



## EUROPEAN CONTRACT LAW

*Jason Rix updates you on the European Commission's ambitious plan to introduce a new single pan-European contract law*

### 1. What are the Commission's plans for European contract law?

In July 2010, Viviane Reding, on behalf of the European Commission, put forward a series of proposals in a [Green Paper](#) on a new pan-European contract law. The consultation closed on 31 January 2011. The results of the consultation will be published on the [Commission's website](#). There were seven options outlined in the Green Paper, ranging from maintaining the status quo and simply publishing the report of an expert group (option 1) to the wholesale harmonisation of all civil law in Europe (option 7). The Commission has publicly narrowed down to these options:

- (a) a "toolbox" to guide legislators on the principles of contract law (also known as option 2); and/or,
- (b) a new "optional" pan-European contract law in addition to the existing national laws of the 27 Member States (also known as the "28th regime" or the "optional instrument" or option 4).

The optional instrument is favoured by the Commission and, it seems, the European Parliament. The UK favours the toolbox.

### 2. If the Commission's proposal is for an "optional instrument", why should it affect business?

Many of the elements of how this option is intended to work have yet to be decided by the Commission. In fact, there are a number of scenarios in which the option might not be optional in any meaningful sense:

- (a) if one of the parties to a contract can insist on the new law being applied to contract (eg a consumer or small or medium sized enterprise (**SME**)), it is not optional for the other;
- (b) if one of the parties to a contract is a government body and insists at a policy level on the new law, it will not be optional for the other;
- (c) the party with the strength of bargaining power may be able to compel the choice;
- (d) it might, conceivably, apply if there is no express choice of governing law; or
- (e) it might be chosen as an ill thought through compromise between two parties, eg one who favours French law and the other Polish law, where the parties cannot reach agreement.

In any event, if, as the Commission plans, the new law comes into force, everyone (lawyers, courts, consumers and businesses (small and large)) will have to understand and consider it and whether it should apply.

### 3. What is the timetable?

The Commission has said it will review all the responses to the consultation over the coming months. However an expert group is already publishing what the draft legislation could look like if the EU adopts the optional instrument. The group will have completed this exercise by April/May 2011.

The Commission will make a formal legislative proposal in Autumn 2011.

### 4. Has there been an impact assessment?

Not yet. In the Green Paper, the Commission says it will carry out one *after* a legislative proposal. In meetings the Commission has said there is a study under way. The terms of reference that we have seen give little if any credence to the “do nothing” option, something the Commission is required to consider. They appear to call for support for the Commission’s proposals rather than a neutral assessment of whether any legislative action is in fact required. They also seem not to call for an assessment of the cost of any proposals.

### 5. Who is the new law for?

The Green Paper claims the new law would benefit consumers and SMEs. Both are very influential lobbyists. However, consumers do not support the current proposals which they see as undermining their protection under existing law.

### 6. What is the substance of the new law?

The expert group has taken as its starting point a body of work called the draft Common Frame of Reference (**DFCR**) published in 2008 which sought to show what a European Civil Code might look like. For an analysis of the DFCR and concerns about its failure to strike the right balance between open textured concepts and legal certainty please see “An Assessment” by Prof Simon Whittaker, 2008. The House of Lords’ European Union Committee also expressed its many concerns in its Twelfth Report of 2008.

The draft chapters already published by the expert group incorporate concepts from the DCFR like good faith and fair dealing, as well as a reference to the binding nature of pre-contractual negotiations. The optional instrument is therefore is much more like a civil code for contract than the English common law of contract.

The Law Society of England and Wales has publicly expressed its concern that the principles of English common law are not being properly represented in the expert group. Prof Simon Whittaker resigned from the expert group in September 2010. The only remaining English law member is Prof Hugh Beale who has been involved in European contract law since the 1980s.

### 7. Is there a proper legal basis for the Commission’s proposal?

The UK Ministry of Justice and others have questioned whether there is a clear legal basis for an optional instrument. An instrument that is optional (ie non-mandatory) cannot it is said, by definition, be the object of harmonisation measures. For further discussion see Hesselink et al, 2007.

## 8. What are the main arguments for and against the initiative?

### For:

- (a) It *may*, according to the Commission, increase online cross border trade.
- (b) The ideal of greater harmonisation.
- (c) A preference (which some see as a hidden agenda) for codification rather than case law.
- (d) Certain surveys cited by the Commission.
- (e) A desire to lower the transaction cost of offering goods and services for sale across the EU.

### Against:

- (f) The Commission has not produced any concrete evidence of a need for its proposals. There has not been a coherent impact assessment (at least from a business to business perspective) looking at what we already have, ascertaining whether there really is a need for something different and assessing the impact of any changes when compared to the status quo. We are not aware of any groundswell of demand from our clients calling for this new regime.
- (g) Cost of implementation and training.
- (h) Other more proportionate solutions are available or already in place (eg national and EU consumer law or Rome I (which protects consumers and others)).
- (i) Lack of certainty stemming from introducing a new law in such an important area. It will take a significant amount of time, possibly a generation, to create a solid volume of precedent in this new law. The uncertainty before such a body of law has been formed will be unwelcome and a concern for businesses (including SMEs) and consumers.
- (j) Increased pressure on the already heavily burdened Court of Justice of the EU (**ECJ**) to resolve differences of interpretation. Will consumers and SMEs really want to refer time sensitive matters to the ECJ with the consequent delay and additional cost?
- (k) There are many other practical and other reasons for a lack of intra-Member State trade such as language, security, trust, shipping costs and the like.
- (l) Widespread satisfaction with existing national laws.
- (m) As currently proposed the instrument would exist outside of Rome I and private international law (and therefore not offer maximum protection to consumers). Prof Whittaker explores this concern as a flaw in the optional mechanism in his [Assessment](#): if the consumer has an informed choice (as he must do under existing EU law) then why would he chose the new law over Rome I which affords him greater protection in his Member State?

## 9. What does the UK government think?

The UK Ministry of Justice has [responded](#) to the Commission's consultation. It rejects the optional instrument but supports the toolbox.

## 10. Who supports this initiative?

It is hard to say definitively until the results of the consultation are published. However big businesses and, ironically (since they are the intended beneficiaries), consumers are not supportive (for different reasons). Some SMEs including the British Federation of Small Businesses are supportive. The Member States have, we understand, expressed a range of view. The Bar Council of England and Wales is strongly opposed stating that it “remains far from convinced that the Commission has proved its case, either that there is a significant problem for businesses generally, or for consumers and SMEs in particular, in their cross border contractual dealings, or that, if there is, that it is caused by differences in contract law as such, or could be fixed by any EU measure in the contract law field.” The Law Society of England and Wales is also opposed to the optional instrument.

Allen & Overy – together with representatives of Clifford Chance, Linklaters, Herbert Smith, Freshfields and the GC100 – has been working closely with the Law Society (where John Wotton, Allen & Overy consultant, is Vice President) and liaising with MEPs and the Commission on the proposals.

## 11. What other proposals are there?

An alternative proposal is that the problem (if there is one) could be addressed contractually using existing national law and developing an EU blessed but entirely voluntary set of terms and conditions for online sale of goods.

## 12. What are the consequences if the Commission’s proposals are adopted?

- (a) If the legal basis is not adequately addressed, any legislation could be subject to challenge.
- (b) An increase in uncertainty while businesses assess the substance of the law, how the option works and everyone awaits clarity in the form of case law and academic commentary.
- (c) Businesses will need to assess whether or not to opt for the new law and if so how their existing contracts need adapting. Equally they will have to consider whether they might be forced into choosing it.
- (d) ISDA, for example, has emphasised “... the fact that all types of transactions to be covered by the proposed European instrument cover markets that are geographically much wider than the European Union. From a more global perspective it appears questionable to embark on a project that is limited to the European Union, while similar global instruments such as the UNIDROIT Principles of International Commercial Contracts and the UN Convention on International Sales of Goods (CISG)/Vienna Sales Convention already exist and cover large sections of what the proposed European instrument envisages.” Might businesses opt for New York law instead? Might they have to accept the new regime as a quid pro quo for doing business in the EU?
- (e) If the new law is implemented all lawyers, clients and judges will need re-training on the new law which is likely to be more of a challenge for common law lawyers and the principles are likely to be more removed from what they are used to than they are for continental European lawyers.