law experts from the Member States ("expert group") currently support the Commission in developing a "Common Frame of Reference" containing civil law principles, terminology and model rules. The expert group is to provide an overview of the different legal traditions in the EU and stakeholders' interests and "take into consideration" the contributions to the present consultation.
- **Options for the legal form of the instrument of "European Contract Law"**
  The Commission is considering the following legal instruments:
  - **Option 1: Publication of the results of the expert group.** The outcome of the work of the expert group is published on the website of the Commission and serves as a non-binding example of legal requirements and standard contract provisions for Member States and the EU.
  - **Option 2: Official "toolbox".** Drawing on the results of the expert group, a frame of reference ("toolbox") is developed to ensure the coherence of new legislative acts concerning EU contract law:
    - Option 2a: The Commission uses the toolbox when drafting new legislative acts concerning EU contract law; council and EP are not bound to it.
    - Option 2b: The toolbox is introduced through an interinstitutional agreement between Commission, Council and EP. All three institutions must take it into consideration when drafting new legislative acts.
  - **Option 3: Recommendation.** In a (non-binding recommendation) the Commission encourages Member States to incorporate the instrument into their national laws as an optional rule.

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– **Option 4: Directive.** Binding EU contract law is established and introduced through a Directive. The Member States must implement it into national law.
– **Option 5: Regulation.** Binding EU law is established and introduced through a Regulation. Consequently, it takes direct effect in all Member States.
  - Option 5a: Optional EU contract law: the contract parties are entitled to choose either between EU or national contract law.
  - Option 5b: Mandatory EU contract law: EU law substitutes national rules. This removes fragmentation and simplifies the harmonised application and interpretation as well as the closure of cross-border contracts.

► **Options for the material scope of the "instrument"**
The Commission puts up four possible material scopes for discussion:
– **Option A: Narrow interpretation.** The "instrument" of EU Contract law defines only rules on definition of contract, pre-contractual duties, formation, right of withdrawal, representation, grounds of invalidity, interpretation, contents and effects of contracts, performance, remedies for non-performance, plurality of debtors and creditors, change of parties, set-off and merger and prescription.
– **Option B: Broad interpretation.** In addition to the above, the "instrument" of EU Contract law defines rules on restitution, non-contractual liability, acquisition and loss of ownership of goods and proprietary security in movable assets.
– **Option C: Regulation of specific types of contracts.** The "instrument" of EU Contract law contains additional extraordinary provisions for common types of contracts (e.g. purchase and service contracts).
– **Option D: European Civil Code.** Regulated are general contract law, specific types of contracts and other contractual obligations (e.g. tort law, unjustified enrichment and the benevolent intervention in another's affairs).

► **Should the instrument cover both cross-border and domestic contracts?**
– The "instrument" can cover either only cross-border or, in addition, merely domestic contracts.
– An instrument covering cross-border contracts only and which resolves the problems of conflict of laws could make an "important contribution" to the smooth functioning of the internal market.
– An instrument covering both cross-border and domestic contracts further simplifies the legal environment.
  - This can create incentives to enterprises to become active across borders as enterprises can restrict their "business policy" to one set of rules only.
  - But this would "impact" on consumers wishing to preserve a possibly stricter national consumer protection.

► **Online trading**
– Online trading has the highest potential for growth. Therefore, an "instrument" tailor-made for the online business could be developed. [see Communication: Digital Agenda COM(2010) 245; cp. CEP Policy Brief].
– It could apply either just to cross-border transactions or also to domestic businesses.

Statement on Subsidiarity by the Commission

The Commission does have some concerns regarding the principle of subsidiarity in relation to a "European contract law" (option 5b) and a "European Civil Code" (Option D). According to the Commission, an optional EU contract law (Option 5a) would be an alternative to full harmonisation.

Policy Context

In 2001 the Commission published a Communication on European contract law [COM(2001) 398] and conducted a consultation on the problems emerging from the differences in national contract law rules. Based on the consultation outcomes, in 2003 it drafted an Action Plan [COM(2003) 68] containing proposals as to how to improve the quality and cohesion of EU contract law through a "common reference frame", a common terminology and sample provisions. In 2008, a draft version of a common reference frame was submitted by "an international academic network" supported by the Commission. On 26 April 2010, the Commission set up an expert group for a period of two years to develop a common reference frame (Decision 2010/233/EU). The "Commission on European Contract Law" worked out the Principles of European Contract Law, PECL.
In 2008 the Commission submitted a Draft Directive on the full harmonisation of consumer rights [COM(2008) 614, cp. CEP Policy Brief]. So far the EP and the Council have failed to agree on it since full harmonisation faces massive opposition in single Member States [cp. CEP Monitor in German only].
In the Stockholm Programme for 2010-2014, the Council asked the Commission to submit a common reference frame and to continue dealing with European contract law [see Council Document No. 17024/09 of 2 December 2009 and COM(2010) 171; cp. CEP Policy Brief]. After the consultation on the Green Paper has been evaluated, the Commission will submit further proposals in 2012.

Options for Influencing the Political Process

Leading Directorate General: DG Legal affairs
Consultation procedure: Every EU citizen may comment. The procedure ends on 31 January 2011; http://ec.europa.eu/justice_home/news/consulting_public/news_consulting_0052_en.htm

ASSESSMENT

Economic Impact Assessment

The development of a European contract law, whatever its design, is a project of historical dimensions. Even though the expert group consulting the Commission is charged with the task of providing an "overview" of the different national legal traditions, it is hardly possible for both the expert group and the Commission to take account of *each and every* legal tradition. Therefore, massive protests can be expected. The current disagreement about the proposal to fully harmonise consumer rights, which constitutes only a small part of contract law, is a good example.

Nonetheless, **EU-wide harmonised contract rules strengthen the internal market**: they can establish the necessary legal certainty and reduce transaction costs. The development of a European contract law is therefore appropriate.

However, expectations of the European contract law should not run too high: it is not only different contract rules that impede cross-border business but also cultural differences (e.g. language, habits and customs). A European contract law cannot eliminate this.

Moreover, the introduction of European contract rules increases legal complexity and, consequently, transaction costs in the short term. **In the medium and long term** on the other hand, experience with the application of the law causes **transaction costs to drop**.

Against this background, the options proposed by the Commission can be evaluated as follows:

Legal form: the desired legal certainty can be ensured only if the rules are implemented uniformly throughout the EU. To this end, options 1 to 4 are therefore inappropriate. **Only the legal form of a regulation (option 5) ensures that contract law rules are implemented uniformly throughout the EU,** as they are effective directly within the Member States.

However, a uniform implementation must be accompanied by a uniform legal application as a precondition. A requirement for this is a uniform case law and – as an upstream measure – a uniform legal education. The Commission does not address these issues.

An optional EU contract law (option 5a) is the only option that makes sense. Only this option can be enforced politically, as in designing the "instrument" massive opposition can be expected. **It** is also appropriate because an optionally applicable EU contract law **does not force anyone to abandon tried and tested national legal rules and can demonstrate gradually its superiority over national rules**.

An optional EU contract law should have to be chosen quite deliberately by both contract parties in order to be valid ("opt-in"). However, it is possible that in particular consumer businesses could have stipulated in their General Terms and Conditions the application of EU contract rules, if this represents a cheaper option for them. Consumers, who are more in need of protection than enterprises, would then have no freedom of choice. The Commission does not address this issue. However, the following provision would be appropriate: if enterprises wish to apply EU contract rules to their consumer businesses, they should also be obliged to offer contracts in accordance with national rules. Only such a practice would ensure that the European contract law is chosen only if it is cheaper for both the enterprise *and* the consumer; otherwise national law applies. Particularly in the case of oral contracts and business deals, which are concluded in everyday life (e.g. purchase at the bakery), this would be a workable solution.

Enterprises concluding consumer contracts under both national and EU contract law can calculate different prices, each according to the law they apply. For instance, in the case of shorter warranty periods, the price can be lower because the reserves that enterprises have to build are lower. Hence, the consumer can choose on its own whether longer warranty periods are worth their higher prices. This type of rule constitutes a more politically practicable alternative to the deadlocked efforts towards a full harmonisation of consumer rights: on the one hand, an optional EU contract law provides the Commission with the chance to demonstrate what in its view an ideal consumer protection could look like, and on the other hand, entrepreneurs and consumers can decide on their own whether or not it means an improvement for them.

Material scope: **the broader the material scope, the more transaction costs drop.** Little would be gained if due to a narrow interpretation (option A) – for instance in the case of restitution or non-contractual obligations – national rules had to be applied. Therefore, **the aim should be** – on the condition of an optional applicability – to regulate these legal issues too (option B), as well as the integration of special provisions for single types of contract (**option C**).

A comprehensive **European Civil Code** (option D), however, is problematic. For it is precisely non-contractual statutory obligations that do not provide the affected legal entities with any choice. Far preferable would be a legal definition of when European and when national civil law has to be applied. This **is not in line with the principle of only optional applicability** (option 5a).

Integration of domestic contracts: EU action is principally only justified where cross-border relevance is involved. This would be an argument in favour of an individual instrument for cross-border contracts. However, an **EU contract law**, deemed superior over national rules by the contract parties, **should also be applicable to domestic contracts – provided it is chosen deliberately by the contract parties** (opt-in). Validity only granted to contracts affecting cross-border businesses would limit the choice options for no obvious reason.

Legal Assessment

Legislative Competence

Pursuant to Art. 114 (1) TFEU, the EU is empowered to adjust contract law if such action contributes to the completion of the internal market. This is the case here. In so doing, it has to assume a high level of consumer protection (Art. 114 (3) TFEU).

Subsidiarity

Legal fragmentation constitutes an obstacle to the free movement of goods and services and reduces the willingness of consumers and enterprises to operate in cross-border trading. Therefore, the introduction of an EU contract law is in line with the principle of subsidiarity pursuant to Art. 5 (3) TFEU.

Proportionality

Currently, the field of contract law fails to provide for a reference frame that is widely accepted in the EU and which defines basic legal terms and principles. However, such a reference frame forms the essential basis for future codifications in contract law. Hence, before starting to shape a European contract law, the currently negotiated reference frame should be finished. Moreover, an EU contract law should take into account the impact on other civil law areas (e.g. property law, corporate law) in order to avoid paradigm shifts.

The principle of proportionality requires an optional EU law which allows for a parallel application of national rules **due to substantial imponderables** which would inevitably occur when introducing a new legal system. For a uniform application of law is subject to a uniform interpretation provided by a European supreme civil court. Furthermore, a uniform EU contract law creates confidence only if the rights standardised therein can be enforced uniformly. To this end, EU contract law should be flanked by a European civil procedure.

The introduction of the EU contract law interferes with the state powers of Member States, as it also pushes aside mandatory national rights if the contract parties choose to apply EU contract law. Mandatory rights take into account the fact that in some cases the consumer has a weaker negotiating position than enterprises. Therefore, certain rights must definitely remain in force to the benefit of the consumer. With the regulation proposed in the Green Paper, whereby enterprises wishing to apply EU contract law are also obliged to offer the application of national rules, there is no risk of discriminating against consumers. They are not put under pressure and will choose to apply EU contract law rules only where they see fit. The fact that in so doing they forego non-disposable national rights is acceptable when seen against the entire background. Last but not least, an optional EU contract law that pushes aside non-disposable national rights is a less harmful intervention than a minimum or full harmonisation, as national rules remain effective in parallel.

Compatitbility with EU Law

Art. 6 (2) of the Regulation on the law applicable to contractual obligations ["Rom I"; (EC) No. 593/2008] defines that consumers are at any time entitled to invoke the mandatory rules of their home countries notwithstanding any other law applicable. Should an optional EU contract law that replaces national rules when chosen by the contract parties be introduced for cross-border cases, then said provision must not be applied.

Compatibility with German Law

As the model of the optional EU contract law favoured herein allows national rules to remain in effect in parallel, there is no need for any modifications to German contract law.

Conclusion

The development of a European contract law boosts the internal market. In the medium or long term a drop in transaction costs can be expected. EU contract law should be adopted in the form of a regulation in order to ensure a uniform implementation in all Member States. As the design of EU contract law is likely to provoke strong opposition, an optional EU contract law is the only politically enforceable option. Besides, it is also appropriate since an optional EU contract law does not push anyone to abandon tried and tested national rules. Moreover, it can gradually prove its superiority over national rules in the application of law. Finally, only an optional EU contract law takes account of imponderables that occur when introducing a new legal system, as national rules remain in effect at the same time.