

January 2013

## A Common European Sales Law (CESL)?

*An update on the European Commission's ambitious plans*

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### 1. WHAT IS THE CESL?

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The EU has been grappling with harmonising contract law for over a decade. More recently, in July 2010, Viviane Reding, on behalf of the European Commission, put forward a series of alternatives in a [Green Paper](#) on a new pan-European contract law. The choices under consideration ranged from making a series of non-binding recommendations to a complete civil code for Europe. Ultimately on 11 October 2011, the Commission published

a [draft regulation on a Common European Sales Law](#) which is proposed to operate as an optional supplement to national law for the sale of goods and related services, and the provision of digital content. The regulation contains, as an annex, a 186 article autonomous code which is intended to operate in parallel to current national laws.

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## 2. WHO IS IT FOR?

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The Commission asserts that the new law would benefit consumers, and small and medium-sized enterprises (SMEs). To quote from the Commission's website: "*Traders who are dissuaded from cross-border transactions due to contract law obstacles forgo at least*

*EUR 26 billion in intra-EU trade every year. Meanwhile, 500 million consumers in Europe lose out on greater choice and lower prices because fewer firms make cross-border offers, particularly in smaller national markets.*"

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## 3. WHO CAN CHOOSE IT?

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The question of who can choose the CESL is not a simple one to answer. The regulation proposes that it could be used in business to consumer contracts (where the consumer has given explicit and informed consent)

and business to business contracts (where at least one business is an SME), but not for consumer to consumer contracts.

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## 4. WHAT IS THE MATERIAL SCOPE?

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The CESL would (as proposed) only be available to cross-border contracts. This includes contracts involving third countries (ie states outside the EU).

The subject matter for which the CESL can be chosen would be the sale of goods and provision of related services,

and the supply of digital content (for example electronic books or downloaded music). It would not (as proposed) extend to financial or legal services. The Commission is to consider whether it should be extended to insurance. An expert group is expected to be set up for this purpose in 2013.

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## 5. IS IT A COMPLETE CODE?

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The CESL does not address a number of areas including legal personality, the invalidity of a contract arising from lack of capacity, illegality or immorality, the determination of the language of the contract, matters of non-discrimination, representation, plurality of debtors and creditors, change of parties including assignment, set-off and merger, property law including the transfer of ownership, intellectual property law and the law of torts. Also, from a practical perspective, it does not address

jurisdiction, service and enforcement. The Commission has proposed "flanking measures" to support the regulation including developing European model contract terms.

Since it is not an all encompassing code and because of the way the CESL operates as part of national law, it will still be necessary for parties to choose a governing law as well as choosing the CESL.

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## 6. IF IT IS "OPTIONAL", WHY SHOULD IT AFFECT BUSINESS?

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There are a still some scenarios in which the "option" might not be truly optional, for example:

- 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; or,
- where the party with the strength of bargaining power

may be able to compel the choice.

In any event, if, as the Commission plans, the new law comes into force, everyone (lawyers, judges, consumers and businesses (small and large)) will have to understand and consider the CESL and may have to advise on whether it should be chosen.

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## 7. WHAT IS THE TIMETABLE?

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Unclear: currently the proposal is with the European Parliament. Originally the Commission had said that it wanted the law to be agreed in time for the 20th anniversary of the Internal Market (since passed). It now seems unlikely that there will be a new law in 2013.

In June 2012, the Justice and Home Affairs configuration of the Council of the European Union (JURI), held an orientation debate on the way forward for the CESL at which it was agreed that, despite a divergence of views, work should be started on the substance of the code contained in the annex to the proposed regulation. On 27 November 2012 there was a

JURI Interparliamentary Committee Meeting on "[The proposal for a Common European Sales Law: taking stock after a year](#)". At this workshop the European Law Institute (ELI) presented its views (discussed below), Diana Wallis, formerly co-rapporteur on the CESL, urged the EU to be bold and adopt an optional instrument, eBay described the CESL as a promising example of an attempt to improve the internal market in a novel way and Prof. Avv. Francesco Sciaudone, giving "the lawyers perspective", warned that the EU needs to take heed of the relatively poor uptake of the Vienna Convention for the International Sales of Goods.

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## 8. HAS THERE BEEN AN IMPACT ASSESSMENT?

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Formally there has been a [Commission impact assessment](#) which found that an optional CESL would meet its policy objectives in terms of reducing legal complexity and transaction costs. Many expressed concerns about the rigour of the process (see for example [Allen & Overy's response](#) to the call for evidence issued by the UK's Ministry of Justice and Department for Business Innovation and Skills). Together with its response to its call for evidence, the UK Government has also published its own [impact assessment](#). This assessment concludes that: the net

impact on UK business exports to EU consumers would be broadly neutral to negative; the net impact on UK consumer imports from EU businesses would be negative; and the net impact on UK business exports and imports with EU businesses would be broadly negative (due primarily to training costs). The European Parliament has recently set up a new [Directorate for Impact Assessment and European Added Value](#) which is intended to improve the process. A further impact assessment was expected to be produced for the European Parliament in December 2012.

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## 9. WHAT ARE THE CONCERNS ABOUT THE SUBSTANCE OF THE NEW LAW?

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From an English law perspective the concerns centre around the introduction of concepts such as good faith and fair dealing which are not typically best suited to arm's length business dealing, where businesses should be entitled to act in their own interest. Other areas that have caused disquiet are the apparent reversal of the caveat emptor rule and a move away from objective rules of interpretation. The fear is that the code lends itself to contracts determined by the judiciary and not the parties because of the discretion the code affords the courts to decide where a particular line should be drawn.

The [ELI has published a detailed paper on the CESL](#). Its recommendations include having the CESL available to domestic as well as cross-border contracts, removing the formal restriction to SMEs which it sees as too complex, making the choice of the CESL by a consumer easier, and creating a case law database and digest as well as establishing an advisory body to produce official commentary on the CESL.

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## 10. IS THERE A PROPER LEGAL BASIS FOR THE COMMISSION'S PROPOSAL?

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Allen & Overy and others have questioned whether there is a clear legal basis for the CESL, an optional regime. It is hard to see how an instrument that is optional and preserves national law can be said to amount to an "approximation" (that is harmonisation) of laws which is what the relevant provision, Article 114 of the Treaty on the Functioning of the European Union, requires. The significance of proposing the regulation under Article 114 is that any regulation will be adopted on the basis of qualified majority voting rather than unanimity so no single member state can effectively veto the proposal. For further discussion see [the preliminary position paper of the Bar Council of England and Wales on legal basis](#). The Council of the European Union's legal service has, however, produced an internal legal opinion endorsing the Commission's proposed legal basis. Even though the Council acknowledges that a firm position on legal basis cannot be taken until the final structure and scope of the proposal are clear, the Council does not believe this should act as an obstacle to reviewing the provisions of the code contained in the annex to the regulation.

Both the UK House of Commons and the German Bundestag have challenged the proposal on the basis that it is not in accordance with principles of subsidiarity and proportionality.

As the UK Government notes in its impact assessment, "[t]he question of whether the EU has competence is a legal matter. It is not therefore discussed here. Of relevance to this review, however, is the extent to which the IA [the Commission's impact assessment] demonstrates that CESL proportionately addresses the market and institutional failures identified by the Commission. Although the Commission rightly note the theoretical possibility that where divergence in laws exists there may be potential for transaction costs for businesses and consumers, their ability to ground the proposal on that basis suffers from a lack of sufficient evidence. This leads to the inevitable conclusion that the Commission's IA has not sufficiently demonstrated that CESL appropriately targets the scale and nature of the problems it seeks to resolve."

There is a separate, but related, question of the interaction between the CESL and the Rome I regulation on applicable law for contracts. Specifically article 6(2) of Rome I provides that "...a choice [of applicable law] may not, however, have the result of depriving the consumer of the protection afforded to him by provisions that cannot be derogated from by agreement ...". At first glance, if French law and the CESL were chosen by the parties where the consumer was

resident in Germany, it is unclear upon which basis the CESL enables the parties to prefer the CESL under French law to the relevant regime in Germany. The Commission however argues in the explanatory memorandum to the proposed regulation that an agreement to use the CESL is a choice between two different sets of sales law within the same national law

and therefore does not amount to, and "must not be confused with," the choice of the applicable law within the meaning of private international law rules. Even if the Commission's argument is correct, the analysis will not work for third states (ie countries not within the EU) since the CESL will not form part of the law of a third state.

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## 11. WHAT DOES THE UK GOVERNMENT THINK?

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The UK Ministry of Justice and Department for Business Innovation and Skills jointly issued a call for evidence in February 2012 which closed in May 2012. The purpose of the call for evidence was to inform the UK Government's stance in negotiations. Allen & Overy's response is available [here](#).

On 13 November 2012, the [Government published its response to CESL](#) (based on the call for evidence). In summary, the Government believes:

- There is insufficient evidence of a need for the CESL proposal as drafted.
- The limitations and uncertainty relating to the applicability of CESL (in terms of jurisdiction,

qualifying parties, and types of transaction) along with its optional nature and partial coverage of contract law topics relevant to sales, are likely to cause confusion and extra cost.

- Although the law in relation to consumer rights for digital content is unclear, the Government agrees with the majority of respondents that an optional European sales law is not the right instrument by which to address this.
- The proposal should remain restricted to cross-border contracts, if indeed the proposal is to proceed. The UK Government would not support an extension of CESL to UK domestic contracts.

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## 12. WHO SUPPORTS THIS INITIATIVE?

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It is hard to say definitively since not all supporters and detractors have published their views. Big businesses are predominantly opposed to the CESL (though there are exceptions such as those in the e-commerce sphere, for example eBay, who are in principle behind the initiative). Ironically (since they are the intended beneficiaries), consumers are not supportive. [BEUC](#), the European Consumer Organisation, considers an optional contract law regime, parallel to existing national consumer law, to be an inappropriate way forward for the regulation of consumer rights for a number of reasons, including the fact that an optional contract law regime

applicable to consumer contracts would give traders the possibility to decide which level of consumer protection consumers would benefit from by choosing to apply either the CESL or "normal", national rules according to their own commercial interests. [UEAPME](#), the European Association of Craft, Small and Medium-sized Enterprises, concludes that there is no evidence that the instrument will meet its original aim to boost cross-border business activities within the Single Market. However, some SMEs, including the British Federation of Small Businesses, are supportive. The Member States have expressed a range of views. The Council of Bars

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and Law Societies of Europe ([CCBE](#)) in its position paper of September 2012 is supportive of the CESL but did express its concern that the lack of legal certainty contained in some provisions of the proposal, including on good faith and fair dealing as well as on reasonableness, and the lack of coherence between different provisions, could be a barrier to the CESL's acceptance. The Bar Council of England and Wales is

strongly opposed stating, "*[w]hat we can be certain of is that the European Sales Law will increase costs for all and lead to less certainty in law; a double whammy which is in nobody's interests*" The [Law Society of England and Wales](#) has stated it supports efforts to improve the functioning of the Single Market and to increase cross-border trade; however it does not believe that a need for the CESL has been demonstrated.

# Key Contacts

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If you require advice on any of the matters raised in this document, please call any of our partners or your usual contact at Allen & Overy LLP.

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