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UNIVERSITY OF SOUTHAMPTON

FACULTY OF LAW, ARTS & SOCIAL SCIENCES

School of Law

**In Search of Coherence and Consistency in European Contract Law: A
Way Forward**

by

Sarah McKeown

Thesis for the degree of Doctor of Philosophy

April 2010

UNIVERSITY OF SOUTHAMPTON

ABSTRACT

FACULTY OF LAW, ARTS AND SOCIAL SCIENCE

Doctor of Philosophy

In Search of Coherence and Consistency in European Contract Law: A Way Forward

By Sarah McKeown

In 2001 the European Commission began a far reaching consultation to ascertain whether obstacles arise for the proper functioning of the internal market and for cross-border trade from the existing divergent and fragmentary state of European contract law at the EU and national levels. This question was answered in the affirmative. Action was needed to simplify the regulatory environment for cross-border trade; to provide businesses and consumers with a single, comprehensive, and directly applicable contractual framework for cross-border transactions in the internal market.

This thesis offers a solution to the current obstacles to cross-border trade on the basis of the Commission's principal proposals for future action; the review of the *acquis communautaire*, the creation of a Common Frame of Reference, and the adoption of optional instruments of European contract law. It undertakes a chronological and critical assessment of the proposals and progress to date, in order to determine the most appropriate way forward for European contract law. It seeks to do so against a wider debate which highlights the economic, socio-cultural and political issues and interests which bear on the suitability and desirability of the Commission's proposals and which must be accommodated within the final response. It also draws on existing examples of trade regulation, in particular, harmonised instruments, which share the objective of facilitating cross-border trade, at the international level. Such examination assists the understanding of the regulatory approach that must be taken to European contract law, and more particularly determines the extent to which the objectives of action at the European level can be realised within the internal market.

It is against this background, and at a time when the EU is looking to the internal market, and the facilitation of cross-border trade as a means for Europe to emerge from economic crisis, that this thesis presents necessary action for the immediate development of the European contract law project. It concludes that the adoption of optional instruments present the most appropriate way forward. This is not, however, an absolute solution. The review of the *acquis* and the resulting proposal for a Consumer Rights Directive has an integral part to play moving forward. In search of coherence and consistency in European contract law however the CFR, both as a legislative toolbox and basis for the optional instruments, must underpin the future regulatory response. It is clear that all three of the Commission's proposals must figure in the way forward.

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DECLARATION OF AUTHORSHIP

I, Sarah McKeown

declare that the thesis entitled

In Search of Coherence and Consistency in European Contract Law: A Way Forward

and the work presented in the thesis are both my own, and have been generated by me as the result of my own original research. I confirm that:

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- none of this work has been published before submission

Signed:

Date: 30th April 2010

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List of Abbreviations

B2B	Business to Business Transaction
B2C	Business to Consumer Transaction
B2SME	Business to Small and Medium Size Enterprise Transaction
B(SME)2B(SME)	Highlights SMEs as a distinct constituent of the wider business group in B2B transactions
B(SME)2C	Highlights SMEs as a distinct constituent of the wider business group in B2C transactions
CFR	Common Frame of Reference
CISG	Convention on the International Sale of Goods
CRD	Consumer Rights Directive
DCFR	Draft Common Frame of Reference
(D)CFR	Political CFR adopted on the basis of the DCFR
PECL	Principles of European Contract Law
SME	Small and Medium Size Enterprise
UCC	Uniform Commercial Code

Chapter 1

Introduction

“Jacques Delors once said that nobody falls in love with the single market. Sadly, one of the EU's main problems is that citizens don't see the benefits of the single market – the crown jewel of our Union's integration.”¹

One issue standing in the way of businesses and consumers alike seeing the benefits of the single market is the present state of European contract law, which is characterised by fragmentation and divergence at the EU and national levels. The result is a non-tariff barrier to trade, impeding the proper functioning of the internal market and rendering it more difficult and costly for businesses and consumers to engage in cross-border contracts. Although action has been taken at the European level to harmonise national contract law in order to facilitate cross-border trade, contracts of sale between contracting parties in different Member States cannot be treated as if they were trading within a single state. Yet today the EU is looking to the internal market and thus to cross-border trade as means for Europe to emerge from the economic crisis. Action is, therefore, necessary to simplify the regulatory environment for cross-border trade, and to make it easier and less costly for businesses and consumers to contract with partners in other Member States. In this way, citizens will “see” the benefits of the internal market.²

The current emphasis, and the need to take action in the area of contract law in order to facilitate cross-border trade, is part of an ongoing debate at the EU level, dating back to 1989 and 1994, when the European Parliament called for work to begin on the possibility of drawing up a common European Code of Private Law.³ The European Parliament stated that harmonisation of certain sectors of private law was essential to the completion of the internal market. The European Commission responded with a consultation on

¹ Viviane Reding Vice-President of the European Commission responsible for Justice, Fundamental Rights and Citizenship, Making the Most of the Internal Market: Concrete EU Solutions to Cut Red Tape and to Boost the Economy Brussels, 24 February 2010

<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/10/42&type=HTML>.

² Ibid. and Communication from the Commission, Europe 2020 a strategy for smart, sustainable and inclusive growth, COM (2010) 2020, 18-19.

³ Resolutions of the European Parliament in 1989 and 1994, OJ C 158, 26.6.1989, p. 400 (Resolution A2-157/89); OJ C 205, 25.7.1994, p. 518 (Resolution A3-0329/94).

European contract law in 2001, which sought to confirm the presence of obstacles to cross-border trade arising from the present state of European contract law, and to encourage debate on the way forward based on a number of proposals contained therein.⁴

The Communication was concerned with obstacles to cross-border trade at two levels: firstly, those arising from divergence in contract law at the national level. The enquiry was then narrowed to obstacles that may be created by the existing legislative approach to contract law and the facilitation of trade at the European level. As a result, and further elaboration in two subsequent Communications from the Commission on European contract law in 2003⁵ and 2004,⁶ the debate on future action now advances on the basis of three principal proposals, which form the basis of discussion in this thesis. The proposed response to obstacles existing at the European level is the review of the *acquis communautaire* in the area, and the creation of a Common Frame of Reference for European contract law (CFR). Together, the proposals share the objective of creating a simplified regulatory environment at the European level, characterised by a high degree of consistency and coherence in the existing and future *acquis communautaire*. At the national level, the proposed response has been the creation of a harmonised body of European contract law in the form of an optional instrument, in order to overcome the existing divergence at this level and thus to facilitate cross-border trade.

The Commission's Communications recognised the belief already held by the academic community that obstacles exist to the proper functioning of the internal market due to the existence of divergent national contract laws and the inadequacies of trade regulation in the internal market. This had prompted private harmonisation initiatives at the European level, resulting prominently in the Principles of European Contract Law⁷ (PECL) by the Commission on European Contract Law. This restatement pursued a number of immediate and long-term objectives⁸ linked to the facilitation of cross-border trade, and

⁴ 2001 Communication on European Contract law COM (2001) 398 final.

⁵ 2003 Communication: A More Coherent European Contract Law: An Action Plan, COM (2003) 68 final.

⁶ 2004 Communication: European Contract Law and the Revision of the *Acquis*: The Way Forward, (COM) (2004) 651 final.

⁷ Principles of European Contract Law (PECL) Parts I-II prepared by the Commission of European Contract Law, O Lando and H Beale (eds.), The Hague, Kluwer, 2000.

⁸ Outlined, *Ibid.* Introduction xxiv.

was again directed at contract law obstacles at both the national and European levels.⁹ In the short term, it were intended for immediate use by parties making contracts, by courts and arbitrators in deciding contract disputes and for national and European legislators in drafting contract rules. The long term objective was to help bring about the harmonisation of general contract law within the EU.¹⁰ To this end the ongoing academic work continues today in the elaboration of the draft CFR, undertaken by the Co-PECL Network of Excellence (Network of Excellence), and is based in part on a revised version of the PECL. The academic efforts, therefore, underpin the Commission's debate and proposals.

While the academic debate has advanced the case for harmonisation on the basis of facilitating cross-border trade and has on the whole accepted, in terms of the Commission's debate, that European integration may require further legal measures to this end, it has also sought to highlight the wider socio-cultural, economic and political issues and interests that are involved in this debate.¹¹ There is a wider debate that must also be addressed in the discussion as to the way forward and accommodated in the final response to the existing obstacles.

This thesis is concerned with the achievement of the EU's principal economic aim, and thus first and foremost with the creation and proper functioning of the internal market. It seeks, therefore, to offer a regulatory solution to the current obstacles to cross-border trade arising from the present state of contract law, at both the national and European levels. It does so on the basis of the Commission's proposals for further action and in view of the progress that has been made to date. In this respect it reflects legal developments up to 31 March 2010. A chronological approach is taken to the development of the Commission's debate and assessment of the proposals. This approach is warranted by the ongoing, dynamic nature of the contract law project, which since 2001 has undergone significant changes in priorities, in the governing European

⁹ I.e. not only a response to the divergence in national contract law, but also to the shortcomings in the existing EU legislative approach. PECL was intended to provide a necessary legal foundation for measures adopted by the EU at this level, PECL introduction, xxii – xxiii.

¹⁰ PECL Introduction xxiv.

¹¹ A notable example being the Study Group on Social Justice in European Private law, a Manifesto: Social Justice in European Contract Law (2004) *European Law Journal* 653.

Commission and in Directorates-General. All of this has impacted upon the proposals, the way in which they have developed and, therefore, the extent to which it is possible today to conclude which proposal(s) serve(s) as the way forward for European contract law.

The regulatory solution must be provided against the background of the wider debate, in light of the issues and objectives which impact upon the desirability of future courses of action. The way forward concerns not only the need to act to facilitate cross-border trade, but also the desirability of further integration and harmonisation of national contractual systems for economic ends. The thesis thus asks: what is the most appropriate way forward for European contract law? This is to be assessed, in the first place, in terms of the suitability of the proposals to overcome identified obstacles to cross-border contracting and thus to facilitate cross-border trade. The proposals must then be assessed in terms of their ability to address and accommodate, as part of the regulatory response, the wider issues and objectives involved in the debate, which bear on their desirability as the way forward.

To this end, Chapter 2 begins with the internal market hypothesis: the argument traditionally advanced for further action, specifically harmonisation, at the European level in order to overcome existing obstacles to cross-border trade. There is, however, a need to validate such claims. Attention turns to the Commission's debate and, significantly, empirical evidence, which seeks to answer three key questions and which is necessary from three perspectives. Firstly, the EU's competence to pursue further action in European Contract Law; secondly, the understanding of the contractual obstacles to the completion of the internal market; and finally, as a result, the ability to ascertain a suitable solution to facilitate cross-border trade. In order to determine an appropriate response, the analysis of the empirical evidence is further narrowed to ascertain whether specific market actors, i.e. businesses, small and medium size enterprises (hereafter SMEs) and consumers, experience the same obstacles, and to the same extent. Since consumers and SMEs form important constituents of the EU's internal market and policy objectives in this area, it will be particularly important for the regulatory response to facilitate cross-border trade for these groups.

Chapter 3 moves on to consider the wider issues and objectives which have impacted on the European harmonisation debate in general and, now, on the Commission's proposals for future action. In particular, since the Commission continues to seek a harmonised instrument of European contract law, although narrowed in the current debate to an optional form, the appropriateness of this course of action must be considered. The chapter thus presents the wider economic, social, cultural and political considerations affecting the approach to be taken, which have not been equally apparent in the Commission's debate to date.

In the first place, the chapter questions the economic goal of harmonisation. It asks whether, in economic terms, this is the most suitable and desirable way forward for facilitating trade in the internal market, and whether the 'level playing field' that centralised regulation seeks can be achieved in the internal market. This is particularly important when differences in national contract law are just one factor acting to obstruct cross-border trade and render such transactions more difficult and costly. An alternative to harmonisation is thus considered – regulatory competition – as a means by which to ensure the greatest satisfaction of wants and needs of the internal market participants, while also resulting in greater convergence between the national legal systems. It becomes apparent that a hybrid response, such as the optional instrument, which can combine the benefits of centralised and decentralised regulation, may present the most appropriate way forward in these terms.

From there, Chapter 3 highlights that the creation of a harmonised European contract law is more than a technical exercise. Harmonisation must result in more than a tool to facilitate cross-border trade. A harmonised instrument must represent a fair balance between contractual freedom and the needs of social solidarity and fairness. The risk is that the narrow, market-orientated agenda of the Commission's debate will not achieve this balance. The immediate issue for consideration is, therefore, the extent to which this balance is achieved in the existing draft CFR (DCFR), which will serve as the basis for the review of the *acquis communautaire* and for the elaboration of an optional instrument of European contract law. This determines the extent to which the wider issues and

objectives involved in the creation of a harmonised instrument can be represented in the Commission's final proposals. Chapter 3 goes on to emphasise the political nature of the harmonisation process and the political decisions that will have to be made in the creation of the CFR. The final CFR, in pursuing its envisaged functions, will, therefore, require political endorsement and regulatory legitimacy. This ultimately demands, in its creation, a representative and accountable process. The chapter considers the extent to which this is being achieved in the Commission's debate and in the ongoing creation of the CFR, and whether the political issues and concerns involved are being adequately addressed.

Chapters 2 and 3 are, therefore, intended to establish the parameters for the assessment of the Commission's proposals, in terms of their suitability to overcome the existing obstacles to trade, and their desirability in terms of the wider debate. The assessment begins in chapter 4 with the review of the *acquis communautaire* and the creation of the CFR, which provide a response to obstacles at the European level.

The chapter provides an overview of the proposals and their objectives, before giving more detailed consideration to the progress made to date. Regarding the review of the *acquis*, the chapter assesses the Commission's Green Paper and proposals advanced for the review of the *acquis* from two perspectives. First, to ascertain the extent to which the proposals for reform can satisfy the objective of the review, which seeks to address the causes of fragmentation at the European level, and thus simplify the regulatory environment for cross-border trade. Second, the Commission's consultation under the Green Paper will be examined in light of the earlier parameters set in Chapter 3 in regard to the political nature of the process, and the extent to which the Commission has maintained a representative and transparent consultative process. Focus then turns to the outcome of the public consultation: a proposal for a Consumer Rights Directive (CRD). An overview of the proposal is provided, in order to ascertain whether it meets the Commission's objectives in conducting the review and, ultimately, whether it provides the regulatory solution to the current obstacles to cross-border trade arising from the present state of contract law at the European level.

Chapter 4 goes on to assess the suitability of the draft CFR: first, as a basis for the Commission's proposals for future action, and thus as the basis for the regulatory solution; then, the suitability of the draft text to be utilised in the political selection process to create the political CFR will be considered. Attention turns to the final CFR, and the instrument that can be expected to result from the current selection process, in light of the present views of the EU institutions regarding the need for and intended functions of this instrument. In view of the relationship and shared objectives of the proposed review of the acquis and CFR, the chapter ends with consideration of the ongoing work on these proposals. It reflects upon their existing relationship and, moving forward, their necessary interaction as part of the regulatory response.

In a break in the assessment of the Commission's proposals, Chapter 5 draws on the existing international regulation of trade, to assist in the understanding of the regulatory approach that must be taken to European contract law. In particular, when the EU is looking to the creation of a simplified regulatory environment at both European and national levels through further harmonisation, the chapter considers an example of an existing harmonised instrument: the United Nations Convention on the International Sale of Goods. The chapter examines the range of regulatory choices that are available to the Commission in meeting the objective of facilitating trade in the internal market, drawing on the international regulation of trade in general and the approach of the CISG in particular. The discussion seeks to identify the successful use of particular regulatory approaches as well as to demonstrate the limits of harmonisation in both practical and political terms. Such limitations apply equally to the Commission's proposals, and impact upon the extent to which the objectives of action can be realised within the internal market. They thus bear on the most appropriate way forward for European contract law.

Chapter 6 returns to the assessment of the Commission's proposals and considers the optional instrument. The chapter begins with an overview of the proposal, and of how it is envisaged that it could provide a direct response to obstacles arising for the internal market from divergent contract law at the national level. It is presented as an appealing and distinct regulatory option and means by which to achieve a simplified regulatory

environment for cross-border trade in the internal market: significantly, one which, owing to the optional nature of the proposal, and to it being based upon the (D)CFR, can also accommodate the wider issues and objectives that arise in the debate as to the way forward. Attention therefore turns to whether the adoption of optional instrument(s) is possible. While political support has more recently fallen behind the proposal as a tool to facilitate cross-border trade, a number of issues must necessarily be addressed: first, the constitutional thresholds that must be surpassed for the adoption of optional instrument(s), before consideration of how effect would be given to the proposed optional contractual regime(s) within the European choice of law system.

With the need to facilitate cross-border trade in both the B2B and B2C contexts in mind, in particular for SMEs, and also consumers, consideration is given to how optional instrument(s) could be developed in order to enable full participation of these distinct market actors in the internal market. In the B(SME)2B(SME) context, discussion is directed at the apparent need to address contractual imbalances that can arise for SMEs with their trading partner, serving to undermine their contractual positions and ability to participate effectively in cross-border trade. In the B(SME)2C context, where one manifestation of the optional instrument as a ‘blue button’ is considered, a comparison is made with the proposed CRD which seeks the same objective as the optional instrument in this context, i.e. a simplified regulatory environment for B2C trade. This is done in order to ascertain the more appropriate regulatory response, and thus the way forward for European contract law in this context.

Drawing on the two initial debates, the review of the Commission’s proposals, and the lessons learnt from the international analogy, Chapter 7 seeks to offer, in conclusion, a regulatory solution to the current obstacles to cross-border trade arising from the present state of European contract law. While all three of the Commission’s proposal must necessarily feature as part of the regulatory response, the chapter concludes that the way forward is through the optional instrument. This proposal can best achieve the objectives of action at both the national and European levels. The adoption of optional instrument(s) is, however, not an absolute solution, and cannot address the existing causes of

fragmentation where it is not chosen as the applicable law. It is clear that it must also be joined, in the B2C context, by the CRD and that further action in respect of that proposal is necessary if it is to form a consistent and coherent horizontal instrument of European consumer contract law which will also serve, in part, as a basis for the ongoing review of the *acquis*. While both instrument share objectives, govern the same transactions, and originate from within the same Directorate-General, however, coherence between the two as part of the future regulatory response must be achieved. It is clear in this respect that while developments in the European contract law project now mean that the CRD will be integral to the coherence of the regulatory response, the CFR still has a pronounced role to play moving forward in both its intended functions as legislative toolbox and basis for optional instrument(s). The relationship between the 3 proposals is thus clarified, and necessary future action is discussed if, almost ten years after the Commission began this project, the benefits of the internal market are to be realised.

Chapter 2

The Commission's Debate and Empirical Evidence

The principal issue to be addressed in this chapter is whether there are in fact obstacles created for the internal market, arising from the existence of divergent national contract laws, which could be resolved through greater harmonisation of these laws. It will begin by presenting the internal market hypothesis, which is traditionally presented as the basis for further harmonisation. The chapter will go on to consider present attempts to validate such suppositions and calls for action. To this end, it will consider how and why the EU has become involved in a predominately academic and hypothetical debate, through consideration of the Commission's Communications on the present state of European contract law. As a complement to this, the chapter will consider a noteworthy attempt to collect empirical evidence, the Clifford Chance Survey on European contract law, before presenting a comprehensive analysis of the results of both initiatives. The chapter ends by evaluating the significance of the results for the future approach to be taken to European contract law and whether they allow us to conclude that the case for further harmonisation, in these terms, is a sound one.

2.1. Internal Market Hypothesis

The theory behind calls for harmonisation is the belief that the existence of divergent national contract laws creates obstacles to the proper functioning of the internal market. This undermines the EU goals of market integration and the completion of the internal market. At present, 27 individual contractual systems co-exist in the EU, subject to noteworthy, but focused, intervention by the EU. There has been harmonisation of Member States' contract rules through a series of minimum harmonisation directives, most notably in the area of consumer protection. These have been directed at specific problems within national regimes that have impaired the proper functioning of the market. The problem-specific nature of the intervention has, however, meant that the interaction of the consumer *acquis communautaire* with national law has been

fragmentary. Thus although harmonisation to date has been intended to ensure the proper functioning of the internal market, it has acted to exacerbate those already existing differences at the national level. As such, fundamental problems exist for the internal market where these two levels of regulation interact.¹

The resulting belief is that market participants cannot utilise the internal market to its full potential. This is contrary to the fact that contract should act as the primary medium for the exchange of goods and services within a market. The present state of contract law is viewed as forming a non-tariff barrier to trade, and to the proper functioning and completion of the internal market. Until recently, however, this belief has been predominantly intuitive and led by academics rather than being based on empirical evidence or strong calls by the business sector for intervention.² It is clear, therefore, that not all those participating in the debate are convinced of the existence of such problems for the internal market, and the debate has also been described as a ‘solution in search of a problem’.³ However, for those who are convinced of the existence of obstacles to the proper functioning of the internal market, the hypothesis can be broken down into three aspects, each of which will be discussed below:

- (i) Fear of legal surprise
- (ii) Transaction costs
- (iii) Problems of choice of law.

2.1.1 Fear of legal surprise

For those operating in the internal market, the existence of divergent national contract laws gives rise to the risk of legal surprise due to uncertainty about or ignorance of the applicable law. Parties cannot, therefore, advance contractual relations confidently

¹ See, for example, Riedl, *The Work of the Lando Commission from an Alternative Viewpoint* (2000) *European Review of Private Law*, 71, 75.

² Some advance the view that too much weight should not be given to the internal market hypothesis, particularly as little empirical evidence has existed to substantiate the claims and where there are other factors and arguments for and against harmonisation, to be considered and weighed in the balance, see Chapter 3.

³ Response of CBI to the Commission’s Communication on European Contract Law (2001), 4. http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/2.1.6.pdf.

without investing in legal advice on the content and effect of the applicable law. The concern is that the fear of legal surprise is such as to deter economic actors from entering the market. However, while many accept that this may well be the basic effect of the co-existence of the contractual systems, it can also be argued that the predicted effect may well be exaggerated. The differences may not be as profound as feared. For example, previous harmonisation projects, notably the PECL, have demonstrated greater consensus in regard to legal outcomes between Member States than would have been imagined.⁴ In many scenarios, despite differences in the legal rules and techniques of the contract systems, the Commission on European Contract Law found the legal result to be the same. It is the legal rules on their face which remain different and these perceived differences can be as damaging to the confidence of market participants as real ones.⁵

This has led others to argue that the problem for the internal market is not simply diversity as such, i.e. the co-existence of 27 contractual systems and thus 27 contractual rules of formation etc. Rather it is the intransparent or unpredictable diversity of contract law which is the key element of surprise.⁶ This can be attributed to a number of peculiarities of national contractual systems which go beyond the differing content of contractual rules. One such cause is structural, in that national rules may appear in different places and under different names from those expected under individuals' own contractual systems. Contractual rules may not, therefore, be easy to discover and, although the rule may be similar in effect to that found in the parties' own national law, it may well not be recognised. Intransparency can, therefore, be as serious as substantive differences for those seeking to enter cross-border transactions.⁷

⁴ For example, see Lando, *Optional or Mandatory Europeanisation of Contract Law* (2000) *European Review of Private Law* 59, 65.

⁵ Joint Response of the Commission on European Contract Law and the Study Group on a European Civil Code to the 2001 Communication, para 11.
(http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/5.23.pdf).

⁶ Storme, *Freedom of Contract: Mandatory and Non Mandatory Rules in European Contract Law* (2007) *European Review of Private Law* 233, 235.

⁷ *Ibid.*

2.1.2 Transaction Costs

Transaction costs arising from the need to obtain legal advice about the applicable law act as a further impediment to cross-border trade. It is advanced that there can be a substantial increase in transaction costs in all phases of commercial activity owing to the diversity of national contract laws.⁸ This risk covers all phases, from planning and negotiations to the conclusion of the contract, through to issues of performance and any additional costs which may arise through litigation.⁹ This means that many parties will be deterred from entering cross-border transaction. However, whether such costs form an insurmountable obstacle to an individual transaction will depend upon the cost of the contract(s) envisaged vis-à-vis the cost of instructing legal advice. Thus, such costs may well be inhibiting for SMEs, where the relatively low value of the transaction may render the cost of legal advice significant and the contract unviable.¹⁰ By contrast, larger businesses will have the economic force and commercial infrastructure, e.g. the existence of subsidiaries in all states in which they trade, which renders the cost of finding out about the other party's law insignificant in comparison to the value of the contract. For them, the associated cost of obtaining legal advice is unlikely to be any more inhibiting of trade than other additional costs incurred in cross-border commercial activity, e.g. transport costs or currency issues.

The effect of transaction costs is thus exclusionary of certain groups with regard to access to the internal market, but depends upon the status of the parties to the contract and their ability to obtain the necessary information on a cost effective basis. For some, therefore, there is a need to avoid overstating this argument as a basis for harmonisation. It is still necessary to show empirically whether these costs are actually prohibitive of trade and, if so, whether harmonisation would reduce them.¹¹

⁸ Joint Response (2001), para 14.

⁹ Ibid.

¹⁰ Beale, *The Future of the Common Frame of Reference* (Paper delivered at the SECOLA Conference, Amsterdam, 2007), 11, (published in the (2007) 3 *European Review of Contract Law* 257).

¹¹ See, Collins, *Transaction Costs and Subsidiarity in European Contract Law*, Chapter 18, *An Academic Green Paper on European Contract Law*, The Hague: Kluwer Law International (2002), 276.

2.1.3. Problems of Choice of Law

The favoured approach to dealing with cross-border trade and the variance in legal systems, in the absence of harmonised substantive rules of contract, has been the harmonisation of conflict of law rules. The aim of such rules, such as those in the EU regime contained in the Rome I Regulation,¹² is to designate with a high degree of certainty the law applicable to contracts containing a foreign element. There are, therefore, some who advance that the aforesaid obstacles to trade do not exist, or are significantly reduced, by the operation of the choice of law system. This is because, in accordance with the principle of party autonomy,¹³ parties are free, by agreement and in advance, to submit their transactions to a legal order that can accommodate their needs and, more generally, the needs of international commerce.¹⁴ On this basis it is argued that there is no legal uncertainty existing for cross-border contracts as to the applicable law.¹⁵ However, for a number of reasons to be discussed, it is clear that choice of law cannot sufficiently meet the needs of those wishing to engage in cross border trade while substantive differences continue to exist at national level.

The first concerns the application of the chosen law, as the contract will be subject to both the dispositive and mandatory rules of that legal system. Dispositive rules do not pose a problem as parties can vary or exclude these in their contract, to avoid the application of national rules, to which they do not wish to subject their agreement. In this way the parties can overcome undesirable substantive differences in the applicable legal system.¹⁶ It is the applicable mandatory rules, which form part of the proper law of the contract, which pose the problem, when parties are unaware of such rules, and where they conflict with those of their home state or the law under which they usually conduct

¹² Regulation 593/2008/EC of the European Parliament and Council on the law applicable to contractual relations (Rome I).

¹³ Central to the scheme of the Rome I Regulation, Article 3.

¹⁴ See Juenger, *The Lex Mercatoria and Private International Law* (2000) 1 *Uniform Law Review* 177, 179.

¹⁵ Rottinger, *Towards a European Code: Recent EC Activities for a European Contract Law* (2006) *European Law Journal* 807, 825.

¹⁶ Although at least one party to the contract may not have knowledge of the applicable law, and would thus incur transactions costs in obtaining such information in the first place, see discussion on the principle of party autonomy.

business. As the parties cannot vary such rules, this results in the associated uncertainty of cross-border contracts and prevents the use of mass-marketing strategies which are incompatible with the applicable law, i.e. as to rules on formation or formalities etc.

The application of mandatory rules via choice of law becomes more controversial, however, when they do not form part of the proper law of the contract. This is where they have the potential to create distinct problems for the internal market. The application of such rules will arise, firstly, where they cannot be derogated from by the parties, irrespective of an effective choice of law. These are commonly mandatory protective rules, such as rules of consumer protection.¹⁷ The second type are overriding mandatory rules, which are of such fundamental importance that they are applied irrespective of the applicable law, i.e. those political, social or economic rules of nations intended to protect the interests of the state.¹⁸ These may be the mandatory rules of the forum, or of the country where the obligations arising out of the contract have to be or have been performed.¹⁹

The first type of mandatory rules have the greatest potential to affect the functioning of the internal market. Rome I operates so that, despite an effective choice of law, the mandatory rules of consumer protection of the consumer's habitual residence will apply where a business has directed its commercial activities to this home state.²⁰ This means that in B2C context, businesses will not be able to direct their goods and services to consumers in other Member States, nor utilise uniform business practices, without prior knowledge of the consumer law of the Member States which they wish to target. The existing divergence between national laws has not been greatly improved by the EU's

¹⁷ These can be categorised as 'ordinary' mandatory rules, such as those referred to in Article 6 of Rome I. On the categorisation of mandatory rules, Sinai, *The Inclusion of Mandatory Rules in an Optional EC Contract Law Instrument* (2004) 15 *European Business Law Review* 41, 42.

¹⁸ Article 9 Rome I refers to them as overriding mandatory rules.

¹⁹ Articles 9 (1) and (2). In the latter case they will only apply in so far as they render the performance of the contract unlawful.

²⁰ Article 6 (1) (b) Rome I. Article 6 (1) (a) provides that the consumer will be protected by the application of the consumer protection rules of their habitual residence where the contract has been concluded as a result of the professional pursuing his commercial or professional activities in that particular country. This situation is less controversial than (b), as it merely requires the application of the domestic mandatory rules, which should apply as part of the proper law of the contract, see recital 25.

legislative action in this field as the consumer directives have been based on minimum harmonisation. Member States have thus been allowed to adopt measures that go beyond the harmonised standard, which means that levels of protection continue to differ between national systems. The result is that businesses have to comply with all national protection provisions in the states where they wish to target their activities, possibly amounting to 27 different consumer protection regimes. This could seriously hamper the provision of distance sales and services.

A further shortcoming in the use of choice of law is concerned with the principle of party autonomy, which is central to the argument that choice of law overcomes much of the legal uncertainty involved in cross-border contracts. More specifically, this criticism is concerned with how this principle is exercised in practice, as often the governing law will be unknown to at least one of the parties. For example, it may be the case that the weaker party, due to the inequality of bargaining power, will have the applicable law decided for them by the stronger. Parties commonly also have difficulties in reaching agreement as to the applicable law, and thus may decide to apply a neutral law of a third state which may, therefore, be unknown to both. The result is legal uncertainty, which leaves at least one side open to legal risk and thus requires them to engage costly legal advice as to the applicable law.

The fundamental flaw in the use of choice of law as a mechanism to overcome the presumed obstacles is that it can do little more than ensure that a contract is subject to the law of a particular state, and all the certainty this provides in the internal market. It operates to localise an otherwise international contract and transaction within a domestic system, which can be considered inappropriate. National laws designed and suitable for domestic transactions are less well attuned to the regulation and needs of international trade, in terms of content and suitability for purpose.²¹ The general consensus is that choice of law cannot establish the legal uniformity necessary for the internal market.²² It

²¹ McKendrick, *Harmonisation of European Contract Law: The State we are in*, Chapter 2, *The Harmonisation of European Contract Law: Implications for European Private Laws, Business and Legal Practice* (Vogenauer, Weatherill eds.) 2006: Hart.

²² See the Joint response (2001), para 60.

is clear that while substantive differences continue to exist between the national systems, parties will continue to experience difficulties, irrespective of their ability to choose the applicable law. It can be concluded that the operation of choice of law cannot count as a feasible objection to the harmonisation of European contract law by those who seek to rely on it.

This section has comprised a short account of the obstacles which are believed to exist for cross-border trade in the internal market, arising from the existing state of European contract law. However, while it is confidently assumed by the academic community that these barriers to the proper functioning of the internal market exist, what is not known is their precise effect. The imperative questions therefore become whether these obstacles do *in fact* exist for the operation of the internal market; whether their effect is *in fact* prohibitive of trade and whether they can be resolved or alleviated through further harmonisation being undertaken at EU level. It is advanced that harmonisation – the existence of a European contract law containing common rules, principles and terminology – would enhance legal certainty, making it easier for parties in different states to conclude and perform contracts. It would enable them to accommodate known legal risks, without incurring the potentially prohibitive costs which exist at present. A European contract law devised for the needs of inter-state trade would further mitigate the problems associated with choice of law. It would avoid the present domesticisation of the contract as well as providing parties with a neutral law that is common to both. By placing the parties on an equal footing, and overcoming the limitations of party autonomy in this respect, it has potential to end the deadlock that exists at present and the associated transaction costs. Ultimately, a harmonised contract law would ensure that businesses, particularly SMEs, can operate more efficiently and viably in the market, stimulating a more competitive supply of goods and services to the benefit of both businesses and consumers. In this way it would contribute to the EU's wider economic objectives, in improving the functioning of the internal market.

2.2. Empirical Evidence

Despite the force of these assumptions, the predominately academic debate has been conducted on the basis of little empirical evidence to substantiate them. However, when the European Commission entered the debate, the need for such evidence became particularly acute. It was necessary to establish such evidence if further EU action in the area of European contract law was to be justified. In particular, it would have to be shown that the differences arising between the national contract systems had a direct and impeding effect on the proper functioning of the internal market, and that the harmonisation of these laws genuinely had as its object the improvement of these conditions.²³ However, empirical evidence was also required from the perspective of strengthening the ongoing debate. There was a need to gain a greater understanding of the effect of the supposed legal obstacles, as well as gathering views as to possible solutions.

Previous attempts by the EU to gather information on cross-border transactions and the functioning of the internal market had been visibly influenced by the consumer focus which has dominated activities at this level in the area of contract law. The EU had conducted a number of public opinion studies to analyse both consumer and business experiences and perceptions of various aspects of B2C cross-border trade. Little attention had, however, been given to discovering the realities of B2B transactions within the market.²⁴ The scope of the debate in which the EU became involved did concern such transactions. This was reflected in the Commission's 2001 Communication on European contract law, in which they called for information as to whether problems for the internal market result from divergences in contract law between Member States, without limiting the debate to the B2C context. A later survey, commissioned by Clifford Chance, focused solely on businesses and their experiences in the internal market. To this extent it can be considered as an important complement to the EU's established consumer focus in this

²³ Case C-376/98 *Germany v Parliament and Council* [2000] ECR I- 8419 (*Tobacco Advertising*).

²⁴ See for example, Standard Eurobarometer 57.2- Flash Eurobarometer 128. Public opinion in Europe: Views of business to consumer cross-border trade, (http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/green_pap_comm/studies/index_en.htm), or Flash Eurobarometer 186, Business attitudes to cross-border sales and consumer protection. (http://ec.europa.eu/consumers/topics/flash_eb_186_ann_report_en.pdf).

field. Both will be examined, in the first place, in terms of their object, scope and methodology.

2.2.1. 2001 Communication

The Commission issued the first Communication on European Contract to the EU institutions and all interested parties²⁵ with the principal object of gathering information on the need for farther reaching EU action in the area of contract law.²⁶ In particular, it sought to ascertain the extent to which the existing problem-specific and piecemeal development of contract law at the European level may be insufficient to solve the problems that might arise in the internal market.²⁷ The object of the Communication was thus twofold. Firstly, it sought to identify whether problems arose for market participants resulting from the existence of diverging national contract rules which acted directly or indirectly to obstruct the proper functioning of the internal market. In the event that such obstacles were shown to exist, then the Commission sought views as to whether existing contract rules at national and EU level were meeting the needs of businesses and consumers in the internal market, or whether further appropriate EU action was necessary. To this end, the Communication's second objective was to seek views on a number of proposals put forward by the Commission for possible solutions to the market's problems, if the existing approach of the EU was shown to be unsatisfactory.

Regarding the first objective, the Commission conceded that despite EU action to facilitate the establishment and functioning of the internal market, which they maintained had allowed it to significantly reduce impediments for economic actors wishing to operate in the EU, it was still not operating as efficiently as it could be, to the detriment of all parties involved.²⁸ The potential obstacles identified as arising from the divergent state of national contract law were familiar to advocates of the internal market hypothesis. In the first place, the existence of uncertainty, in particular for consumers and

²⁵ Consumers, businesses, professional organisations, public administrators and institutions, the academic world and all interested parties, 2001 Communication, para 11.

²⁶ Ibid. para 10.

²⁷ 2001 Communication, 10.

²⁸ Ibid. Paragraph 25.

SMEs, to the extent that they do not know other contract regimes, which may act to increase the legal risk involved and thus act as a disincentive to cross-border trade.²⁹ Such uncertainty may result in higher information and litigation costs for enterprises in general and SMEs and consumers in particular. This has the potential to create a further impediment to cross-border trade and to form competitive disadvantages in the market.³⁰ The problems of choice of law were also alluded to in the Commission's account of potential obstacles. It refers to the possible conflict of different national mandatory rules and to the costs involved in ascertaining the content of the applicable law, when unknown to one or both parties.³¹ Throughout this section of the Communication the tone is one of acknowledgment; the Commission recognises that these obstacles exist within the internal market. As such the aim of the consultation process was to determine the extent to which the issues described created obstacles for the internal market.

The Communication also sought information on what other issues, relating to contract, act to obstruct the functioning of the market.³² Within the scope of the Communication and the Commission's definition of contract for this purpose, it concerns general rules such as formation, validity, performance and issues of performance and remedies. It is also concerned with those contracts which have significant economic importance to cross-border trade, including contracts of sale and all kinds of service contracts, including financial services.³³ Given the economic context and search for those rules which act to hinder cross-border trade, the scope of the Communication extended to issues of property law, i.e. securities in regard to moveable goods, and unjust enrichment as well as those aspects of tort relating to contract.³⁴

The Communication presented the existing state of EU law and regulation in the area of contract as potentially creating a distinct problem for the functioning of the market. The Commission highlighted the piecemeal approach to harmonisation which has been

²⁹ Paragraph 30.

³⁰ Paragraphs 31–32.

³¹ Paragraphs 28 and 31.

³² Paragraph 33.

³³ Paragraph 13.

³⁴ Ibid.

pursued at this level to date. It has been characterised by inconsistencies both between directives and internally, as well as problems at national level in regard to the implementation and interpretation of EU measures.³⁵ The Communication thus sought to discern whether the EU could continue its existing piecemeal and fragmentary approach to harmonisation and to the specific problems arising within the market, or whether the desired and necessary consistency, at both European and national levels, required a different approach to be taken. The consultation thus sought information on the practical problems relating to contract that arose from the way in which EU rules were applied and implemented in the Member States.³⁶

In the event that obstacles were shown to exist for cross-border transactions and that the EU's existing case-by-case approach to resolving them was proved to be inadequate, the Communication's second objective was to encourage discussion of the future measures which could be taken in order to remove them.³⁷ To this end four options were proposed for future EU initiatives as a means to generate debate, although the Commission noted that this was not an exhaustive list and other options could be envisaged.

The first option proposed taking no EU action, thus leaving the market itself to respond to the problems that exist within it. The Commission envisaged that different incentives could be led by Member States and trade associations to offer assistance and advice on cross-border transactions as a means of overcoming many of the economic and psychological risks associated with cross-border activity.³⁸ The second option envisaged the EU taking on a coordinating role in the promotion of comparative law research. It would encourage cooperation between academics and legal practitioners to develop common contract principles which would lead to greater convergence of national laws. This option thus promoted the continuance of the restatement work undertaken by groups such as the Commission on European Contract Law, which formulated the PECL, and the

³⁵ Paragraphs 34-39.

³⁶ Paragraph 40.

³⁷ Paragraph 41.

³⁸ Paragraphs 49-50.

Commission envisaged the use and development of this instrument in the proposal.³⁹ The Commission anticipated that these principles, which would represent the most common solution found in the national contract systems, could be used by parties at the drafting and execution stages of their contracts, as well as being of assistance to national courts and arbitrators in deciding legal issues in cross-border cases.

The Commission's third option was to improve the quality of existing EU legislation and represents a distinct solution to the problem identified by the Commission in regard to the *acquis communautaire* in this area. The Communication proposed to improve the quality of the *acquis communautaire*, while reducing the volume of existing regulatory instruments and remedying inconsistencies between legal instruments. This would improve the coherence of the EU legislation in this area.⁴⁰ The final option proposed the adoption of new comprehensive legislation at EU level; a harmonised text comprising provisions on general contract law, and on specific contracts of importance to the internal market.⁴¹ The Commission laid down a number of parameters for discussion regarding the choice of legal instrument which would implement such a measure and, significantly, the binding nature that such a measure would have. Regarding the latter, a number of approaches could be envisaged. In the first place, the measure could be a purely optional model which could be chosen by the parties as the governing law of their contract and as such provide an 'opt-in' model. Alternatively, it could form a set of rules which would apply unless excluded by the parties to the contract and thus be 'opt-out' in nature. In either case the harmonised body of rules would co-exist with national contractual systems. The third approach, however, envisaged a mandatory European contract code, which would replace existing national law.

While the proposal therefore encompassed the possible need for a comprehensive European contract law that would replace the law of the Member States, the ultimate end sought by the harmonisation debate, the proposals also looked to a less contentious alternative, with the proposal for an optional model. The proposals were further narrowed

³⁹ Paragraph 52–56.

⁴⁰ Paragraph 57–60.

⁴¹ Paragraphs 61–69.

to address more specifically the inadequacies of the harmonisation approach that the EU had pursued to date. Whilst seeking to remedy this, they also provided a possible soft law option, through a restatement at European level attempting to bring about greater convergence in contract laws of Member States, thus furthering academic efforts to harmonise the law of contract.

In order to generate an open and extensive debate on the questions and issues raised in the Communication, it was published on the Commission's Europa website. This acted as a forum for debate since contributions were, where permitted, also published.⁴² The Commission received some 180 responses,⁴³ from within and outside the EU,⁴⁴ from the EU institutions, and from all stakeholders groups.⁴⁵ The largest number of these came from the academic and business communities⁴⁶, with 70 and 47 contributions respectively. The legal profession⁴⁷ also made a noteworthy contribution to the debate. There was, however, a more limited representation of only 4 responses from consumer associations, in contrast to the business sector. Although this may readdress the consumer focus that had prevailed at the EU level to date, it must also be considered when assessing the Communication's results. Support for the initiative was received from other the EU institutions.⁴⁸ They requested that, as a follow-up to the initial consultation process, the Commission's observations and recommendations for future measures be published. These are presented in the 2003 Action Plan. Within it, the Commission presented its conclusions and refined the proposals, in light of the collected results and opinions, as to the most appropriate future action that the EU could take in overcoming the problems identified. Because of the level of interest generated by the 2001 Communication and the apparent influx of scholarly publications which ensued, the Commission was confident in

⁴² http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/communication2001_en.htm.

⁴³ 2003 Communication, para 4.

⁴⁴ 7 responses received from outside the EU.

⁴⁵ Governments, business community, consumer organisations, legal practitioners and academics.

⁴⁶ 47 Representing the manufacturing industry, retail, financial services, media and others (see Annex I: List of all contributing stakeholders, Summary of responses to the 2001 Communication, 1. (http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/summaries/sum_en.pdf)).

⁴⁷ 27 responses.

⁴⁸ European Council, Response to the 2001 Communication on European Contract Law (2001) (doc.12735/01), and European Parliament resolution on the approximation of the civil and commercial law of the Member States, 15.11.2001, A5-0384/2001.

concluding that the ideas expressed in its first Communication had fallen on fertile ground. It provided them with the necessary mandate to pursue work in this field.⁴⁹

2.2.2 Clifford Chance Survey on European Contract Law

In 2005 a survey was commissioned by Clifford Chance LLP in an attempt to gauge business views on the Commission's initiative and proposals to date, and to gain a greater understanding of the effect that divergent national laws had on businesses operating within the internal market.⁵⁰ While the law firm supported the Commission's aim of improving the quality of EU legislation in the area, they had vocalised misgivings regarding the possibility of further harmonisation activity at the European level and the Commission's proposals which they felt were related to this aim.⁵¹ In particular, they were of the opinion that the case for a comprehensive European contract code to address the problems in cross-border transactions had not yet been made by the Commission.⁵² While it was conceded that in some cases obstacles arose from the diversity of national contract law and that these gave rise to costs for businesses, they did not consider a harmonised European contract law to be the appropriate response.

The advancement of this opinion and the commissioning of the survey must be considered in view of Clifford Chance's position in Europe. It is the largest exporter of legal services, benefiting from a broad client base, including leading banks, multinational and national commercial organisations and governmental and regulatory authorities. As a result, the law firm had an interest in maintaining the status-quo in European contract law, to the extent that law can be considered as a commodity. In the case that the harmonised rules formed a mandatory European code, parties could no longer choose between the 27 legal systems to govern their contracts, and in particular those systems which are particularly prevalent in international transactions, such as English law. This

⁴⁹ 2003 Communication, para 8.

⁵⁰ Clifford Chance Survey on European Contract Law, April 2005.

⁵¹ In particular the Commission's proposal for a Common Frame of Reference, discussed in Chapter 4. See Clifford Chance's comments on the European Commission's Action Plan. http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/stakeholders/4-5.pdf.

⁵² Ibid. para 7–11.

could result in a considerable amount of international legal business being lost to non-EU states, and would risk serious damage both to individual law firms within the EU, and to a large sector of the European economy in general. It has thus been advanced that by 2005, and despite two follow up Communications by the Commission, the questions first put forward by the 2001 Communication had still not been conclusively answered.⁵³ The survey thus sought to determine whether the users of contract law, i.e. businesses, find that different national laws act as an obstruction to trade and, if so, whether they considered that a European contract law would help.⁵⁴

Although the Commission's consultation had attempted to substantiate this thesis and the theory behind the calls for harmonisation by seeking to ascertain the views and experiences of all interested parties, the Commission itself conceded that the process could not provide a complete picture of the problems in the internal market.⁵⁵ It remained the case that little research beyond this had been undertaken to establish whether the call for harmonisation was a sound one in the B2B context. It is pertinent to note in regard to the level and nature of the interest and awareness of the initiative that the Commission managed to generate, that most contributions from the business sector came from business associations and councils. The consultation process had failed to obtain the views of individual businesses: those who use European contract law on a regular basis. This trend was similarly apparent in the 2003 Communication where the Commission's new proposals for European contract law, which were based on the findings of the former communication, were met with a fall in response by the business sector.⁵⁶ It was thus considered necessary to ask European businesses whether they thought a European contract law was necessary.⁵⁷

⁵³ See, Vogenauer and Weatherill, *The European Community's Competence to Pursue Harmonisation of Contract Law – an Empirical Contribution to the Debate*, chapter 7 in *The Harmonisation of European Contract Law: Implications for European Private Laws, Business and Legal Practice*, Vogenauer & Weatherill (eds.), 117. The authors of this paper were the academic advisors to Clifford Chance for the survey and their account of the process of the survey forms the basis of this discussion.

⁵⁴ Survey, 2.

⁵⁵ 2003 Communication, paragraph 15.

⁵⁶ 29 responses, from 122 overall, this was also a general fall in responses from the 2001 Communication (181).

⁵⁷ Survey, 2.

The survey was conducted amongst 175 businesses across 8 Member States.⁵⁸ The participants belonged to a wide range of industries,⁵⁹ and were large⁶⁰ and small in size. Some of them operated at national and European levels while others could be regarded as global players. It was considered important to ensure that SMEs were appropriately represented in the survey,⁶¹ given the strong presumption that SMEs will suffer more acutely from the existence of differences between national contract laws, and therefore they represented approximately one fifth of the respondents. Those interviewed on the whole worked in the legal departments of their firms, or were directors, vice-presidents, company secretaries and similar.⁶²

The survey was prepared in collaboration with the Oxford Institute of European and Comparative Law and all questions were approved and, in some cases, formulated by the academic advisors. However, before the participants were interviewed they were sent a background note, intended to provide those who were unfamiliar with the debate with an opportunity to reflect on the key issues that would be addressed by the questionnaire.⁶³ This information and the framing of the debate was particularly important for the 39% of respondents who, prior to being contacted for the purposes of the survey, were unaware of the Commission's initiative in this area.⁶⁴ It was, therefore, necessary for the academic advisors, who were also involved in the formulation of this information, to ensure not only that it was correct, but also that the issues were presented in a balanced and unbiased way.⁶⁵ Notwithstanding this academic objective, the information note provides an insight into the views which Clifford Chance held of the Commission's initiative to date, and highlights the issues that they wished to address through the survey. Thus the information note takes as its starting point what is viewed as the end objective of the debate initiated by the Commission, namely a harmonised European contract law, be it a replacement for existing national legal systems or as valuable addition to them. In seeking business views

⁵⁸ For a full account of the methodology see Weatherill & Vogenauer (2006), 60 and the Survey, 2.

⁵⁹ Survey Appendix, Table A2.

⁶⁰ At least 250 employees.

⁶¹ 19.4% (a fifth) were small (10- 49 employees) or medium (50- 294 employees) size enterprises.

⁶² Survey, 2.

⁶³ See Weatherill & Vogenauer (2006), Appendix A: Background Information, 140.

⁶⁴ Ibid. 138 in footnote 61.

⁶⁵ Weatherill & Vogenauer (2006), 119.

on the direction in which the Commission's proposals have gone, they present the initiative to date as "tentative steps that could eventually lead to a European contract law".⁶⁶ Whether this is a fair portrayal of the Commission's Communications and proposals is questionable.

In regard to the 2001 Communication, the information note presents a balanced view of the questions asked in that process and the proposals put forward by the Commission. The account is, however, somewhat biased in its description of the Communication, describing it as a consultation on the possible harmonisation of contract law, despite the fact that the content of this section demonstrates that harmonisation was only one of four possible solutions advanced by the Communication. Further discussion in the note refers to the subsequent communications,⁶⁷ including the responses in these Communications to the notion of a harmonised European contract law, and the proposals put forward therein. Significantly, nothing in this account reveals an explicit plan on the part of the Commission for the comprehensive harmonisation of European contract, be it mandatory or otherwise. Indeed, the note refers to a statement of the Commission stressing that it is not their intention to propose a "European Civil Code" which would harmonise the contract laws of the Member States.⁶⁸ This does not, however, prevent the tone of the information note appearing openly sceptical of the true intentions of the Commission in regard to several of its proposals in this area which, although not being their stated purpose, could ultimately lead to a harmonised European contract law.⁶⁹ One weakness in the otherwise factually correct account of the Commission's Communications is, therefore, the importance that the background note attaches to the possible harmonisation of contract law. The survey sought to discover whether a European contract law would serve the purposes of business better than the existing individual national laws, or provide businesses with a valuable addition to them.⁷⁰ The information note is very clear; it is only if the existence of different contract laws within Europe do obstruct business that

⁶⁶ Weatherill and Vogenauer (2006), Background Information, 140.

⁶⁷ 2003 and 2004 Communications.

⁶⁸ Background Information, 142, See 2004 Communication, 2.3.

⁶⁹ Notably, the CFR and its connection to a possible optional instrument.

⁷⁰ I.e. should it take the form of an opt-in or opt-out instrument co-existing with national contract systems, as first envisaged by the 2001 Communication.

there is a powerful reason for a change in the direction of that proposed by the Commission. If, however it is shown through this survey not to be the case, then it is concluded that the Commission should direct its energies into other areas.⁷¹

2.2.3. Key Questions

From the foregoing discussion of the Commission's initial 2001 Communication and the Clifford Chance Survey, it is clear that the consultations share a number of objectives or key questions. First and fundamentally, they had to ascertain whether the co-existence of different national contract laws acted directly or indirectly to obstruct the proper functioning of the internal market. This question would have to be answered in the affirmative, if the Commission was to justify any further EU action in the area of contract law. In particular, such evidence is crucial in regard to the EU's competence to pursue any further harmonisation in the area.⁷² It would also be necessary, if the Commission was going to convince stakeholders and the users of contract law, who would potentially share the same scepticism as Clifford Chance, that further action was necessary in order to gain support for their proposals. The Clifford Chance Survey in this regard sought to extend the scope of the Commission's Communication by considering the extent to which not only legal, but also non-legal, obstacles existed between Member States. It sought to discover the nature of such obstacles, whether financial or otherwise, and ultimately the extent to which they acted to deter cross-border contracting.⁷³

The second common objective of the consultations was to determine whether existing EU legislation in the area of contract law, which is characterised by its sector-specific and minimum harmonisation approach, was an adequate response to such obstacles. The Clifford Chance Survey sought specifically to address those concerns raised by the Commission regarding differences in the implementation and interpretation of EU Directives across Member States. In particular, the survey was intended to determine how

⁷¹ Background Information, 143.

⁷² Tobacco Advertising.

⁷³ Questions 2- 5 of the survey.

significant the obstacles arising in this regard were across Member States, and the extent to which they impinged upon a business's ability to conduct cross-border trade.⁷⁴

The third shared objective was to ascertain the views of stakeholders on the possible solutions proposed by the Commission to the problems experienced, in the event that they were shown to exist, and if the existing approach of the EU was shown to be unsatisfactory. The Clifford Chance Survey focused upon the creation of a harmonised European contract law, be it one which would replace existing national laws or one that would co-exist in parallel with them. In the limited alternative, the survey presented more uniform implementation and interpretation of EU Directives as the other possible course of action, or ultimately that none of the above would be the preference of businesses.⁷⁵ Clearly, the options presented by the survey do not reflect the width of the debate on the future approach to be taken to European contract law, as presented by the Commission.

2.3. The Findings

This section presents the combined findings⁷⁶ of the Commission's 2001 Communication⁷⁷ and the Clifford Chance Survey. It presents an overview of the results in an attempt to answer those questions postulated in Section 2.2.3. It then considers the specific obstacles which are identified in the processes as arising for the respective market actors; businesses, SMEs and consumers, and the impact that they have on their ability to trade effectively with each other in the internal market.

The results confirm the internal market hypothesis; the existence of obstacles and disincentives to cross-border trade arising, directly or indirectly, from divergent national rules of contract law. These are exacerbated by the limitations of the EU's legislative approach to harmonisation in overcoming those problems.⁷⁸ Indeed, the Clifford Chance

⁷⁴ Questions 6-10 of the survey.

⁷⁵ Questions 22-27.

⁷⁶ These are supplemented, where appropriate, with updated statistics.

⁷⁷ Findings presented in the Commission's 2003 Action Plan on a More Coherent Contract Law.

⁷⁸ 2003 Communication, para 25.

Survey confirmed that 65%⁷⁹ of the total number of respondents experienced some form of obstacle to trade existing between EU Member States.⁸⁰ In terms of the nature of the obstacles, however, the survey sought to rank⁸¹ the impact of legal obstacles within a wider range of factors capable of impeding cross-border trade. In this way the survey gives a greater understanding of the existing obstacles, as opposed to the contract law focus of the Communication.⁸² Those factors presented could also be divided between policy and non-policy induced issues. Thus in the first instance, variations between legal systems, differences in the implementation of EU directives, the cost of obtaining legal advice, tax, and bureaucracy and corruption, could all be addressed through legislation. In the latter case, namely cultural differences and language, they could not.⁸³ The approach reflects that not all were convinced, at that stage, of the existence or the degree of impact that contractual obstacles were purported to have within the internal market. Indeed, many consider that there are other barriers to cross-border trade, such as language and differences in cultural traditions, which are more significant than the existing diversity of laws.⁸⁴

In result, however, it was the policy induced factors that were viewed as slightly more significant by the respondents, although the results for all seven factors were closely collated around, or just below the central point, being 5.⁸⁵ Respondents noted appreciable impact on their ability to conduct cross-border transactions arising from the variation between legal systems, the associated cost of legal advice, as well as problems in the implementation of EU directives, as could be expected from the internal market hypothesis. However, the strong impact of tax suggests that it is not just contractual

⁷⁹ Appendix, Table A3, 14% experiencing obstacles to a 'large extent', 51% experienced obstacles to 'some extent'.

⁸⁰ A larger percentage (87%) of the 22% of respondents who did "not really" experience obstacles, while not excluding their existence, are also taken into consideration.

⁸¹ 1 = no impact, 10 = high impact.

⁸² The Communication sought concrete examples of cases in which differences between the contract laws of the Member States had made cross-border trade more difficult, 2001 Communication, para 72.

⁸³ See Vogenauer & Weatherill, (2006), 126.

⁸⁴ For example, the reaction of legal practitioners to the Action Plan, 7.

http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/analyticaldoc_en.pdf

⁸⁵ Appendix: Table A11. Averages: Tax (5.64), Variation in legal systems (5.35), Cost of foreign legal advice (5.16), Different implementation of EU law (5.04), Bureaucracy/Corruption (4.53), Cultural differences (4.37), Language (4.05).

divergences which detrimentally impact in trade. The impact of the non-policy factors of language and cultural differences were ranked only marginally lower on the impact scale. Nevertheless, the academic advisors to the Clifford Chance Survey concluded that the legal differences have a comparably strong adverse impact on cross-border trade. Although the survey therefore confirmed the existence of obstacles arising from the existing divergences in national contract systems, and from the impact of the EU's legislative approach at national level, it becomes necessary to return to the 2003 Action Plan. This identified the specific nature of those obstacles arising from issues of contract law.

2.3.1. The Effect of the Co-Existence of Different National Contract Laws on the Proper Functioning of the Internal Market

The 2003 Action Plan identified the divergence of rules on fundamental issues of contract law as a specific and fundamental problem for the functioning of the internal market.⁸⁶ Contributions confirmed that differences existed between contractual systems at all stages of the contracting process, from divergent rules relating to the formation of contract, to differences in regard to the validity, interpretation, and performance.⁸⁷ Respondents made clear that the only way to ensure legal certainty was to take local legal advice, which they viewed as being an expensive and inconvenient solution for an everyday act, as well as confirming that divergences lead to distortions in competition.⁸⁸

Respondents further highlighted specific problems with the use of standard terms and conditions.⁸⁹ The Communication identified the existence of divergent rules on their inclusion and application, that is to say, on incorporation, admissibility, and over the level

⁸⁶ 2003 Communication, para 34.

⁸⁷ See for example, the Joint Response of the Commission on European Contract Law and the Study Group on a European Civil Code to the 2001 Communication, paragraphs 6–10.

⁸⁸ 2003 Communication, para 34 and see Business reactions to the 2001 Communication in the summary of responses, 6.

http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/summaries/sum_en.pdf

⁸⁹ Although the Communication also identifies problems arising from the use of clauses excluding or limiting contractual liability; specific problems arising in the area of financial services and insurance contracts, as well as in the field of cabotage transport.

of control that national systems will exercise over their use. It was concluded that these differences result in uncertainty for businesses and make it necessary for them to use different standard contracts in different Member States. As a result they incur additional administrative costs, despite the fact that the use of standard contracts is intended to facilitate cross-border trade.⁹⁰ Distinct problems are also identified as arising from the use of retention of title clauses and other securities. Reservation of title for example, is regulated differently between states, and thus the effectiveness of such contract clauses can vary between states.⁹¹ Contributions identified this as an example of a significant aspect of this debate, which concerns the relationship between contract law with that of the law of obligations and the law of property.⁹² These areas of law play an important role in the conclusion and performance of contracts, not only, for example, where the exporter of goods wants to ensure a security interest over their goods, but also interact with the law of sales, in particular the rules on the transfer of property. It is thus advanced that the lack of uniformity in the areas adjacent to the law of contract, combined with the diversity inherent in the latter, can itself create a significant obstacle to the proper functioning of the internal market. As such, it becomes apparent that the future of contract law cannot be advanced without proper consideration of its interaction with the laws of property, tort and unjust enrichment.⁹³

A caveat must, however, be made as, as was discussed in regard to the problems associated with choice of law;⁹⁴ it is clear that not all (diverging) rules of contract law are capable of forming significant obstacles to trade. The findings begin with a distinction between mandatory and non-mandatory, or dispositive rules, as contributors stressed that the main problems of contract law in the market result from those provisions which restrict the parties' contractual freedom.⁹⁵ While the Commission acknowledged the argument that many of the problems for cross-border trade can be avoided by choosing

⁹⁰ 2003 Communication, para 36–39.

⁹¹ Para 42.

⁹² 2003 Communication, para 41 and Joint response to 2001 Communication, pg 18.

⁹³ Joint response (2001), 18.

⁹⁴ 2.1.3.

⁹⁵ 2003 Communication, para 26 and see for example, the response of Orgalime (Industry) to the 2001 Communication.

http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/2.1.7.pdf

the appropriate applicable law, it also highlighted that the use of choice of law is not always a commercially realistic or desirable option. It is, for example, of little assistance to parties where the applicable mandatory rules are not those chosen by the parties as the applicable law,⁹⁶ or to the party which does have the bargaining power to impose their choice.⁹⁷ The Clifford Chance Survey confirmed that although 83% of respondents thought that it was important to be able to choose the applicable law of the contract, two thirds of those, unsurprisingly, opt for their own law in negotiations.⁹⁸ This evidences the belief that at least one party to the contract will be unfamiliar with the applicable law, or that in the case of deadlock, this will be both, if a neutral law is preferred. In either case, the Communication indicates that taking advice on the unknown applicable law will involve considerable legal costs and commercial risk for the affected party to the contract. The impact of such costs will be felt more acutely by SMEs where the cost of legal assistance, which will be proportionately higher than for larger enterprises, may discourage them from entering cross-border transactions.⁹⁹

It is clear that most obstacles experienced by market actors can be overcome by legal advice, and the residual problem is cost. Respondents to the Clifford Chance Survey confirmed that the existing obstacles have a financial impact on their companies. 62% of those who felt that obstacles existed between states considered them to have a large or at least some financial impact on their trading capabilities.¹⁰⁰ It was, however, clear that these costs were not wholly prohibitive of trade. Only 27%, although still a significant percentage, were often or sometimes deterred from conducting cross-border transactions. The consensus appeared to be that the existence of differences, and thus the resulting costs, may determine whether a deal is viable or not, but that it would not stand in the way of a lucrative contract.¹⁰¹ The effect would, however, presumably depend upon the parties to the contract, i.e. be they large or small businesses. Nevertheless, and returning to those key questions put forward, both the Commission's Communication and the

⁹⁶ I.e. where they do not form part of the proper law of the contract.

⁹⁷ 2003 Communication, para 27–31.

⁹⁸ Clifford Chance Survey, Appendix Table A19.

⁹⁹ 2003 Communication, para 29 – 30.

¹⁰⁰ Clifford Chance Survey, Appendix Table A7.

¹⁰¹ From the Survey results presented to the conference of the Oxford Institute of European and Comparative Law (October, 2005), 5.

Clifford Chance Survey confirmed the existence of obstacles to trade arising from the existing state of national contract laws. This raises the issue of how EU legislative intervention in this area had affected cross-border trade; whether it had reduced the obstacles to intra-state trade or, as feared by the Commission, had created a distinct group of problems for the internal market.

2.3.2 Adequacy of the Existing EU Response to the Obstacles Experienced in the Internal Market

The Commission's Communication confirmed shortcomings in the EU's existing legislative approach, owing to its preference for sectoral and minimum harmonisation. It identified problems within EU legislation in this area, as well as problems arising for the uniform implementation, interpretation and application of the *acquis communautaire* at national level. Internally, the *acquis communautaire* is shown to suffer from a number of inconsistencies. The Commission notes that it currently provides for the application of different requirements and consequences to the same commercial situation with the effect that similar situations are treated differently without relevant justification. In other cases it is possible for several directives to be applicable to the same circumstances, while also producing conflicting results.¹⁰² So, for example, in some cases it is possible to apply both the Doorstep Selling Directive and the Timeshare Directive, both of which give the consumer a right of withdrawal; however, the time period in which they allow the consumer to exercise this right is different.¹⁰³ A further underlying and critical problem identified for the *acquis communautaire* is the use of abstract terms in directives: terms as fundamental to the law of contract as "contract" itself are often either too broadly defined, or not defined at all.¹⁰⁴ This is exacerbated by the absence of a common contractual vocabulary at European level, and thus a lack of common definitions of what can be new and often alien concepts, introduced into national contract systems. The present internal state of the *acquis* is thus not only a problem at European level but is also

¹⁰² Problems with the existing *acquis* will be discussed in full in Chapter 4.

¹⁰³ See 2001 Communication, para 35, and 2003 Communication, para 16. It further highlights different modalities in regard to the right of withdrawal across other directives.

¹⁰⁴ 2003 Communication, para 18–20.

capable of impacting upon the coherence and consistency of national contract law,¹⁰⁵ resulting in great uncertainty for commercial and legal practice.

Together with the prevalence of the minimum harmonisation approach, the result is that the *acquis* is not achieving the uniformity of solutions for similar situations that the internal market would require.¹⁰⁶ Member States are left with a large degree of discretion as to the implementation of EU legislation, resulting in fragmented levels of consumer protection. Inconsistencies will also occur between Member States in application and interpretation, owing to the internal state of the *acquis*, meaning that similar cases may be decided differently, depending on the State in which the law is applied. Indeed, the legal profession made clear in their responses to the 2001 Communication, that it was necessary, in advising their clients, not only to know the relevant EU law, but also how the directive had been implemented in the Member State in question.¹⁰⁷ Businesses noted that differences at the national level lead to distortions of competition, particularly in the context of consumer protection, where the implementing measure may exceed the minimum level of protection fixed by the EU measure.¹⁰⁸ These responses were confirmed by the Clifford Chance Survey, which indicated that six out of ten respondents had experienced significant differences in the implementation and interpretation of directives.¹⁰⁹ However, despite the foregoing, when asked how EU directives and regulation had affected cross-border trade and, in particular, whether it had reduced or increased obstacles, 59% of the Clifford Chance respondents held that they had in fact reduced obstacles, while 29% concluded that they had made no difference at all.¹¹⁰

Given these somewhat conflicting findings in regard to the existence of obstacles arising from the legislative action of the EU in the area, it becomes necessary to consider whether the existing approach to the harmonisation of European contract law has been a

¹⁰⁵ See Tilleman, Du Laing, Directives on consumer protection as a suitable means of obtaining a (more) Unified European Contract Law? Chapter 6, An Academic Green Paper (2002), 83.

¹⁰⁶ 2003 Communication, para 24.

¹⁰⁷ Summary responses to the 2001 Communication, 8.

¹⁰⁸ *Ibid.* 10.

¹⁰⁹ See, Vogenauer & Weatherill (2006), 128 (Implementation: 15% 'very significant', 50% 'significant'; interpretation: 13% 'very significant', 45% 'significant').

¹¹⁰ Clifford Chance Survey, Appendix Table A9 (8% believed that they had increased obstacles).

sufficient response to the identified problems for the internal market, or whether other possible solutions would be more appropriate.

2.3.3. Proposals for Future Action

One of the principal conclusions that the Commission drew from the initial consultation was that it was possible to continue with the existing sector-specific approach to harmonisation.¹¹¹ However, in light of the above findings, and overwhelming support from respondents for Option III of the 2001 Communication, and the improvement of the existing EU law in the area of contract law, it was necessary to take action to increase the coherence and consistency of the existing and future *acquis* in the area.¹¹² This measure also gained support from the Clifford Chance Survey, where the majority of respondents¹¹³ opted for more uniform implementation and interpretation of European directives as the best means for achieving a more harmonised European contract law. The preference for maintaining the status-quo in the area, subject to improvement, by the respondents of both surveys therefore lends great support to the proposals for future action in the area.

The Commission's 2003 Action Plan presented a mix of non-regulatory and regulatory approaches¹¹⁴ which could be taken in order to overcome some of the problems identified, with the improvement of the existing and future *acquis* being the key action. The Commission's object was to achieve a European contract law with a high degree of quality and consistency in its drafting as well as implementation and application.¹¹⁵ This would require the review of existing measures in order to remedy the identified inconsistencies, fill the existing gaps and simplify existing measures where necessary.¹¹⁶ Central to the implementation of such action would be the creation of a Common Frame

¹¹¹ 2003 Communication, para 55.

¹¹² *Ibid.* Para 55 and 7.

¹¹³ Clifford Chance Survey, Appendix Table A25.

¹¹⁴ 2003 Communication, Section 4.

¹¹⁵ 2003 Communication, para 56.

¹¹⁶ *Ibid.* 4.1.2 and para 76. For a detailed discussion of the review of the *acquis communautaire*, see Chapter 4, 4.1.

of Reference (CFR) for both EU and national legislators.¹¹⁷ This would create an overall methodology and terminology for European contract law and would thus also serve to address the fragmentation of the *acquis* internally, as well tackle the problems identified as occurring at national level for the implementation and interpretation of EU measures.¹¹⁸

In addition to the improvement of EU legislation in the area, the 2003 Action Plan also proposed a number of other measures aimed at resolving the identified problems for the market. These included the elaboration of EU-wide standard terms to overcome the problems experienced by businesses wishing to utilise standard contracts as a means of facilitating trade in the internal market.¹¹⁹ Significantly, the Commission would also continue to reflect on the opportuneness of non-sector specific measures, such as an optional harmonised instrument of European contract law, to facilitate the exchange of goods and services in the market.¹²⁰ This proposal gained support from the results of the Clifford Chance Survey, with 83% of all businesses asked viewing the concept of a harmonised contract law favourably or very favourably.¹²¹ They were, however, drawn as to whether such a law should replace or exist in parallel with national contractual systems.¹²² 30% of businesses approved of the introduction of European contract law, while a similar number (28%) favoured an optional instrument. The Commission's intentions to continue to reflect on such options in the Action Plan were therefore warranted. Indeed, the academic advisors to the Clifford Chance Survey, who concede that they are not uncritical enthusiasts of the Commission's proposals in the area, concluded that their findings are more supportive of the Commission's activities than they could have expected.¹²³

However, to appreciate the most appropriate way forward for European contract law, it becomes necessary to consider the impact of the obstacles for the respective market

¹¹⁷ 2003 Communication, paragraphs 79 and 59. For a detailed discussion of the CFR, see Chapter 4, 4.2.

¹¹⁸ 2003 Communication, para 56 – 57.

¹¹⁹ 2003 Communication, para 55.

¹²⁰ 2003 Communication, para 89. This proposal will be discussed in detail in Chaptered 6.

¹²¹ Clifford Chance Survey, Appendix Table A13.

¹²² Appendix, Table A25.

¹²³ Vogenauer & Weatherill (2006), 138.

actors: businesses, SMEs and consumers. Although it is clear from the foregoing analysis that the existing state of European Contract law can act to render cross-border transactions less attractive for market actors, the level of dissuasive effect may vary according to the nature of the transaction and thus the contracting parties involved. It is thus common to distinguish between the impact of the obstacles on business to business (B2B) and business to consumer transactions (B2C). However, for reasons advanced above concerning SMEs, and in particular their ability to manage the associated additional costs of cross-border contracting, they will also be considered as a distinct group and transaction in the following sections.

2.3.4. Business to Business Transactions (B2B)

In response to the Communication, businesses confirmed that greater obstacles arise for the function of the internal market, where the contractual freedom of the parties is limited. Respondents noted that industry is able to deal with differences arising from non-mandatory or dispositive national contract rules, and some highlighted the successful use of standard terms and conditions between the Member States to this end.¹²⁴ However, it is clear from the Commission's 2003 Communication that this success is not one which is shared by all industries, and that many businesses experience obstacles to contracting due to divergence of national rules on the inclusion and application of standard contract terms.¹²⁵ The result is that few businesses have successfully managed to create EU-wide standard terms and conditions as a tool to facilitate trade.¹²⁶

It is domestic mandatory rules, those forming the applicable law of the contract, which the parties cannot vary or exclude and which can conflict with their usual law of business, which create the most acute barriers to cross-border trade. Responses commonly identified different rules on formation, limitation periods, the use of exemption clauses, the validity and applicability of standard terms, and rules concerning the transfer of title

¹²⁴ See response of Orgalime (trade association representing the mechanical, electrical and metalworking industries), 1.

¹²⁵ 2003 Communication, para 36.

¹²⁶ See, 2004 Communication, 2.2.1, which notes the existing obstacles as well a number of successful examples of EU-wide STC's.

and security in goods, as adversely affecting the possibility of entering cross-border contracts. Orgalime noted a problem commonly experienced by businesses, which is the application by national courts and legislation of consumer protection principles to business contracts. This once again, and in this context quite unnecessarily, limits the parties' freedom of contract.¹²⁷ Examples include the strict formal rules applied in Italy for the inclusion of general conditions in contracts, and the French principle that the seller cannot limit liability for a hidden defect ("vice cache"), even where the other contracting party is also a professional. They maintain that they create unnecessary problems in B2B contracts, and thus call for a strict distinction in the application of such rules in these contexts.¹²⁸

The existence and impact of obstacles can, however, be seen to vary according to the nature of the industry in which the respondents are involved. For example, contributions from the manufacturing industry did not consider that the present state of European contract law resulted in significant obstacles to cross-border trade.¹²⁹ It was noted that in most cases private international law, international harmonised law, notably the Convention on the International Sale of Goods (CISG), and existing EU law provided adequate solutions to the existing diverging state of national rules. However, it could be advanced that by virtue of both European and international harmonisation, from which they benefit in this area, they are not experiencing the most severe obstacles arising from divergences in national systems. In contrast, the financial services sector pointed to fundamental problems in cross-border trade, owing to Member States'¹³⁰ different contractual requirements and approaches. A distinct problem for financial services is that the products are embodied by the contracts which form them. This means that the nature and availability of financial products will be determined in accordance with local legal requirements.¹³¹ Thus businesses in the sector will be unable to provide cross-border

¹²⁷ Response of Orgalime, 2. Although it may be necessary in the case of contractual imbalance which exists for SMEs.

¹²⁸ Although there may be a case for extending the protection of such rules to small and medium enterprises, see 2.3.5. See, Chapter 6, 6.4.1.

¹²⁹ Summary of responses to the 2001 Communication, 6.

¹³⁰ Ibid.

¹³¹ See, 2003 Communication, para 14 and specifically the response of the London Investment Banking Association to the 2001 Communication, 1.

financial services because their products are state specific, or will be deterred from offering their services in other Member States because of different national rules which would result in excessive adaptation costs, or unacceptable uncertainty, and place them at a competitive disadvantage to local providers.¹³²

However, in the B2B context, and across the areas of trade and industry in the consultation,¹³³ it was held that on the whole such problems can be overcome by the choice of the appropriate applicable law by the parties. Indeed, in this context, the use of choice of law will not suffer equally from the deficiencies in this approach described in preceding sections, as larger businesses contracting together are more likely to be of comparative bargaining power. This is not to say, however, that the negotiation process may not result in the adoption of a neutral law where the parties reach deadlock, and this in turn will potentially involve cost implication for one or both parties if they are unfamiliar with the chosen law.¹³⁴ It is, however, common for parties operating and contracting in a particular area of trade to agree to contract under a commonly used neutral state law, for example English law. Through repeated use and practice, this will become familiar to parties operating in the sector as the common governing law of their contracts. A spontaneous degree of harmonisation and certainty will result through the parties' choice, and this will eventually overcome those fears of legal surprise and the associated legal costs arising from them which act as obstacles to trade. As discussed, a further example of what can be termed as private harmonisation of trade practices is also being brought about through the use of EU-wide standard contract terms and contracts, which are developed by trade associations to meet the particular needs of specific markets, although with varying degrees of success. In these ways, through the exercise of

http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/2.3.4.pdf

¹³² Ibid. 2.

¹³³ See for example, the response of the Confederation of British Industry (CBI) to the 2001 Communication, 1

http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/2.1.6.pdf, and confirmed by the results of the Clifford Chance Survey, 83% of businesses believing that it is important to be able to choose the governing law (Appendix, Table A19).

¹³⁴ The contract will also, as outlined, continue to be subject to the domestic mandatory rules of the applicable law.

contractual freedom in this context, commercial parties are overcoming the existing limitations of European contract law.

Contracting parties are also increasingly turning to international commercial arbitration as an alternative means of resolving disputes and avoiding the application of national law.¹³⁵ This also allows them to avoid the deficiencies of choice of law, which simply acts to render an otherwise international contract subject to national contractual systems. Indeed, in so far as arbitration allows for the application of non-national, transnational harmonised standards, and the *lex mercatoria*,¹³⁶ the increase in its use indicates that businesses are not necessarily committed to the resolution of their disputes in accordance with national laws.¹³⁷ The growth in the use of arbitration can therefore be seen as a sign of dissatisfaction with the traditional approach of national regulation. The current practices of international trade in overcoming obstacles to cross-border trade arising from divergent national contract rules is clearly an important facet of the contract law debate, which must be acknowledged in considering the most appropriate way forward for European Contract law in the B2B context.¹³⁸

2.3.5. Business to Small and Medium Size Business Transactions (B2SME)

Although SMEs will experience the same obstacles to trade arising from contract law as larger enterprises, it has been maintained that the impact of such obstacles may be more acute, owing to the difficulties for SMEs in offsetting additional associated costs in order to maintain viable and profitable cross-border transactions. Indeed, responses to the 2001 Communication confirmed that, owing to the current divergent state of contract law, SMEs are particularly vulnerable to the significant transaction costs that can arise, and this is in part because they lack both the financial capabilities and the legal infrastructure possessed by larger enterprises.¹³⁹ Few SMEs will have the appropriate cross-border, in-house legal advice enjoyed by larger enterprises, or the size or finances to establish

¹³⁵ See, McKendrick, (2006), 18.

¹³⁶ Including the application of PECL as the applicable law, Article 1:101 PECL.

¹³⁷ McKendrick (2006), 18.

¹³⁸ In this regard, see chapter 5.

¹³⁹ Summary of Responses to the 2001 Communication, 7.

subsidiaries in the states of their principal trading partners, and thus also have access to the language capabilities necessary to support cross-border trade.

The results of the Clifford Chance survey, however, gives rise to some doubt about the extent to which SMEs actually suffer more acutely than larger enterprises, as consistently throughout the survey the results for SMEs do not differ significantly from those of major enterprises.¹⁴⁰ When asked how far obstacles to cross-border trade exist between Member States, 65% of all businesses, including SMEs, said that they experienced obstacles to a large or some extent. The figure for SMEs alone¹⁴¹ was surprisingly similar at 68%. However, in considering these results, as others within the survey, caution should be taken in comparing SMEs results against larger enterprises, as they accounted for only 19% of the respondents.¹⁴² This representation of SMEs was considerably out of line with the distribution of enterprises in Europe, where 85% of enterprises are deemed small, 12% medium and only 3% large. It is surprising, in this context, that the latter category was the principal focus of the survey and accounted for 81% of respondents. SMEs are, therefore, significantly under-represented in the process and the usefulness of these results is questionable for those who wish either to substantiate or to invalidate the contention that SMEs suffer more acutely as a group from the present state of European contract law.

As stated, the principal contention is that SMEs suffer more acutely from additional transaction costs inherent in cross-border transactions. The survey confirmed that 55% of SMEs who experienced obstacles to trade felt that they impacted financially to a large or to some extent on their organisations,¹⁴³ and, perhaps unexpectedly, a larger percentage of large enterprises¹⁴⁴ (65%) said that the obstacles impacted financially on them. The issue is, then, whether the financial impact of obstacles, which is felt to a significant extent by both groups, is such as to deter cross-border trade. In response to this question,

¹⁴⁰ See Vogenauer & Weatherill's (2006) analysis of the results, 119.

¹⁴¹ 34 SMEs participated; see Clifford Chance Survey Appendix, Table A1.

¹⁴² Or 34 SMEs, before the 5 SME respondents who do not experience obstacles are removed from some questions.

¹⁴³ Clifford Chance Survey, Appendix, Table A7.

¹⁴⁴ Not including the SMEs.

there is, once again, a surprising proximity in the results from between larger businesses and SMEs. 31% of SMEs who reported obstacles to trade concluded that these, and their financial impact, deterred them either often, or at least sometimes, from conducting cross-border trade. In comparison, 27% of larger enterprises were sometimes or often deterred.¹⁴⁵ These results may lead one to conclude that the presumed variance in impact may not be as great as articulated by those involved in the hypothetical debate. However, regard must also be given to the nature of the obstacles which deter trade for the respective groups, as SMEs ranked all policy-induced obstacles higher than the average results for businesses at large, including variations in legal systems, differences in implementation and the cost of obtaining legal advice.¹⁴⁶ Differences in language, culture and tax issues, on the other hand, figured more prominently across the wider business group. Thus, although the degree to which obstacles deter trade for larger businesses and SMEs does at first sight appear comparable, the evidence suggests that SMEs suffer more from, or at least perceive as more significant, the legal and specifically contract related obstacles within the internal market. This lends credence to the belief that SMEs suffer more acutely from the present state of European contract law.

The next issue that must be addressed is the capacity of SMEs to overcome these legal obstacles in order to participate in cross-border trade. Here, it is clear that choice of law to overcome contractual obstacles is not as useful as for larger enterprises, owing to SMEs' inequality in bargaining power, which means that contractual freedom is deficient. In practice, the more powerful party will impose the law of their home state, as well as their standard terms and conditions, on SMEs, leaving them open to legal surprise due to lack of knowledge about the applicable law and their inability to obtain cost effective legal advice.¹⁴⁷ Similarly, even in contracts between SMEs, the parties will often fail to make a choice of law as this will usually be part of standard contract terms, and smaller businesses will not have these owing to the cost of legal advice.¹⁴⁸ SMEs will, therefore,

¹⁴⁵ Appendix, Table A5.

¹⁴⁶ The larger business category, including SMEs and larger enterprises, ranked non-policy induced factors higher, notably language and culture.

¹⁴⁷ Summary of reactions to the 2001 Communication, 5 and 7.

¹⁴⁸ See, T.Q. de Booy et al., [Is there a need for a common frame of reference for European contract law?] *Bestaat er behoefte aan een Gemeenschappelijk Referentiekader voor Europees Contractenrecht?* Een

often subject their contractual relations to an unfamiliar default law, and commonly and unknowingly to the provisions of international sources of law, notably the CISG.¹⁴⁹ Otherwise small companies may only concern themselves with the most desirable governing law after a dispute has arisen.¹⁵⁰ The Clifford Chance Survey confirms that, in terms of current cross-border trade practice, and the importance of being able to choose the governing law of the contract, businesses as a whole showed a much stronger preference for the use of choice of law than SMEs as a distinct group.¹⁵¹ This result is clearly reflected in the prominent use by larger businesses, of equal bargaining power, of choice of law as a tool of international trade. However, while freedom of contract and use of choice of law remain the principal mechanisms in the internal market to overcome existing obstacles, it is clear that SMEs will continue to be in an unfavourable contractual position vis-à-vis larger businesses. In view of the foregoing, and to facilitate trade for SMEs, as by far the largest business constituent in the market, the future approach to European contract law would have to acknowledge the needs of this group in order to readdress this balance.¹⁵²

2.3.6. Business (SME) to Consumer Transactions (B(SME)2C)

Businesses wishing to sell or provide services to consumers in Member States other than their own will encounter obstacles arising from differences in national contractual rules in two ways.¹⁵³ In the first place, diversity in national regimes will arise from the fact that the EU's harmonised consumer protection rules are based on the principle of minimum harmonisation. In allowing Member States to maintain rules which are more favourable to consumers than those provided for in the EU measures, the level of consumer

quick scan van het Nederlandse bedrijfsleven. Report by the Hague Institute for the Internationalisation of Law (Hiil; June 2009; downloaded from www.hiil.org), No. 17-20, and Hesselink, SME's in European Contract Law, Background note for the European Parliament on the position of small and medium-sized enterprises in a future Common Frame of Reference and in the review of the consumer law acquis, (Final version, July 2007), 26.

¹⁴⁹ Ibid. Hesselink, 26.

¹⁵⁰ De Booy et al (2009), No. 17.

¹⁵¹ See Vogenauer & Weatherill (2006), 120, Clifford Chance Survey, Appendix Table A 19.

¹⁵² How this would be achieved is discussed in Chapter 6, 6.4.1

¹⁵³ See Beale (2007), 11.

protection and the content of the rules varies between States.¹⁵⁴ Secondly, businesses encounter difficulties because of the underlying differences in national regimes, which remain outside of the scope of the harmonisation measures. For example, the right to and measure of damages is governed entirely by national law in the context of consumer sales.¹⁵⁵ Businesses, therefore, have to acquire local legal advice and will incur additional transactions costs associated with this increase in legal risk. This is exacerbated because the mandatory nature of consumer protection rules prevents businesses from using contractual freedom to overcome these obstacles. An effective choice of law by the parties cannot deprive a consumer of the protection of the mandatory rules of their habitual residence, where the professional party directs their activities at this home state.¹⁵⁶ The result is that businesses are exposed to additional contractual risks and the multiple mandatory rules of up to 27 consumer protection regimes if they wish to target consumers in all Member States.

This situation is unaltered by the EU's harmonised consumer protection measures. To take as an example the Doorstep Selling Directive:¹⁵⁷ contributions from the retail trade isolated this measure, and its uneven transposition into national law, as a distinct obstacle to direct selling in the internal market.¹⁵⁸ Thus the Federation of European Direct Selling Association¹⁵⁹ reported that the Directive had led to insufficient harmonisation in this context owing to the use of minimum harmonisation. This had allowed, for example, national legislation to exceed the period of cancellation of a contract beyond the minimum period of 7 days,¹⁶⁰ and to further lower the minimum threshold provided for by the Directive for the consumer contract to fall within its scope.¹⁶¹ The use of this

¹⁵⁴ See discussion in 2.3.2, and 2003 Communication, para 50.

¹⁵⁵ Beale (2007), 11.

¹⁵⁶ Article 6 (1) Rome I Regulation.

¹⁵⁷ Council Directive 85/577/EEC to protect the consumer in respect of contracts negotiated away from business premises.

¹⁵⁸ Summary of responses to the 2001 Communication, 6.

¹⁵⁹ (Fedsa) http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/2.2.1.pdf.

¹⁶⁰ E.g. the Member States are free to decide whether the minimum right of cancellation of 7 days must be in calendar or working days, thus German legislation provides for 7 calendar days, while France provides for 7 working days.

¹⁶¹ The Directive provides that Member States may decide that the Directive shall apply only to contracts for which the payment to be made by the consumer exceeds a specified amount. This amount may not

technique has, therefore, led to additional uncertainty and created further unnecessary barriers to cross-border trade. This conclusion can also be implied from the results of the Clifford Chance Survey, where 71% of respondents from the consumer and retail industries said that they experienced obstacles to cross-border trade, which is markedly higher than the average percentage in other industries, which stands at 58%.¹⁶² Despite this, when asked how EU legislation had affected cross-border transactions, 65% of the consumer and retail industry maintained that the EU intervention had in fact reduced obstacles to trade, which is above the average of the industries, at 59%.¹⁶³

It is clear, however, that businesses will be discouraged from engaging in cross-border transactions with consumers owing to the legal risks involved. Their inability or unwillingness to contract with consumers in Member States other than their own is to the detriment of consumers, who will be discriminated against based on whether the business is willing to contract under the law of their country of habitual residence.¹⁶⁴ The deterrent effect of obstacles is considered, for reasons already outlined, to be felt in particular by SMEs.¹⁶⁵ The present situation demands a great deal in terms of the trading capabilities of businesses to provide cross-border sales and services to consumers. Unsurprisingly, therefore, businesses most likely to be involved in cross-border distance retailing are medium and medium-large retail enterprises, with a limited number of outlets in other Member States and with existing language capabilities.¹⁶⁶

Consumers are, therefore, also detrimentally affected by the present state of European consumer law. This is in part due to businesses' unwillingness to sell to consumers in different Member States, thereby reducing the range of goods and availability of offers to

exceed 60 ECU (Article 3). Member States have however reduced this threshold in implementing the Directive, resulting in divergences. For examples, see the response of Fedsa, 2.

¹⁶² Clifford Chance Survey, Appendix Table A4.

¹⁶³ Ibid. Table A10.

¹⁶⁴ See, Commission Staff Working Document, Report on cross-border e-commerce in the EU, SEC (2009) 283 final. It notes the inability or reluctance of distributors to serve unsolicited customers from another Member States ('passive selling') appears to be one of the factors holding back cross-border e-commerce, 14. E-commerce as a trading medium within the internal market is discussed in greater detail in Chapter 6, 6.4.2.

¹⁶⁵ Summary of responses to the 2001 Communication, 7.

¹⁶⁶ Flash Eurobarometer no. 224, Business attitudes towards cross-border sales and consumer protection' (2008), 6 and 14.

consumers from alternative suppliers in other Member States. The present situation, however, also detrimentally affects consumers in their own right. The response of consumer associations to the 2001 Communication¹⁶⁷ confirmed that disparities in national contract law create real uncertainties for consumers because they do not have enough information on the applicable law¹⁶⁸ and, further, the choice of law regime does not always provide assistance from this perspective. Article 6 of the Rome I Regulation does not apply in the case of an active consumer who wants to take advantage of opportunities offered by the market.¹⁶⁹ In cases where the law of their habitual residence is not the applicable law to the contract, they may be subject to the standard terms and conditions of the trader and thus subject to their chosen law, or the applicable law may be determined objectively under the private international law regime.¹⁷⁰ In either case, the need for the consumer to acquire legal advice prior to the conclusion of the contract may be more important, and will lead to increased transaction costs and may even deter them from engaging in cross-border transactions.¹⁷¹

In practical terms, but with clear regulatory underpinnings, it is after-sales issues which are seen to influence consumers' willingness to acquire goods and services from businesses in other Member States. Provisions on delivery, complaints and refunds and difficulties in taking legal action are seen as significant obstacles to cross-border trade from their perspective.¹⁷² It was noted by one respondent that consumers are being encouraged to participate in the Single Market without there necessarily being any adequate safeguards or means to exercise rights of redress when things go wrong and that, as such, differing contract law was only one factor and, in their view, not the one

¹⁶⁷ Summary of responses to the 2001 Communication, 7.

¹⁶⁸ Consumer confidence in the internal market is undermined by a lack of information, with only a fifth of European consumers knowing where to obtain information and advice about cross-border shopping, E-Commerce report (2009), 12. The lack of information is mirrored by businesses in this context, with two-thirds of EU retailers unsure of where they would obtain information about consumer regulations in the different Member States, Flash Eurobarometer 224 (2008), 38.

¹⁶⁹ 2003 Communication, para 31.

¹⁷⁰ Articles 3 and 4 Rome I Regulation.

¹⁷¹ 2003 Communication, para 31.

¹⁷² Summary of responses to the 2001 Communication, 7 and, Vogenauer & Weatherill (2006), 115.

requiring the most urgent attention.¹⁷³ From the consumer's perspective, and at a basic level, it is also the fact that such transactions are occurring across borders which is considered to complicate and render more difficult such purchases. In particular, language and cultural barriers act to deter consumers from purchasing goods and services from other Member States.¹⁷⁴ The result is that consumer confidence in cross-border contracting is low. This combined with businesses' unwillingness to offer goods and services to consumers in other Member States, means that neither group is fully benefiting from the potential of the internal market.¹⁷⁵ It is clear, however, that as distinct market actors, businesses and consumers are being deterred from contracting with each other for very different reasons. Both reflect the fact that European consumer contract law in its present state is not an adequate means of ensuring the proper functioning of the internal market for their benefit.

2.4. Evaluation

This section first evaluates the extent to which the questions posed in 2.2.3 have been addressed and answered. It then assesses how successfully the consultations have satisfied the need for empirical evidence in three key aspects: first, the EU's competence to pursue further action in European Contract Law; secondly, the understanding of the contractual obstacles to the completion of the internal market; and, finally, whether the way forward for European Contract Law has been ascertained.

Regarding whether the co-existence of different national contract laws acted directly or indirectly to obstruct the proper functioning of the internal market, both initiatives confirmed the existence of impediments to cross-border trade. However, these were not shown to be prohibitive of trade and could, on the whole, be overcome through local legal advice. The residual obstacle to cross-border contracting is, therefore, financial and trade depends upon market actors' financial capacity to overcome legal difficulties.

¹⁷³ Response of the Consumer Association to the 2001 Communication, 1.

http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/3.2.pdf

¹⁷⁴ E-Commerce report (2009), 13.

¹⁷⁵ Flash Eurobarometer 224 (2008), 4.

The Commission's 2001 consultation confirmed that greater obstacles to trade arise where contractual freedom is limited. It was shown that, on the whole, (larger) businesses are well placed to deal with dispositive rules through legal advice, choice of law and the ability to vary and exclude such rules, often resulting in the formulation of standard terms and conditions. It is the domestic mandatory rules of the chosen law which act as obstacles to cross-border trade. In the B2C context the problem is more acute, as contractual freedom is substantially limited when a business directs its activities at the consumer's home state, in which case it will have to comply with the mandatory consumer protection provisions of the consumer's habitual residence.

This fundamental distinction between the impact of dispositive and mandatory rules on cross-border trade is very important to the reflection on the nature of future action. It was, however, not specifically addressed by either consultation. Although the 2001 Communication highlighted that conflicts between different mandatory rules may have a negative impact upon cross-border transactions, it failed to ask respondents specifically to distinguish between the effect of mandatory, as opposed to dispositive, rules. The disparate impact was, however, confirmed by the responses. Similarly, the Clifford Chance Survey failed to distinguish between the effects of such rules. Its failure to address this fundamental distinction is part of a wider criticism: that the initiatives lacked the focus necessary to determine, with clarity, the specific problems facing the internal market due to differences in contract law at national level.¹⁷⁶ If it had been made clear to respondents that the consultations were concerned only, for example, with dispositive rules and their effect on trade, then the results may have been quite different. In all likelihood, those who did confirm the existence of obstacles were concerned with the impact of conflicting mandatory rules on their contractual freedom. Such information would have aided the understanding of whether, if a harmonised instrument is supported, it should contain mandatory and/or dispositive rules. The usefulness of the results was further undermined in this respect by the fact that the questions posed by the Clifford Chance Survey failed to distinguish between the nature of the transaction in which the

¹⁷⁶ See Goode, *Contract and Commercial Law: The Logic and Limits of Harmonisation* (2004) Vol. 7.4 Electronic Journal of Comparative Law, section II 3.

respondents were participating, be it B2B or B2C. Such analysis would have aided the understanding of the specific nature of the obstacles at this level.¹⁷⁷

In sum, both initiatives confirmed the existence of obstacles to trade arising from the existing state of European contract laws. They further highlighted inadequacies at the national level in facilitating cross-border transactions. Choice of law was shown to be an inadequate solution and, in particular, of little assistance where the contracting parties are not of equal bargaining power. It is also evident that businesses are turning to market-based solutions,¹⁷⁸ and away from national regulation of their contracts. It is, however, in the EU's existing legislative approach to the *acquis communautaire*, and in the B2C context, that distinct inadequacies are apparent.

The second question addressed whether the EU's legislation in the area, characterised by its sectoral and minimum approach to harmonisation, was an adequate and suitable response to such obstacles. Both consultations confirmed the existence of problems for the uniform application of EU law. These included internal inconsistencies in the *acquis*, as well as problems at national level concerning its implementation, interpretation and application. The EU's focused activities in this area have failed to achieve a sufficient level of harmonisation and have, in fact, led to additional uncertainty.

Despite these findings, when considering the solution to the identified problems, the Commission concluded in the 2003 Communication that it was possible to continue with the existing sector-specific and fragmentary approach to harmonisation. However, in light of the findings, it was necessary to take action to increase the coherence and consistency of the existing and future *acquis* in the area. This proposal was certainly warranted and it has formed the focus of European action and resources in the area. Significantly, it is those academics at the forefront of the original harmonisation debate who are undertaking

¹⁷⁷ One would expect greater obstacles to exist in the B2C context where more mandatory rules would apply, including those harmonised at the EU level, than in the B2B commercial context where rules are largely dispositive in nature.

¹⁷⁸ E.g. using EU-wide standard trade terms of European and international trade associations such as Orgalime and the ICC, discussed further in chapter 5, 5.2.1.2.

work on the creation of a Common Frame of Reference, the Commission's key action, and the accompanying review of the *acquis communautaire*.

In a similar vein, an increase in the uniform implementation and interpretation of EU Directives was the preferred method of bringing about further harmonisation by the respondents of the Clifford Chance Survey.¹⁷⁹ However, despite the survey seeking to ascertain what the users of contract law think about the Commission's proposals, it failed to seek respondents' views on the CFR as the key proposal in this area. This was, however, fully discussed in the information note preceding the survey. This reflects the imbalance of the consultation in this respect, which focused on the desirability of a harmonised European contract law as the solution and – whether or not it was the intention in commissioning the survey – the concept did find support from respondents.¹⁸⁰ In favouring more uniform implementation and interpretation of the *acquis communautaire*, however, the respondents took one opportunity to express support for the Commission's proposals in the area beyond harmonisation.

A further limitation of the approach taken by the Clifford Chance Survey is its failure to distinguish between B2B and B2C transactions in presenting the results. One is left to presume, given the consumer focus of the *acquis communautaire* in the area, that it is businesses contracting with consumers in other Member States which experience those problems associated with the existing state of the European harmonisation measures. It is, therefore, those respondents who would favour the improvement of the *acquis communautaire*, and thus by implication, those involved in B2B transactions, that are in favour of a harmonised European contract law. This conclusion, however, cannot be reached with certainty, as it may be that those commercial actors involved in B2B transactions that favoured the *acquis* option as a means of preventing further harmonisation or limitation of contractual freedom via the creation of a (compulsory) harmonised European contract law. As such, again, it is the lack of specific focus of the survey, in the formulation of questions and presentation of results, which hampers the

¹⁷⁹ Clifford Chance Survey, Appendix Table A25.

¹⁸⁰ 58% were in favour of a harmonised European contract law either to replace the existing national systems or to exist in addition to, Table A25.

search for effective and distinct solutions necessary for facilitating trade in the internal market.

Regarding the Commission's other proposals, in addition to the continuation of the sector-specific approach traditionally utilised, they also undertook to continue to reflect upon the opportuneness of non sector-specific measures: notably, an optional instrument of European contract law. This proposal, which was specifically addressed by the Clifford Chance Survey, gained the unwitting support of respondents, who indicated that they would be likely to use such an instrument.¹⁸¹ The Commission's final proposal, which was not addressed by the survey, was to promote the elaboration of EU-wide standard terms and conditions, as a response to those obstacles identified by the Communications that hampered the use of standard contracts across borders. The Commission subsequently decided, however, not to pursue this proposal.¹⁸² They questioned the utility of such terms, and in the result were unconvinced that economic actors would in fact benefit from the exercise.¹⁸³

It can, therefore, be concluded that the findings of the consultations, in identifying obstacles to trade and to the proper functioning of the internal market, confirmed the need for further EU action in the area of European contract; providing competence to take the proposed actions.¹⁸⁴ Further, the Commission's proposals, and thus the 'way forward' outlined in the 2004 Communication, had found support and approval.¹⁸⁵ However, the extent to which the consultations strengthened the original harmonisation debate and, more specifically, advanced the understanding of the contractual obstacles in the internal market is open to question.

¹⁸¹ Clifford Chance Survey, Appendix Table A15.

¹⁸² For this reason, it will not be discussed further at length.

¹⁸³ First Annual Progress Report on European Contract Law and the Acquis Review, COM (2005) 456 final. 10-11. For example, it was acknowledged that if STC's are to be enforceable in all EEA legal systems, they would need to comply with the most restrictive national law. As such, those parties that do not operate in all EU jurisdictions, in particular those with the most restrictive national regimes, may not use such STC's. This would greatly reduce those economic actors that would benefit from such an exercise.

¹⁸⁴ The issue of competence in regard to the adoption of an optional instrument of European contract law however, needs further examination, and is addressed in Chapter 6, 6.2.

¹⁸⁵ Conceded by Vogenauer & Weatherill (2006), 137- 8.

Both initiatives can be criticised for lacking the sufficient focus necessary for determining with absolute confidence the specific nature of the problem facing the market, and thus advancing our understanding of what an effective solution would be. The Clifford Chance Survey in particular fails to make fundamental distinctions, which are central to this debate, concerning the nature of the transactions at issue, be it B2B or B2C and in distinguishing between the nature of the rules which are in fact creating obstacles to trade. It is conceded, not only by the academic advisors to the Clifford Chance Survey, but also the Commission, that the responses received respectively, cannot be presumed to give a complete picture of all the problems which may exist for the functioning of the market arising from the present state of contract law.¹⁸⁶ Both initiatives can therefore be criticised for failing to optimise the extent of interest and resources which fell behind the debate at this time, in order to substantiate it.

A further ground for these criticisms is the small sample sizes of both initiatives. The findings of the 2001 Communication were based upon the responses of only 180 respondents, which were intended to cover all interested stakeholders in the debate. The largest proportion of these came from the academic and business communities. Of the latter, contributions were dominated by business associations. This raises the question of how successful the Commission's Communications had been in informing interested parties about the debate and their involvement in it. Only 61% of the Clifford Chance Survey business respondents knew about the Commission's initiative in this area before being approached by the survey. The individual business focus of the Clifford Chance Survey therefore made a welcome contribution to the continuance of the debate. However, this consultation also involved a modest sample of respondents, with 175 companies in 8 Member States participating and as few as 12 responses from some Member States.¹⁸⁷ Further diminishing the value of the Clifford Chance Survey was its failure accurately to represent the distribution of enterprise by size in Europe in its chosen sample. In particular SMEs, which represent 97% of enterprises within the internal market, were significantly under-represented in the Survey, which is unfortunate given

¹⁸⁶ Ibid, 138, and 2003 Communication, para 15.

¹⁸⁷ Spain, see Vogenauer & Weatherill (2006), 138 and the Clifford Chance Survey, Appendix, Table A1.

the significance attached to the needs of this group in the harmonisation debate. While it is presumed that SMEs suffer more acutely from the identified contractual obstacles, the results of the survey cast doubt on this presumption in terms of comparability vis-à-vis large businesses. The impact of such obstacles was not seen to have a significant differential impact on SMEs. It is, however, submitted that the sample size of SMEs considered in the survey¹⁸⁸ was insufficient to substantiate these beliefs in one way or another and should thus be treated as inconclusive.¹⁸⁹ Indeed, the Commission remains convinced of the weak trading position of SMEs vis-à-vis large businesses, and thus of the need to specifically assist this group in the internal market; to create a more predictable regulatory environment for them in order to decrease their compliance costs and more generally to allow them to trade more easily across the EU.¹⁹⁰

The significance of the consultations should not, however, be undervalued to the extent that they met their objectives in substantiating and thus reinforcing the ongoing debate. They provide it with a greater, although not complete, understanding of the existing problems for the internal market arising from the present state of European contract law. The consultation initiated by the Commission signified the EU's willingness to engage in a more fundamental discussion about the future needs of European contract law, and the debate thereafter has been enhanced by the commitment of resources and political will. Beyond this, the Clifford Chance Survey was an important complement in terms of its commercial focus. The fact that it was conducted without the involvement of the EU lends credibility to the results and, importantly from the Commission's perspective, support for their future actions. The consultations thus also succeeded in a secondary objective, by making a case for further EU action in the way that the Commission's Communications has envisaged. Thus, they go some way towards meeting the objections and scepticism of those who remained unconvinced of the need for further harmonisation in the area.

¹⁸⁸ 19%.

¹⁸⁹ Particularly as the 2003 Communication confirms that they do suffer more acutely.

¹⁹⁰ Commission Green Paper on the Review of the Consumer Acquis COM (2006) 744 final, 4. The need to assist SMEs specifically in cross-border transactions is discussed in Chapter 6.

2.5. Conclusion

The empirical evidence validates the internal market hypothesis: the existence of obstacles and disincentives to cross-border trade arising, directly or indirectly, from divergent national rules of contract law. These are exacerbated by the limitations to date of the EU's legislative approach to harmonisation, which has attempted to overcome those obstacles. The case for further EU action in the area of European contract law is thus a sound one. It must, however, be acknowledged that the present state of contract law in deterring cross-border trade is only one of a host of other factors. Among these, are language, differences in cultural traditions and the perception that transactions are made more difficult simply because that they are occurring across borders. The general inadequacies in the existing approach to facilitating cross-border trade within the internal market, and in particular choice of law, have also been demonstrated. These issues and their net effect must also be overcome in the way forward.

The debate now advances, in so far as the need for a comprehensive harmonised instrument is concerned, on the basis of an optional instrument of European contract law. Such an instrument could act as a tool to facilitate cross-border trade for both B2C and B2B contracts. In particular, given the weak position of SMEs in the market, it is apparent that this group could benefit greatly from the creation of a harmonised body of contractual rules. This proposal must necessarily, however, be joined by the review of the consumer acquis and elaboration of a CFR, to improve the coherence and consistency of the *acquis communautaire*, which in its present fragmentary state creates a distinct obstacle to B2C trade. The proposals, therefore, while addressing the distinct obstacles arising in the internal market, present two levels of response. In the latter case, the proposals are directed at obstacles arising from the existing harmonisation approach at the European level. An optional instrument, on the other hand, would address obstacles arising at national level, from the divergence in national contract rules. Whether these proposals provide suitable and sufficient solutions to address the current obstacles, and thus whether they present the best way forward, remains to be considered.

Chapter 3

The Wider Debate

The Commission's proposals must be considered against the background not only of the internal market hypothesis, and the objective of facilitating cross-border trade within the internal market, but also against the wider issues and objectives which have impacted on the harmonisation debate in general and, now, on these proposals in particular. This chapter will, therefore, consider the wider economic,¹ social, cultural,² and political considerations³ that bear on the future approach to be taken. This will assist in determining how far the proposals provide solutions which are not only suitable, in the sense of facilitating trade,⁴ but also desirable, from the wider perspectives. It will further consider the extent to which such issues are being accommodated within the ongoing process conducted by the Commission.

In the first place, however, the proposals and the following discussion must be viewed in light of the traditional solution that has been advocated in response to the internal market hypothesis. This has been the creation of a harmonised European contract law, or wider, a European civil code, to replace the law of the Member States. There has, however, been a lack of support for such a move for reasons relating to the wider issues to be discussed. As a result, calls for alternative action have arisen, such as those articulated by the Commission in the 2001 Communication. Thus, although the Commission proposed at that stage the adoption of comprehensive legislation at EU level,⁵ this was presented with a number of options as to its form and binding nature. These included mandatory harmonisation of the existing laws of Member States: a European contractual code, and an optional instrument of European contract law. In the latter case, parties could either choose to opt-in to the contractual system as the applicable law of the contract in place of

¹ Section 3.1.

² Section 3.2.

³ Section 3.3.

⁴ Chapter 2.

⁵ Comprising provisions on general contract law as well as specific contracts. Option IV, 2001 Communication, 16.

a national system, or to opt-out, leaving them free to choose, if they so wished, to apply the law of another contractual system, i.e. a national system.⁶ In either case, the optional system would co-exist with national law. In light of the responses⁷ however, the Commission distanced itself from the creation of a mandatory contractual system and, along with the proposals aimed at improving the coherence and consistency of the existing and future *acquis* in the area, narrowed its proposal to the creation of an optional instrument of European contract law. Further (optional) harmonisation of European contract law, as the necessary and appropriate response, therefore remains central to the Commission's proposals to facilitate trade in the internal market.

3.1. Economic and Competition Issues

From an economic perspective, the principal argument in favour of harmonisation has concerned the internal market hypothesis. Both the Commission and sectors of the academic community have looked to justify further harmonisation, or ultimately the creation of a European contractual code, in order to facilitate cross-border trade, with reference to this economic argument.⁸ Because of the empirical evidence, however, it no longer maintains this hypothetical nature. Nevertheless, there remain a number of powerful and practical counter-arguments against the internal market hypothesis specifically and further harmonisation in general.

While many recognise that harmonisation may in fact be advantageous for the internal market, by enhancing legal certainty through the creation of a neutral body of law which will assist businesses in operating more efficiently and cost effectively within the European market, they also highlight that it may impose costs which are disproportionate to the gain.⁹ Such arguments surround the potentially negative adaptation costs and

⁶ These options are discussed in detail in chapter 6.

⁷ Responses to the 2001 Communication differed on the necessity and justifiability of this proposal. Few contributions outwardly supported the creation of a mandatory European contract code, with a number of Member States speaking out against such an instrument replacing their national laws and there were doubts as to whether the EU would have the competence to create an instrument of this nature and scope, see generally, summary of responses to the 2001 Communication, 17.

⁸ Discussed in Chapter 2, 2.1.

⁹ See for example, the Information note to the Clifford Chance Survey, 142.

unpredictability that would confront both businesses and legal practitioners, arising from the introduction of a new system of contractual rules.¹⁰ In response to the 2001 Communication's proposal, it was highlighted by one respondent that any plans to create a mandatory European contractual system or, on a grander scale, a European civil code, could only be a long-term aim. It would need to be developed in stages, including the voluntary approximation of laws, so that businesses would not be suddenly confronted with massive adjustment costs.¹¹ Those who hold this view¹² may, therefore, see merit in an optional instrument as an interim measure, to the extent that its application would be voluntary. However, such concerns can also be levelled at this proposal, as the unpredictability and potential costs of a new legal instrument may render parties reluctant to take the lead in the harmonisation process, preferring to learn, initially at least, from the negative costs of others. Following on from this, it is also clear that an institutional structure would be needed to support such harmonisation. Uniform laws alone cannot ensure a uniform interpretation of the instrument across the Member States, and this suggests a pronounced role for the European courts in this project, if legal certainty is not to be undermined.¹³

Ultimately, a strong body of opinion exists that harmonisation is simply not necessary and is thus a disproportionate response to the difficulties currently faced.¹⁴ For those holding this view there are more significant barriers to trade, such as language, differences in cultural traditions, currency and distance, which will influence the behaviour of market participants. This finding is confirmed by the results of the Clifford Chance Survey where non-policy induced factors, i.e. cultural differences and language,

¹⁰ See, Lando, *Optional or Mandatory Europeanisation of Contract Law* (2000) 1 *European Review of Private Law* 59, 60, and Smits, *Diversity of Contract Law and the European Internal Market*, Maastricht Working Papers (2005), <http://www.unimaas.nl/default.asp?template=werkveld.htm&id=F60BL5P00MJO466V63M6&taal=nl>, 27. Smits maintains that the costs of transition from one legal system to another, or put differently, the transaction costs of eliminating national legal systems, should not be overlooked as they too can be considerable. The costs also include those of political decision making and the costs of the effective realisation of the reform.

¹¹ Summary of responses to the 2001 Communication, 18.

¹² Also see Wagner, *The Economics of Harmonisation: The Case of Contract Law* (2002) 38 *Common Market Law Review* 995, 1018-19.

¹³ See for example, Collins, *An Academic Green Paper* (2002), 276, and see discussion in Chapter 6, 6.4.1.

¹⁴ For an account of these arguments see, McKendrick (2006), III Why object to the creation of a European contract law, 19.

were ranked only marginally lower on the impact scale to the policy induced factors, including the existence of variations between legal systems.¹⁵ It is also clear that psychological barriers exist for both businesses and consumers. It is the fact that transactions are occurring across borders which acts to undermine their confidence, and thus at one level the problems that exist for cross-border trade are one of perception. For example, it is those businesses without direct experience of cross-border trade - most likely SMEs¹⁶ - that are more concerned about the possible obstacles, than those already trading.¹⁷ This should not, however, discredit the internal market hypothesis and the empirical evidence. It is in fact a distinct problem which, along with those issues discussed here, must be overcome in the future approach to European contract law. The solution will need to encourage such businesses to engage in cross-border trade.¹⁸

Those against the harmonisation of European contract law also maintain that the problems encountered from the law of contract cannot be viewed in isolation. This is because of the lack of uniformity in the areas with which contract interacts, such as property, tort and unjust enrichment. This means that the harmonisation of contract law, as an attempt to remove the trade barriers, would also require the review of the interaction between these areas, in articulating the future approach.¹⁹

A final group of arguments points to the fact that the internal market, among others, already functions as single market despite the existence of different national laws. In response to the 2001 Communication, the UK government highlighted that the UK itself is an example of a 'perfectly functioning single market,' despite the fact that differences exist between the Scottish and English legal systems.²⁰ They also noted that the states of the USA also have different laws of contract without these inhibiting the single American market. However, it must be advanced that the UK overlooked the significance of the US Uniform Commercial Code in advancing this view, and in particular the extent to which

¹⁵ Chapter 2, 2.3.

¹⁶ Chapter 2, 2.3.5 and 2.3.6.

¹⁷ Flash Eurobarometer 224 (2008), 22 and 23.

¹⁸ Discussed in Chapter 6, 6.4.

¹⁹ See Chapter 2, 2.3.1 and McKendrick (2006), 23.

²⁰ Response of the UK Government,
http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/1.4.pdf, 3.

this uniform body of commercial rules has facilitated intra-state trade. It is further contended that there is no need to harmonise at the European level as there are already international harmonised instruments, notably the United Nations Convention on the International Sale of Goods. This body of rules can be adopted by parties to contracts made within the EU and, potentially, by the EU itself.²¹ For those expounding this view, the relevant issue at debate is to determine the appropriate level for harmonising contract law and regulating cross-border trade. At the European level, internationally or not at all, leaving it to domestic regulation and thus variation? From an economic perspective this question is concerned with the issue of the centralisation or decentralisation of legal rules, and thus with the question of the optimal vertical allocation of competences.²² It is necessary, therefore, to look at the advantages and disadvantages of both approaches.

The economic arguments in favour of harmonisation, or centralised regulation of contract law, draw on the gains that will arise for market participants from the creation of a level playing field. At present, the existing differences in national contract laws isolate domestic markets from competition from businesses in other Member States. Businesses are reluctant to enter new markets due to the inherent legal uncertainties and, where they do enter, they are placed at a competitive disadvantage in the form of transaction costs vis-à-vis domestic businesses which are familiar with the home state regulations.²³ The enhancement of legal certainty through harmonisation is thus to be welcomed under this view to the extent that it would reduce information and transaction costs arising from the existing divergence, which mean that it is more costly to contract under a decentralised system,²⁴ and thus overcome barriers to cross-border trade and result in greater competition. There are, however, those who consider the creation of a level playing field undesirable, fearing that the effect may be anti-competitive, as benefits to trade in fact arise where parties can exploit differences.²⁵ Further, the harmonisation of contract law may not, after all, result in a level playing field for businesses across Europe, as it would

²¹ McKendrick (2006), 23 and 29.

²² Kerber and Grundmann, *An Optional European Contract Law Code: Advantages and Disadvantages*, (2006) 21 *European Journal of Law and Economics* 215, 216; Van den Bergh, *Forced Harmonisation of Contract Law in Europe: Not to be continued*, *An Academic Green Paper*, (2002), 250

²³ See, Wagner (2002), 1005.

²⁴ Kerber and Grundmann (2006), 221.

²⁵ Van den Bergh (2002), sees this as a prerequisite for trade, 253.

leave ‘competitive distortions’ intact in other fields of regulation, i.e. those areas adjacent to contract. Such differences would then become more apparent.²⁶ Van den Bergh maintains that it is not in fact possible to create a level playing field, since businesses will retain competitive advantages in some states owing to variations in the level of regulation in areas such as wages and labour productivity.²⁷ This underlines that differences in contract law is only one factor which raises transaction costs for cross-border trade. Higher transport costs and additional bank expenses, for example, will continue to make such transactions undesirable or untenable.²⁸ The creation of a level playing field and the presumed benefits of this through the harmonisation of contract law alone is simply not feasible.

The effect of centralised regulation²⁹ is to reduce competition between legal systems, which is disadvantageous given that a monopoly on regulation can result in inefficiencies as the regulator is left with no incentive to reduce legal costs.³⁰ Decentralisation, on the other hand, encourages innovation and adaptability to new problems and thus increases efficiency.³¹ With centralisation, therefore, there is the perceived risk of a resultant decline in the quality of the legal systems. Proponents of this view advocate the continued promotion of regulatory competition within the internal market and thus the process by which, “legal rules are selected and de-selected through competition between decentralised, rule making entities, which could be nation states or other political units”.³²

²⁶ Ibid.

²⁷ Van den Bergh (2002), 253.

²⁸ Collins (2002), 276.

²⁹ Discussed for example by Weatherill, Why Harmonise? (in) *European Law for the Twenty First Century: Rethinking the Legal Order* (Tridimas, Nebbia eds.), (2004), Chapter 2, 15.

³⁰ Van den Bergh (2002), 256.

³¹ I.e. Competition between governments creates incentive to develop new efficient rules. For further discussion on the nature and effects of decentralisation, see, Wagner (2002), 1001- 1003; Kerber and Grundmann (2006), 222, and Ogus, *Competition Between National Legal Systems: A Contribution of Economic Analysis to Comparative Law* (1999) 48 *International and Comparative Law Quarterly* 405, part B.

³² Deakin, *Legal Diversity and Regulatory Competition: Which Model for Europe?* (2006) 12 (4) *European Law Journal* 440, 441.

Regulatory competition can be seen to pursue three objectives which are highly relevant to the debate concerning the future approach to be taken to European contract law.³³ In the first place, the theory provides that differences in legal rules allow for the greatest satisfaction of wants or preferences of the consumers of law to be met, while also maintaining diversity. Such diversity not only leads to the former object, but can also be seen as a good itself from a number of perspectives, including the socio-cultural.³⁴ Ultimately, regulatory competition can aid and promote information flow between systems, thus allowing for learning processes towards better law and, potentially, resulting in greater convergence between legal systems.³⁵ Existing legal diversity in the internal market is thus seen as an advantage which should be preserved.³⁶ This conclusion is confirmed by current trade practices and the prevalence of use of choice of law.³⁷ As Goode maintained in response to the 2001 Communication, there is value in retaining the diversity of legal systems in the area of dispositive law, allowing contracting parties to select from a wide choice of law which best suits their needs.³⁸ Thus the maintenance of diversity would maximise the satisfaction of wants of market participants³⁹ within the internal market, while also ensuring the other beneficial effects discussed above.

On this view, it is thus advanced that the regulation of contract law should be decentralised unless there is compelling reason for this power to be vested at a higher level.⁴⁰ Indeed, as Van den Bergh maintains, competition between legal systems should only be rejected if it would result in a 'race to the bottom,' whereby the quality of the legal systems would be too low. This possibility is then rebutted by the fact that international trade and regulatory competition will, in fact, result in a race to the top as

³³ Discussion is based in part on Deakin's, discussion of Tiebout's theory on regulatory competition, Ibid. 442.

³⁴ See discussion, Section 3. 2.

³⁵ See, Ogus (1999), 409, and Van den Bergh (2002), 254.

³⁶ See generally, McKendrick (2006), 27.

³⁷ At least in the B2B context, see discussion of Clifford Chance Survey results in this regard, Chapter 2, 2.3.5.

³⁸ Goode, http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/5.6.pdf. Para 11, while also recognising the value of harmonising mandatory law.

³⁹ Deakin (2006), 442.

⁴⁰ Wagner (2002), 1002.

states will compete to retain and attract economic resources.⁴¹ A caveat must however be made, as the theory of regulatory competition is based on a number of assumptions which cannot be considered as realistic,⁴² particularly in the case of the internal market. Significantly, it rests on the assumption that consumers and businesses are informed on existing differences between legal systems, and that they know of the costs and benefits associated with that.⁴³ On this basis it is presumed that they can make a rational choice between the systems as part of their choice of law, in order to choose a law which satisfies their preferences, and which results in competition between those systems.⁴⁴ The empirical evidence has, however, demonstrated that parties in making or becoming subject to a choice of law will often know very little about the applicable law, or of its costs or benefits.⁴⁵ If parties are to gain such information then the resulting obstacle to contracting is financial. The existence and strength of competitive pressure between the systems, to bring about those benefits of decentralisation outlined above, will therefore depend on the cost of making an informed choice of law.⁴⁶ If the cost of that information outweighs the costs of the transaction it is unlikely that the choice of law will be an informed one which will reflect the parties' preferences. As such the benefits of regulatory competition cannot be realised, as competition between the contractual systems is undermined by the existing transaction costs.⁴⁷ The need to address such costs, which result from existing decentralisation, thus remain and clearly demand harmonisation of European contract law.⁴⁸

It is clear, therefore, that both centralised and decentralised levels of regulation present both advantages and apparent disadvantages for the internal market and its participants. At a basic level, questions arise as to the feasibility of harmonisation in any case and thus the possible creation of a level playing field of regulation within the internal market. It is

⁴¹ Van den Bergh (2002), 253 and 260.

⁴² See, Wagner (2002), 1006. The assumptions are made by Tiebout's theory of regulatory competition.

⁴³ Ibid, 107.

⁴⁴ Wagner (2002), 1010, and Ogus (1999), 408.

⁴⁵ This is particularly for SMEs, see Chapter 2, 2.3.5.

⁴⁶ Ogus (1999), 408.

⁴⁷ Wagner (2002), advances that the transaction costs of a deliberate choice of law in all but the most exceptional cases by far exceed the gains to be obtained from such a decision, and thus prove prohibitive, 1011.

⁴⁸ Ibid. 1011-12.

also clear, however, that on balance neither approach rules the other out. It could, therefore, be advanced that the way forward for European contract law would be to combine the advantages of centralised and decentralised regulation, while minimising the perceived disadvantages or limitations through the creation of an optional instrument of harmonised contractual rules.⁴⁹ Indeed, it is highlighted that the basic assumption of the optional instrument is that neither a fully centralised or decentralised system of contract laws is the optimal solution, but some combination of both.⁵⁰ As such contracting parties should have the choice between national and European rules,⁵¹ and thus the addition of a 28th contractual system of contract rules would prove a useful addition to market participants.

3.2. Social and Cultural Issues

This section considers further the apparent need to balance the desire to facilitate trade within the internal market trade through harmonisation, with the need to respect the value of legal diversity, inherent in the EU in articulating the future approach to be taken to European contract law. Specifically, it will address a group of what can be termed as “value” arguments.⁵² These are characterised by the belief that, although European integration may require further legal measures for facilitating trade within the internal market, these measures cannot be regarded solely as a technical problem. Ultimately, certain value choices will have to be made, and therefore criticism exists of the market-orientated agenda with which the EU has pursued this debate.⁵³ The Commission can be criticised for failing to address many significant issues in this respect.

⁴⁹ This approach gains support from Kerber and Grundmann (2006), 228, and Wagner (2002), 1023.

⁵⁰ Kerber and Grundmann (2006), 219.

⁵¹ Ibid.

⁵² See for example, Wilhelmsson, *The Legal, the Cultural and the Political – Conclusions from Different Perspectives on Harmonisation of European Contract Law* (2002) *European Business Law Review* 541, 544.

⁵³ See specifically, the Special Edition of the *European Law Journal* on the Future of European Private Law, published in response to the Commission’s 2003 Action Plan (2004) 10 (6) *European Law Journal*, 649. Collins (ed.).

Such criticism comes despite calls, from the beginning of the EU's involvement in the debate, for them to consider the social functions of contract: that it facilitates social as well as economic relations and is an articulation of a society's values and principles of justice.⁵⁴ The Commission has, however, continued to advance and defend the needs of the internal market as the principal purpose for further action in the area of European contract law. The Communications have been viewed as presenting a series of technical measures to deal with technical problems, namely barriers to trade.⁵⁵ As Miller notes,⁵⁶ by presenting the elaboration of the CFR as simply a technical, value-free exercise, the Commission obscures the real difficulties that harmonisation poses. Partly, this criticism recognises the connection between a state's contract law and its particular economic, political, philosophical and social choices and traditions, which applies equally to the articulation of a European contract law. It is clear, therefore, that if the harmonisation of European contract law is to mean more than simply the creation of "surface" rules, what is needed, and what many see as absent from the Communications, is recognition of the real issues at stake.⁵⁷ The Commission needs to engage more fully in discussion of what type of law a European contract should be: the philosophies on which it should be based, its functions and the values that inform it.⁵⁸ Their failure to do so and to continue to base their claims for harmonisation solely on the needs of the internal market may ultimately lead to resentment by those advocating this view.⁵⁹

The issue that arises is why the Commission has failed to engage fully with these issues, and the answer lies in the EU's competence. The market-orientated focus can be viewed as a means of empowerment, as the existence of barriers to trade arising from divergences in national regulation has proved to be the most successful justification for extending EU action in this field⁶⁰ and, specifically, for claiming a Treaty basis⁶¹ upon which to pursue

⁵⁴ See for example, The Study Group on Social Justice in European Private Law, *Social Justice in European Contract Law: a Manifesto*, Ibid. 653, 654 and Hesselink, *The European Commission's Action Plan: Towards a More Coherent European Contract Law?* (2004) *European Review of Private Law* 397, 415.

⁵⁵ Study Group on Social Justice in European Private Law (2004), 662.

⁵⁶ Miller, *The Common Frame of Reference and the Feasibility of a Common Contract Law in Europe* (2007) *Journal of Business Law* 378, 383.

⁵⁷ Ibid. 384.

⁵⁸ Miller (2007), 384.

⁵⁹ Hesselink (2004), 417.

⁶⁰ Thus the need for on empirical evidence, Chapter 2, 2.2.

further regulation.⁶² The Commission has thus, quite properly, limited its discussion of the future approach to European contract law to discussion of areas within its competence: to examination of technical problems, while suppressing the more fundamental social and political questions.⁶³

The concern remains that, while acting within its competence, the Commission's narrow focus excludes issues and concerns addressed by national law, such as fairness, solidarity, equality and other basic values that contribute to social cohesion.⁶⁴ Ultimately there is doubt that the needs of the internal market alone can support the proposals for a uniform law.⁶⁵ The Social Justice Group goes further, questioning whether the EU has a mandate to pursue such a scheme of fairness or distributive justice and thus, ultimately, the EU's competence in any case to create a suitable body of rules.⁶⁶ It is thus advanced that liberation from an exclusively market focus is both a necessary and desirable development in the furtherance of this debate.⁶⁷

The task of ensuring a balance between private autonomy and social solidarity has, however, been viewed as an arduous one in the harmonisation process owing to the contradictory nature of these values.⁶⁸ The result is that existing harmonisation instruments imply a strong emphasis on liberal values, and the PECL are a key example of harmonised contract rules which are absent of such welfarist values and rules.⁶⁹ In light of this, and given the prevalence of the market-orientated values of the Commission in conducting the debate, the concern is that the same fate awaits any harmonised instrument of European contract law originating with the Commission.⁷⁰

⁶¹ Namely Article 114 TFEU (ex 95 EC).

⁶² Hesselink (2004), 413.

⁶³ Study Group on Social Justice in European Private Law (2004), 664.

⁶⁴ Ibid. 661.

⁶⁵ Study Group on Social Justice in European Private Law (2004), 656.

⁶⁶ Ibid. 661.

⁶⁷ Hesselink (2004), 415.

⁶⁸ Wilhelmsson (2002), 544

⁶⁹ See Chapter 5, 5.2 for discussion of the nature of existing harmonised instruments at the international level and the absence of mandatory rules of protection for weaker parties in such instruments.

⁷⁰ See for example, Memorandum by Professor Geraint Howells, to the House of Lords European Union Committee on the Future of European private law (2005) (<http://www.publications.parliament.uk/pa/ld200405/ldselect/ldeucom/95/5011902.htm>, para 8.

The extent to which provisions of consumer protection and other welfare principles can impinge upon freedom of contract, and thus the level of consumer protection to be afforded will always be contentious. The harmonisation proposal advances on the basis of the adoption of an optional instrument of European contract law that would apply to contracts between businesses and consumers, between businesses of equal bargaining power, but also with SMEs. The Commission thus needs to strike the correct balance between respective values and interests. On the one hand, businesses will want to maximise contractual freedom and thus keep the level of consumer protection low, while at the same time benefiting from the harmonisation process in terms of increased legal certainty and reduced transaction costs. When contracting with SMEs, it will be necessary to redress the imbalance that exists in such contracts.⁷¹ One way would be to extend protective consumer provisions and the principles of solidarity and fairness to this group, as akin to consumers.⁷² Consumers themselves will require a sufficient level of protection vis-à-vis businesses in order that they remain confident, if not potentially becoming more confident, in entering cross border transactions in the internal market.⁷³ These considerations need to be taken into account by the Commission in articulating the ideological basis of a European contract law.

The concern that a harmonised regime of European contract law would reflect the same liberal imbalance apparent in existing harmonised instruments is, however, initially confounded by the Commission's Communications. The Commission asserted that contractual freedom should be one of the guiding principles of a harmonised contractual law instrument, and that as such restrictions on this freedom should only be envisaged where it can be justified by good reason.⁷⁴ As a caveat, the Commission did acknowledge that some mandatory provisions aimed at protecting consumers will have to limit the principle in any potential optional instrument.⁷⁵ However, this qualification has done little

⁷¹ Discussed in Chapter 6, 6.4.1.

⁷² As is the approach in some Member States, for example, where the SME concludes a contract outside their field of usual business. For a review of such examples see, Beale et al, *Ius Commune casebooks on the common law of Europe: Cases, Materials and Text on Contract law* (Oxford: Hart, 2001), from 527.

⁷³ See Lim, *The European Union Common Frame of Reference: An Inspired Idea or a Distraction?* Paper presented to 2008 W G Hart Legal Workshop on "Theory and Practice of Harmonisation", 7.

⁷⁴ 2003 Communication, para 93.

⁷⁵ 2004 Communication, 18.

to allay the concerns. The Social Justice Group, for example, criticise the Commission for taking freedom of contract as the starting point and thus foreclosing the question of whether that principle should hold such a privileged position in governing policy choices.⁷⁶ Indeed, they are critical of the heavy burden of proof that any limitations must surpass in order to trespass on freedom of contract.⁷⁷

Such concerns must, however, be balanced against the consumer-driven agenda which has dominated the *acquis* in this area to date, and which has more recently impinged on the contract law project, leading to the prioritisation of the proposed review of the consumer *acquis*. The prioritisation impacted upon the elaboration of the CFR,⁷⁸ which became, at least from the Commission's perspective, a consumer-driven instrument⁷⁹ owing to its relationship with the ongoing revision of the *acquis*.⁸⁰ The issue that arises, therefore, in the ongoing process is the impact that this prioritisation will have on the content and nature of the final CFR. This is particularly relevant as, following the prioritisation of the *acquis* and completion of the CFR workshops on those topics directly relevant to consumer contract law, the CFR workshops stopped.⁸¹ This raised concerns even among the academic researchers that the Commission had no interest in including general principles of contract law within the harmonised instrument.⁸²

The result could in fact be an instrument that is balanced too far in favour of social solidarity and fairness, and against contractual freedom. This is particularly alarming as the CFR is also to serve as a basis for an optional instrument of European contract law, which must balance the respective interests of market participants. The prioritisation of the consumer *acquis* within the CFR process exacerbated existing scepticism as to the origin of the European contract project, with the consumer Directorate of the

⁷⁶ Study group on social Justice in European private law (2004), 663.

⁷⁷ Ibid 664. They note that by fleeting reference to such questions, the Commission implicitly acknowledges that they are present, but clearly it has no desire to initiate any debate about them.

⁷⁸ Discussed further in 3.3.

⁷⁹ Lim (2008), 3.

⁸⁰ The relationship between the *acquis* review and the CFR, and the prioritisation of the consumer *acquis* is discussed in Chapter 4, 4.3.

⁸¹ Discussed further in 3.3.

⁸² Beale (2007), 14.

Commission, DG SANCO. In the UK, for example, business interests fear that the CFR will be heavily influenced by the origin of the instrument and that the balance achieved between the respective interests would fail adequately to reflect the Common law tradition and all that that encompasses, namely party autonomy, freedom of contract and legal certainty.⁸³ Concerns for the balance of interests achieved in the CFR also arise from confusion in regard to the relationship between an optional instrument and the CFR. The fear for some is that the final political CFR would look like a potential optional instrument⁸⁴ and, as such, one not fairly balanced in the interest of businesses.⁸⁵

The immediate issue, however, concerns the balance which is achieved in the academic draft of the CFR.⁸⁶ In the first place, the DCFR⁸⁷ contains rules of general contract law as well as consumer rules. The idea that the draft could only deal with consumer contracts was rejected, as consumer law cannot be considered as a 'self-standing' area of private law. Rather it is drawn from deviations of general principles of private law, which must also be included within any harmonised instrument of European contract law.⁸⁸ The rules then take freedom of contract as their starting point. Natural and legal persons should therefore be free to decide whether or not to contract and with whom to contract. They should also be free to agree on the terms of their contract.⁸⁹ Such freedom will however be subject to any applicable mandatory rules, and thus must be balanced against the needs of justice.⁹⁰ Freedom of contract is, therefore, unaffected where the parties are of equal

⁸³ See for example, Minutes of evidence of Clark (Linklaters) and Hann (Confederation of British Industry) to the House of Lords European Union Committee on the Future of European private law (2 February 2005), Evidence of Clark, Q. 167.

<http://www.publications.parliament.uk/pa/ld200405/ldselect/ldeucom/95/5020201.htm>. These are perceived as distinct and important characteristics of the Common law tradition, particularly in regard to choice of law. See discussion below on the potential loss of the Common Law tradition through harmonisation.

⁸⁴ Hann, Q. 183, 'It would be like Blue Peter: "Here is one I made earlier".'

⁸⁵ An issue of fair representation of businesses in the ongoing process also arises, see discussion of political issues in section 3.3

⁸⁶ What can be expected from the political CFR is discussed in Chapter 4, 4.2.3.

⁸⁷ Draft Common Frame of Reference, Outline Edition, Principles, Definitions and Model Rules of European Private Law, Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group), Based in part on a revised version of the Principles of European Contract Law, Edited by von Bar, Clive and Schulte-Nölke (2009), Sellier, European law publishers GmbH, Munich.

⁸⁸ Ibid. 24, para 40.

⁸⁹ DCFR Outline Edition (2009), Principles, 62 para 3.

⁹⁰ Ibid. Principles, 84 para 40.

bargaining power and are fully informed.⁹¹ Where this is not the case, the rules of the DCFR will be tempered by the needs of justice and social solidarity and will seek to protect the weaker party. In this way, the contractual principles of freedom and justice are ensured and reflected within the model rules.⁹²

They are joined, as the underlying principles of the DCFR, by the principles of security and efficiency. These are discussed in a self-contained section, which draws on the work on governing principles and the CFR project by the Association Henri Capitant and the Société de Législation comparée as part of the ‘CoPECL Network of Excellence’ who also prepared the *Principes directeurs du droit Européen du contrat*.⁹³ It is here that the principles are developed and illustrations of their operation provided in order to demonstrate their role within the DCFR. It was envisaged that this would assist the reader in understanding the instrument more fully as well as providing general guidance to those using the CFR, for example, in the preparation of legislation. Ultimately, as part of the draft text, it may be hoped that they provide considerations which might be taken into account in the transformation of the draft into a political instrument.⁹⁴

Alongside the underlying principles, the introduction to the DCFR elaborates on a number of “overriding principles”. Although some of these are reflected in parts of the DCFR, they are considered by the Network of Excellence to be primarily relevant to an outside assessment of the DCFR as a whole.⁹⁵ They are considered to be highly political in nature and consist of the protection of human rights, the promotion of solidarity and social responsibility, the preservation of cultural and linguistic diversity, the protection and promotion of welfare and the promotion of the internal market.⁹⁶ In this way, the overriding principles reflect the wider aims and issues at stake in the European

⁹¹ DCFR Outline Edition (2009), 63 Principles, para 3.

⁹² For discussion of how these principles are reflected in the model rules, see discussion in Chapter 4 4.2.2. and Chapter 6, 6.4.1.

⁹³ *Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules*. Produced by Association Henri Capitant des Amis de la Culture Juridique Française and Société de Législation Comparée. Edited by Fauvarque-Cosson and Denis Mazeaud. Prepared by Racine, Sautonie-Laguionie, Tenenbaum and Wicker (Munich 2008).

⁹⁴ DCFR Outline Edition (2009), 6, para 4.

⁹⁵ *Ibid.* 13, para 14.

⁹⁶ DCFR Outline Edition (2009)14, para 16.

harmonisation debate. Thus, the Network points to the impetus for the DCFR in its present form and for its present purposes.⁹⁷ On the one hand, it seeks to recognise cultural and linguistic diversity. The Network makes clear the principal purpose of the CFR is as a legislator's toolbox. It is not an attempt to create a single European law, to replace that of the Member States. Rather, it seeks to enable people from diverse legal backgrounds to understand European legislation, and to reflect, as far as possible, all legal systems in the EU.⁹⁸ On the other hand, it arises from concerns about the harmful effects of the internal market arising from the excessive diversity of contract laws. The promotion of the internal market aim, an overriding principle, is considered as a subheading of the promotion of welfare, as the welfare of European citizens and businesses can be promoted by the DCFR through the promotion of the smooth functioning of the internal market. The Network highlights that the issue of whether this can be achieved simply through the DCFR's toolbox function in improving the quality, and therefore accessibility and usability, of the *acquis*, or whether this may require the development of optional instruments, is ultimately a political decision.⁹⁹

What is clear is that the academic researchers' approach to the DCFR goes some way towards addressing the concerns articulated in the beginning of this section, namely that the elaboration of the CFR is being treated as simply a technical, value-free exercise by the Commission and one which is not fairly balanced in the interests of all interested parties. The DCFR recognises and gives due attention to many of the real issues and interests at stake in the harmonisation process. The extent to which the Commission will engage with these issues and, although clearly desirable, the extent to which they will adopt the DCFR as the politically authorised text¹⁰⁰ is, however, still unclear

⁹⁷ Ibid. 16, para 19.

⁹⁸ DCFR Outline Edition (2009), 16, para 19.

⁹⁹ Ibid. 17, para 21.

¹⁰⁰ Which is the intention of the academic researchers, DCFR Outline Edition (2009), 7, para 6.

3.3. Political Issues

The existing harmonisation debate can be understood as being concerned with the need to represent, reconcile and fairly balance the economic and socio-cultural aims and interests inherent within the EU and the national contractual systems. The issues and choices that arise therefore in creating a harmonised body of rules, and in the first place a CFR, as the basis for the revision of the *acquis*, and for future *acquis* and ultimately for the adoption of an optional instrument are of a political nature. As is already apparent in the academic text, the creation of a harmonised European contract law requires recognition and accommodation of the often conflicting interests discussed in preceding sections, which bear on the content of a body of harmonised rules. The harmonisation process is not merely a matter of technical input, but also political. This section will therefore outline the political issues and concerns that arise, many of which are related to the nature, demands and magnitude of the harmonisation project. It considers the extent to which they have so far been accommodated in the ongoing harmonisation work.

The political nature of the harmonisation project can be considered from two perspectives. The first is the nature of the harmonisation process and its participants, i.e. EU institutions, stakeholders and academics, as well as the need to involve the public at large. It is clear that the involvement of the Commission in what was otherwise a private academic debate and effort to create a set of common European contractual rules converted this process into an EU program. It therefore became a political process and the Commission remains the dominant influence on the harmonisation agenda.¹⁰¹ The project, however, remains an interplay between European institutions, including the European Parliament and Council, and European legal science,¹⁰² with the continuance of the harmonisation work of the Commission on European Contract Law and Study Group on a European Civil Code within the research structure of the Co-PECL Network of

¹⁰¹ On the transition from a private initiative into an EU one, see Schulze, *European Private Law and Existing EC Law* (2005) *European Review of Private Law* 3, 5. Also see Chapter 4, 4.2.3. on the transition of the project and development of the political CFR under DG JFS.

¹⁰² For discussion of the existing interplay of the project, as termed by Von Bar, *Working Together towards a Common Frame of Reference* (paper delivered at *Juridica International 10. Anniversary, European Legal Harmony: Goals and Milestones*, Tartu, 2005 (video on line), <http://video.ut.ee/juridica10.htm>.

Excellence. Indeed, it is conceded by Von Bar that, if it were not for political developments, notably the European Council's request at the Tampere Summit¹⁰³ for an overall study on the need to approximate Member States' legislation on civil matters, joined by calls from the European Parliament for work to begin on the unification of private law as being essential for the completion of the internal market¹⁰⁴, then the existing developments and, particularly, the possible political authorisation of a largely academic text¹⁰⁵ would not have occurred. The 2001 Communication on European contract law responded to these calls,¹⁰⁶ and the Commission equally acknowledged, at an early stage, that it would be essential in the elaboration of the CFR that existing research activities were to be continued and exploited to the full. It was, therefore, their goal in this respect to combine and coordinate the ongoing research with any new research activity, to avoid any repetition.¹⁰⁷ Thus, despite initial concerns advanced by the Study Group on Social Justice, the involvement of others, beyond the Commission, there is the prospect that those involved may appreciate the wider issues involved in the current harmonisation debate. However, while the Commission continues to influence the current agenda, the concern remains that the political process will be driven by a narrow market-orientated approach, unless this agenda is properly challenged.¹⁰⁸

The second perspective is how the wider issues and debate must be addressed and accommodated within the political process of creating a harmonised European contract law. It is the nature of the decisions that are of a political nature, to the extent that contract law can be understood as an articulation of a society's political values. As such, it is clear that a harmonised European contract law cannot be devoid of political judgments, nor treated as a technical exercise. As Beale highlights, once we move beyond a toolbox and legislative tool to a set of optional rules which can be chosen by parties to govern their contracts, there are political choices to be made by the legislator. It is important that these choices are pursued on some democratic basis, rather than solely on

¹⁰³ Presidency Conclusions, Tampere European Council 15 and 16 October 1999, SI (1999) 800, para 39.

¹⁰⁴ See the initial resolutions of the European Parliament in 1989 and 1994, OJ C 158, 26.6.1989, p. 400 (Resolution A2-157/89); OJ C 205, 25.7.1994, p. 518 (Resolution A3-0329/94).

¹⁰⁵ Von Bar (2005) from 6 minutes.

¹⁰⁶ 2001 Communication, 5.

¹⁰⁷ 2003 Action Plan, para 66 and 67.

¹⁰⁸ Study Group on Social Justice in European Private Law (2004), 655.

technical input.¹⁰⁹ It is, therefore, when the perceived end objective of the harmonisation project changes, that is to say beyond a non-binding tool for legislators, that the task becomes a political one and much more difficult. As has been highlighted, much opposition to harmonisation, which continues with the Commission's current project, centres in the belief that what is actually being proposed is a mandatory harmonised instrument to replace the contractual systems of the Member States. For those holding this belief, the aim of harmonisation must necessarily be towards the political goal of creating a shared European identity, based upon a union of shared fundamental values. Clearly, such a statement requires both democratic endorsement and regulatory legitimacy.¹¹⁰ The issue is how this is to be ensured in the current harmonisation process, the issue applying equally if the final result is an optional harmonised instrument.

The 2004 Manifesto of the Study Group on Social Justice was fundamentally a call for the introduction of a more representative and accountable process in order to reveal the issues that are really at stake.¹¹¹ If this is not achieved, such issues will never be openly addressed and the risk is that powerful interest groups will be able to exploit the ongoing process to advance their own interests at the expense of all European citizens. In the same vein, Hesselink calls for the empowerment of the citizen and for a more open debate at EU level. This is necessary if the future proposals are to be properly considered in light of what best corresponds with the socio-economic, cultural and political interests and expectations of all stakeholders, namely all European citizens.¹¹² Failure to launch such an all inclusive process would ultimately risk the legitimacy and credibility of any resulting instrument. It would undermine not only the harmonisation work of the Network of Excellence and the CFR, but also the success of any future optional instrument, which depends upon the willingness of parties to participate by applying the instrument as the governing law of their contract.

¹⁰⁹ Beale's evidence to the House of Lords European Union Committee on the Future of European Private Law (12 February 2005), <http://www.publications.parliament.uk/pa/ld200405/ldselect/ldeducom/95/5011205.htm>, Q. 62.

¹¹⁰ Study Group on Social Justice in European Private Law (2004), 655, and Collins (2004), who as a member of the Group interprets their manifesto, 650.

¹¹¹ Study Group on Social Justice in European Private Law (2004), 568. Those issues highlighted in this section and 3.2. in the demonstration of the wider debate.

¹¹² Hesselink (2004), 418.

The legitimacy of the ongoing project will thus be secured through democratic participation and dialogue, and, for this to be achieved, fair and open representation of all stakeholders must be ensured. Additional benefits will also arise from the nature of such input, as academic research can be met with the practical and technical experience of experts and practitioners in the respective fields. The demands of democratic participation will further ensure the necessary accountability of those leading the project; in the first place the Commission, but also the academic researchers. With regard to the Commission, it is also clear that, because of the existing scepticism about their true intentions as to the end product, they must be transparent in their intentions and proposals. Only in this way will the harmonised rules gain legitimacy and will confidence and trust be created in the end product.

It is, therefore, necessary to consider the extent to which the current project has ensured a representative and accountable harmonisation process and thus addressed the apparent political issues and concerns involved.

With regard to the nature and extent of representation achieved, the Commission has been credited with ensuring a valuable and probably the most extensive exercise of this kind: one which it is maintained must be recognised as such even by its detractors.¹¹³ Although the success of the consultation initiated by the Commission in 2001 in these terms can be questioned, as Chapter 2 does,¹¹⁴ it must be conceded that the Commission identified the need to consult widely on their proposals from the beginning. The consultative nature of the project has been maintained, which has in part been a response to calls from EU institutions. The European Parliament and Council, which welcomed the Commission's Communications, also underline the need to involve all interested parties in the project, in particular in the elaboration of the CFR.¹¹⁵ In response to the 2003 Communication, the Council called upon the Commission to establish appropriate mechanisms at both

¹¹³ Opening Speech of Wallis (MEP), Conference on the Review of the Consumer acquis and the Common Frame of Reference hosted by the Austrian Council, Second discussion forum (2006), http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference052006/diana_wallis.pdf, 1.

¹¹⁴ Chapter 2, 2.2.1. and 2.4.

¹¹⁵ 2004 Communication, 2.

political and expert level, in order to allow all interested parties and, significantly, also the Member States and EU institutions, to participate actively in the CFR process.¹¹⁶ This was to be achieved through mechanisms such as discussion forums, annual progress reports on the ongoing process and the creation of the CFR-net. The Commission was to ensure that the elaboration of the CFR would take into account the practical needs of all stakeholders, particularly Member States' legal cultures and traditions, in the development of the project.¹¹⁷

The process continues to be characterised by the relationship between the Commission and the academic researchers, who together form the Network of Excellence. This follows from the work of the Commission on European Contract Law and, later, the Study Group on European Civil Law. Under their contract, the researchers were expected to submit a first draft of the CFR by the end of 2007, with a complete version expected by 2009. The academic researchers were joined by a network of stakeholder experts, known as the CFR-net, consisting of business, professional and consumer interests,¹¹⁸ who were intended to provide the necessary complement to the academic research with practical feedback based on their experiences in the preparation of the CFR. In addition, there was also the network of Member State experts, consisting of contract law experts representing the Member States and ensuring their direct involvement in the preparation of the CFR.

As indicated, the Council and European Parliament have also expressed interest in the project and have maintained their involvement. The European Parliament has acknowledged the project as the most important initiative under way in the civil law field¹¹⁹ and has sought to ensure the participation of the democratic arm of the EU directly in the process. This was considered particularly necessary in view of those who were seen as leading the project, the soft law nature of the process and the possible long-term outcomes. Thus Wallis (MEP) highlighted that the European Parliament was

¹¹⁶ Response of the Council to the 2003 Communication, OJ C 246/1. .

¹¹⁷ Ibid.

¹¹⁸ The network includes representatives of industry, trade, services, legal practitioners, judiciary and consumer organisations, see Commission introduction to the first conference of the CFR-net, http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/cfr_15122004_en.htm.

¹¹⁹ Resolution on the 2004 Communication, P6_TA (2006) 0109, para B.

nervous of the nature of the CFR because of its proposed soft law nature, which can be perceived as threatening democracy and thus the Parliament's legislative place to the extent that this would be assumed by researchers and stakeholders.¹²⁰ To ensure that the European Parliament remained fully engaged in the process, a Parliamentary working group was established to provide a forum for discussion of subjects dealt with by the researchers and stakeholder experts, for which the European Parliament considered it important to provide political guidance.¹²¹

The potential long term outcomes of the project were also believed by the European Parliament to dictate its involvement. While recognising that the Commission maintains that it is not its objective to propose the creation of a binding code – an idea to which the European Parliament has long been predisposed to in order to aid the completion of the internal market – it also considered that, in the future, the political will may exist to adopt such a code.¹²² With this in mind, and given that the very decision to adopt a code is political and that its content will pursue social and political objectives, it considers it essential that the present process be done well and with appropriate political input.¹²³ In any case the European Parliament views it as essential, even if the project is limited to the present proposals, namely the revision of the *acquis* and the elaboration of a CFR, that the political authorities have proper input into the process.¹²⁴

The Commission can thus be seen to have conducted a seemingly representative debate on the future approach to be taken to contract law.¹²⁵ It can be criticised, however, for the manner in which it chose to conduct other aspects, with potential implications arising for the legitimacy of the ongoing harmonisation process and of the confidence therein. In particular, the Commission has been accused of being deliberately ambiguous and tentative in the manner in which it has chosen to put forward and define its proposals.

¹²⁰ Wallis, Second discussion forum (2006), 1.

¹²¹ See, the Commission's Second Progress Report on the Common Frame of Reference COM (2007) 447 final, 10.

¹²² European Parliament Resolution on the 2004 Communication, para C.

¹²³ *Ibid.*

¹²⁴ European Parliament Resolution on the 2004 Communication, para D.

¹²⁵ Although the success of this is also open to criticism in the following discussion.

This concerns particularly the CFR and a possible optional instrument,¹²⁶ and the approach has led to uncertainty even for those involved in the process.¹²⁷ Although the CFR presented as a legislative ‘toolbox’ sounds rather innocuous, there has been concern that this may potentially be a “Trojan horse” for the development of a mandatory contractual or civil code.¹²⁸ Similarly, scepticism has surrounded the way in which the Commission proposed to reflect on the opportuneness of a “non-sector specific measure” such an optional instrument.¹²⁹ Collins, in response to the Commission’s 2003 Communication, questioned the meaning of the term and what was potentially camouflaged behind this new jargon.¹³⁰ For Collins, this is simply a European contractual, or greater, civil code and this for him, like others, explains the Commission’s “need for reflection and camouflage, whilst reflecting on whether they can get away with it (opportuneness), and how to explain that it is even constitutional (legal basis)”.¹³¹

Much uncertainty and distrust underlies the current initiative due to the lack of transparency surrounding the Commission’s approach and the relationship between the CFR and an optional instrument. This has ultimately impeded the ongoing process. For example, it is considered¹³² to have frustrated CFR workshops where little progress was made owing to ‘lengthy and repetitious’ debates on whether the CFR was intended to form a ‘toolbox’ or an optional instrument: an outcome which, it is felt, the Commission brought upon itself.¹³³ The lack of transparency and resultant uncertainty has also frustrated the efforts of the academic researchers involved. Schulte-Nölke¹³⁴ noted that

¹²⁶ Although concern also exists as to the transparency of the Commission’s approach in regard to the review of the *acquis* and the outcome of this, see discussion, Chapter 4, 4.1.2.

¹²⁷ Study Group on Social Justice Group in European Private Law (2004), 662 and Collins (2004), 649.

¹²⁸ To this end see the memorandum of Howells, para 4, the evidence of Beale, Question 63, and the evidence of Hann, Question 183 to the House of Lords European Union Committee on the Future of European private law (2005).

¹²⁹ 2003 Communication, 4.3.

¹³⁰ Collins (2004), 649.

¹³¹ *Ibid.*

¹³² Keane (Law Society of Ireland), Contribution to the First discussion forum (2005), http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference092005/keane2005.pdf, 2.

¹³³ *Ibid.* 3. Further, it was not aided by the academics researcher’s drafts which were presented to the stakeholders in the form of a completed code (PECL), which is a criticism considered below in regard to the CFR process and in particular the interaction between the academics and stakeholder experts.

¹³⁴ Schulte-Nölke, The Review of the Consumer *Acquis* and the Common Frame of Reference

the possibility of advancing the CFR to an optional instrument in the future has overlaid and perhaps even impeded awareness of the currently more pressing need for the CFR as a toolbox for European contract law. He therefore hoped that everyone familiar with the CFR work would distinguish between this urgent need and what he described as the still rather vague but interesting idea that the CFR may in future serve as the basis for the discussion about a possible optional instrument. Any opposition to the latter idea should not spoil discussion of how the actual state of EU law could currently be improved.¹³⁵

Criticism further surrounds the Commission's organisation of participation and interaction between academic researchers and stakeholder experts. As discussed the role of the academic researchers in a political process has not been uncontentious. For some, given the nature of the task that they were assigned, the Network of Excellence holds an unjustifiably prominent position in the harmonisation process. The elaboration of the CFR can be viewed as law-making under the auspices of research¹³⁶ as the process requires academics to make political decisions: for example, deciding on how the respective interests must be balanced. This raises a contentious point of legitimacy regarding private law-making in accord with the demands of democratic principles, and in light of concerns raised by the European Parliament as to their legislative place being usurped. Those within the Network of Excellence are, however, aware of such views and have made clear that it is not their intention to seize the political initiative. On the contrary, it is considered as vital that the democratic institutions realise that there are policy choices being made at researchers' level and that the political process should be left to them and not to technocrats.¹³⁷

Legitimacy is thus felt to have been added to the project, and the overall quality of the future instrument improved, where the academic researchers have been joined by

– Progress, Key Issues and Perspectives, Contribution to the second discussion forum (2006), http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference052006/hans_schulte-nolke.pdf, 3.

¹³⁵ Ibid. 4.

¹³⁶ This opinion is shared by those within the Network of Excellence and was articulated in discussion by Wilhelmsson at the 2007 SECOLA Conference.

¹³⁷ Beale, Evidence to the House of Lords (2005), Question 22.

stakeholder experts in the field.¹³⁸ The CFR-net provided for practical input on the researchers' drafts through participation in CFR workshops and via the dedicated website created to facilitate communication between members.¹³⁹ The extent to which the addition of stakeholders has ensured an all-inclusive, open and representative process is, however, open to question and shortcomings in the way that the Commission ensured their involvement were apparent from an early stage. Stakeholders were critical from the beginning of the workshops' organisation, some noting that it is not possible to expect a meaningful contribution from groups when dates and extensive, often complicated and unfamiliar academic topic drafts, were communicated to them only a few weeks in advance.¹⁴⁰ Such criticism resulted in a number of procedural improvements, outlined in the first annual progress report, including the extension of time within which the stakeholders could examine the researchers' drafts from 1 to 2 months.¹⁴¹ Not all, however, were wholly convinced of these limitations. It was noted that difficulties, including the volume of the research material and the breadth and size of some workshops' subject matter, were problems that could not and should not have been overcome. It was essential that stakeholders considered not only the text but also the accompanying comments and notes.¹⁴²

While practical and necessary limitations in the process clearly existed, those noted were just some of a number of fundamental issues¹⁴³ which stakeholders felt undermined their

¹³⁸ Turro (Federation of European Direct Selling Associations), Contribution to the First discussion forum (2005), http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference092005/Turro2005.pdf, 1.

¹³⁹ On the CFR- net, see generally, the First Annual Progress Report on European Contract Law and the Acquis Review (2005), 4.

¹⁴⁰ See the views of Brandão, (First Vice President of the Council of Bars and Law Societies of Europe (CCBE)), First discussion forum (2005), http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference092005/brandao2005.pdf, 2.

For full discussion of the organisation of the workshops, see The First Annual Progress Report (2005), 4.

¹⁴¹ Ibid.5.

¹⁴² Beale, Issues arising from the First CFR Workshops, paper presented to the First discussion forum (2005), http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference092005/beale2005.pdf, 2.

¹⁴³ Others concerned the way in which stakeholder participation and representation was ensured, and the order in which sessions and topics were organised. See for example the Evidence of Clark to the House of Lords European Union Committee on the Future of European Private Law (2005), Q. 163.

input, and the degree to which their interests were represented in workshops.¹⁴⁴ It resulted in concern among some that they were involved in no more than an empty exercise designed to claim wider endorsement for the project.¹⁴⁵ There were calls for the Commission to take stakeholder input effectively into account and not, as was felt, merely to test their reaction to work already completed by academic researchers at what was, by then, a relatively late stage.¹⁴⁶

The latter criticism concerns the nature of the drafts presented by the academic researchers to stakeholder experts which were somewhat inevitably, owing to the fact that draft material was based upon the existing Principles of European Contract Law (PECL), drafted in the form of a code. The drafting style, together with the opacity of the Commission's objectives in the creation of a CFR, led to greater confusion and uncertainty about what was actually being proposed: whether it was a legislative toolbox or, as the existing form may lead one to believe, a mandatory European contractual code.¹⁴⁷ Stakeholder experts felt that the CFR-net process was operating so as to approve work already carried out by researchers many years in advance.¹⁴⁸ Such criticism can be overcome to the extent that the researchers had the benefit of basing their Draft CFR on the wealth of harmonisation work and rules contained in PECL. Nevertheless, the academic researchers and thus the drafts were receptive to stakeholders' input, with a number of significant changes made to the existing PECL rules in light of the stakeholder workshops, and included within the Outline Edition of the DCFR.¹⁴⁹

A further issue in the relationship between the academic researchers and stakeholders concerned the coverage of the material presented by the Network of Excellence. There was an apparent divergence in this respect between the academic DCFR as presented to the CFR-net, and what was envisaged by the latter stakeholder experts. For some

¹⁴⁴ Ibid.

¹⁴⁵ See the supplementary memorandum by the CBI to the House of Lords European Union Committee on the Future of European private law (2005), <http://www.publications.parliament.uk/pa/ld200405/ldselect/lducom/95/5020206.htm>

¹⁴⁶ Brandão (CCBE) (2005), 1.

¹⁴⁷ Keane (2005), 2.

¹⁴⁸ Brandão (CCBE) (2005), 1.

¹⁴⁹ DCFR Outline Edition (2009), 31, para 52.

stakeholders, a discrepancy existed between the limited objectives of the instrument as a legislative toolbox, and the seemingly unlimited coverage of the proposed CFR instrument.¹⁵⁰ Stakeholder concern was that what was being created was an instrument which was “too wide, too extensive, too elaborate for purpose”.¹⁵¹ It thus becomes apparent that the stakeholder experts had different objectives in terms of the coverage and thus end product of the CFR exercise than those of the academic researchers’. Stakeholders characteristically took a pragmatic viewpoint on the creation of a CFR, ultimately seeking a workable end product to improve the existing state of European contract law or else their resources in terms of time, money and expertise – a real issue dictating their involvement in this process – had been wasted.¹⁵²

In contrast, the researchers’ objective was the continuation of their far reaching research activities in the area and, for the first time, they received EU funding. Indeed, their submission for funding under the Sixth Framework Programme for research was based solely on furthering the European legal science community and, in line with this, under their research contract they were obliged to include initially, in terms of coverage of the draft CFR, material from seven existing academic publications.¹⁵³ These comprised two volumes of the Principles of European Contract Law and four books in the series on Principles of European Law (PEL),¹⁵⁴ produced by the Study Group on a European Civil Code, covering distribution contracts, service contracts, personal security contracts and benevolent intervention in another’s affairs. Finally, the first volume published by the Acquis Group on pre-contractual obligations, conclusion of contract and unfair terms

¹⁵⁰ Patchett- Joyce (General Council of Bars of England and Wales), Contribution to the First Discussion Forum (2005), http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference092005/patchett-joyce2005.pdf, 3.

¹⁵¹ Ibid. This also raises issues concerning the credibility of the instrument, discussed below.

¹⁵² On the influence of resources on stakeholder participation in this process see, Murray (Director of the European Consumer Organisation), Speech to the First Discussion Forum (2005), http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference092005/murray2005.pdf, 1.

¹⁵³ For a full account of the initial scope of the research contract see, Von Bar, Coverage and Structure of the Academic Common Frame of Reference, paper delivered to the SECOLA Conference (Amsterdam, 1 June 2007), 4.

¹⁵⁴ N.b. The Study Group confines the scope of its private law research to patrimonial law, defined as; the law of obligations: i. the general law of contracts, ii. the special law of particular contracts iii. non-contractual obligations, as well as the law of moveable property. <http://www.sgecc.net/pages/en/introduction/101.scope.htm>.

would also be included within the scope of the harmonised instrument. It follows that the Academic CFR, which also includes rules on unjust enrichment and non-contractual liability, does have a somewhat expansive coverage for the perceived remit and purpose of the CFR as presented in the Commission's Communications and, indeed, PECL – on which it is principally based. Such disparity can, however, be explained by the source of the funding, which came from DG Research, and the researchers' fear that they would not receive funding if their proposal were limited to areas already covered by PECL, as that work already exists, subject to amendments through the CFR process.¹⁵⁵ The academic value of the research contract undertaken has been recognised by others involved in the process. For example, Wallis (MEP) acknowledged the work as a huge scientific undertaking and as such worthy for its own sake.¹⁵⁶ From this it follows that the scope and coverage of the research may not be "tailor made, for the CFR, nor for the European legislator" and Wallis concedes that it is, therefore, inevitable that there will be some tensions, but that this should not be allowed to detract from the need for the research or its results.¹⁵⁷

Not all, however, are of the same opinion, and as the goal posts have been moved for the researchers in terms of their research contract and the Commission's changing agenda, the aforementioned tension has grown. As Von Bar notes, despite the research contract being concluded with DG research, the academics realised early on that they were in fact working to an imposed time frame and that their research proposal was being influenced by the DG for consumer affairs and their agenda.¹⁵⁸ A notable unforeseen development was the dramatic change in the Commission's priorities with the decision to prioritise the review of the consumer acquis in 2005. This meant a switch of focus for the researchers and a revised programme of workshops to this end, in what is perceived as an attempt to finish the revision of the acquis within a shorter timescale.¹⁵⁹ The Commission made clear at that time, in contrast to other views, that this project was not to be an academic exercise but rather one which produced practical results to be used in both the existing

¹⁵⁵ Von Bar (2007), 5.

¹⁵⁶ Wallis, Second discussion forum (2006), 1.

¹⁵⁷ Ibid.

¹⁵⁸ Von Bar (2005), Paper delivered at Tartu, from 9 minutes.

¹⁵⁹ For discussion see Beale (2007), 13.

acquis and new legislation.¹⁶⁰ This sentiment was shared by others, who feared impractical results would follow if the researchers' more ambitious targets were to be pursued in the time frame. The prioritisation of the acquis and the need to review the overall structure of the proposed CFR was, therefore, viewed by many as a welcome development.¹⁶¹

This, however, was not the case for all and, while the consumer acquis workshops were considered a success, the change of agenda did have a negative impact on those stakeholders who were not concerned with consumer matters: in particular, those who were still interested in participating in the CFR process in the B2B context and in the idea of the CFR serving as the basis for a possible optional instrument. Once-active participants therefore no longer attended meetings.¹⁶² It also raised concerns for the academic researchers as, following the completion of the consumer acquis workshops, they were no longer continued and it outwardly appeared at that time that the Commission's agenda was no longer concerned with a CFR containing even principles of general contract law.¹⁶³ Ultimately, however, this period of "crisis" for the academic researchers¹⁶⁴ did not prevent the completion of the DCFR in their terms and with their intended coverage and scope.¹⁶⁵

To what extent, therefore, has the current project ensured a representative and accountable harmonisation process and thus addressed the apparent political issues and concerns involved? It is clear that the Commission sought to ensure an inclusive process, by involving the stakeholder experts and EU institutions, in addition to the academic researchers, in the elaboration of the draft CFR. In this way, and also through publicly

¹⁶⁰ Commissioner Kyprianou, First Discussion Forum (2005), http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference092005/kyprianou2005.pdf, 1.

¹⁶¹ See Keane (2005), 6 and Patchett- Joyce (2005), 3.

¹⁶² Beale (2007), 14.

¹⁶³ Ibid.

¹⁶⁴ Described as such by Von Bar, Common Frame of Reference for European Private Law - Academic Efforts and Political Realities, vol. 12.1 Electronic Journal of Comparative Law, (2008), 9.

¹⁶⁵ The coverage and scope of the DCFR is considered in Chapter 4.2.2. It also considers, in response to the concerns of some stakeholder experts, whether the existing instrument presents a suitable basis for the legislative toolbox.

available update reports,¹⁶⁶ it has sought to maintain the consultative nature of the project and, in this way, maintained some accountability. The mechanisms were in place for a representative debate and it has been demonstrated that the range of actors involved clearly understood the wider issues involved in the process and, thus, the political nature of the task. Notwithstanding this, the process has come in for criticism, and clear limitations have been shown to exist. Some of these, such as the demands placed on stakeholder expert involvement, were unavoidable, and the input of this important group has been ensured in the end product, as a complement to the academic basis of the text. The process has, however, been further undermined by a lack of transparency on the part of the Commission, which undermined interaction between the respective actors. As a result, the project has been afflicted with uncertainty, and distrust exists as to the end that is sought. This further undermines the identification and accommodation of the political issues and concerns involved. The Commission, in going forward, therefore must be clear on what the end proposal is, whether it ultimately is a legislative toolbox, or more ambitiously an optional instrument of European contract law. Without such clarity the continued risk is that the real issues at stake will be obscured.

3.4. Conclusion

The economic arguments highlighted the need to be aware of the types and scale of potential positive and negative impacts associated with proposals and bore specifically on their suitability.¹⁶⁷ On balance, it is possible to question the suitability of the creation of a body of harmonised rules of European contract law as the solution. Fundamentally, it is open to question as to whether such a course of action would achieve the desired goal of creating a level playing field for European trade. To the extent that the centralised regulation of European contract law would address existing divergences which are identified as creating problems for the functioning of the market, this option cannot be discounted. However, the benefits of any such course of action must outweigh the costs.

¹⁶⁶ The Commission's Europa website has also been an important source of information and updates for the European public.

¹⁶⁷ The discussion as a whole highlighted that such impacts will not be confined to economic interests but will also impact upon and the social, cultural and political aims of the proposed action.

For example, it was shown that the choice as to the binding nature of such a harmonised instrument may in fact result in greater costs for market participants, particularly if the decision is to create a European contract code to replace that of Member States. Indeed, the perceived disadvantages of such action points to the need to adopt alternative responses to current problems. Thus there is acknowledged potential in adopting a hybrid measure, such as an optional instrument of European contract law which would benefit from centralised regulation and, thus, enhanced certainty and reduced transaction costs. At the same time, the instrument would benefit from the advantages of decentralised regulation, thus limiting the negative impacts, in particular the anti-competitive effects of harmonisation. Regulatory competition would in fact be promoted through the adoption of an optional instrument. Indeed, as a course of action in its own right, regulatory competition, with its aim of allowing for the greatest satisfaction of wants and needs of market participants, creates distinct benefits for the internal market, while also potentially leading to greater convergence between the legal systems.¹⁶⁸ Also, the fact that regulatory competition views diversity as a good would have socio-cultural benefits for the internal market which must also be weighed in the balance in assessing the most suitable way forward.

The social and cultural perspective focused on the desirability of potential proposals and, more specifically, highlighted wider issues and needs which must be accommodated within the Commission's response. The continuance of the Commission's technocratic approach, aimed at removing divergence between national contractual systems with the object of facilitating trade, is therefore neither a sufficient nor desirable response alone to the problems encountered in the internal market. In terms of the objective of future action, although principally to facilitate cross-border trade, there are wider objectives which must be accommodated within the proposal, to represent, reconcile and fairly balance the apparent socio-economic and cultural aims and interests inherent in the internal market and thus in the national contract systems. To this end, the final proposal will have to make value choices and ensure a balanced approach between private

¹⁶⁸ A possible by-product of the optional instrument.

autonomy and social solidarity if it is to address the needs of the respective market actors and, further, to reflect a European society's common values and principles of justice.

The nature of the decisions that have to be made, and of the proposals themselves, will impact upon the manner in which the EU continues to conduct this debate and the nature of the process by which the proposals are to be realised. Taking the CFR as an example, it is clear that if the purpose of the instrument is to move beyond a non-binding legislative toolbox and to form the basis of optional but binding contractual rules, once it is chosen by the parties as the governing law of their contract, then a political process will be necessary. It has been shown that the Commission must continue to ensure an all-inclusive process and thus one which ensures fair, open and meaningful representation and input of all interested parties. Maintaining this nature of the debate will also increase transparency, which has been seen to be lacking at some points in the process and this will ensure support and legitimacy for the Commission's proposals. Beyond this, the Commission must also continue to engage with wider issues involved in the debate as to the future approach to be taken to European contract law,¹⁶⁹ and a good starting point would be for the Commission to draw to a large extent on the restatement work in the DCFR in the elaboration of the political CFR, to support its future uses.

¹⁶⁹ Such as those included and recognised in the parameters that the Commission set for the reflection on the need for a non sector specific measure, in the 2004 Communication, section 2.3 and Annex II, 17.

Chapter 4

The Review of the Consumer Acquis and the Common Frame of Reference

In light of the empirical evidence, the wider issues identified and the parameters set for the assessment of future courses of action, it is necessary to consider in greater detail the Commission's proposals. The focus of this chapter is the review of the consumer acquis communautaire and the creation of a Common Frame of Reference (CFR). Each can be considered as a response to the evident inadequacies in the EU's ongoing legislative approach to harmonisation in the internal market, which had already been directed towards the removal of obstacles arising from divergent national contract rules for B2C contracts. The creation of a CFR, establishing common principles and terminology for European contract law, is presented as an important step towards achieving better quality EU legislation in the area, being characterised by a high degree of consistency not only in its drafting, but also in its implementation and application.¹ The interrelated proposal, and need to review the existing acquis, must be considered in light of the EU's better regulation aims and objectives and the overall strategy of simplifying the regulatory environment and quality of EU legislation.² It was recognised that the problems identified internally within the acquis demanded its review in order to remove existing inconsistencies, fill gaps and simplify the legislation. From an early stage, it was envisaged that the outcome may result in the need to consolidate, codify and recast the existing instruments³ and a clear link was made with the function and role of the CFR to this end.⁴ The following discussion will consider these proposals and their objectives, critically assessing the progress that has been made to date. It will consider the relationship that exists between the proposals and the direction in which we can expect these measures to go in the future, as part of the overall strategy to meet the objectives of the European contract law project. It will be asked whether these proposals and the current actions of the Commission provide a suitable, sufficient and, in light of earlier

¹ 2003 Communication, para 59.

² Ibid. paragraphs 69 – 71.

³ 2003 Communication, paragraphs 76 – 77.

⁴ As an initial example of the anticipated relationship between the two measures see 2003 Communication, para 79 – 89.

discussion, a desirable solution to address the problems currently experienced at the European level.

4.1. The Acquis Review

4.1.1. The Proposal and Objectives

In light of the apparent inadequacies and limitations of the EU's legislative approach to harmonisation, this proposal promised to fundamentally question the existing policy approach in the area. The review process⁵ began with a diagnostic review of eight consumer Directives⁶ which would be reviewed as a whole as well as individually in order to identify regulatory gaps and shortcomings in the existing approach. The overarching aim of this phase was to assess the extent to which the current legislation had met the Commission's principal objectives in the area. These had been to enhance consumer and business confidence, through a high common level of consumer protection, and the elimination of internal market barriers. More specific to this proposal was the aim of regulatory simplification to create a more predictable regulatory environment for businesses and thus encourage cross-trade.⁷ The assessment required not only a review of the Directives, but also analysis of their transposition and application in the Member States.⁸

The diagnostic phase culminated in the Green Paper on the Review of the Consumer Acquis. Here, the Commission presented their initial findings and identified a number of

⁵ The process was first outlined in the 2004 Communication, 3 and was further elaborated upon in the Commission's Green Paper on the Review of the Consumer Acquis, (2006) 744 final, 3.

⁶ Directive 85/577/EEC to protect the consumer in respect of contracts negotiated away from business premises. Directive 90/314/EEC on package travel, package holidays and package tours. Directive 93/13/EEC on unfair terms in consumer contracts. Directive 94/47/EC on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of a right to use immovable properties on a timeshare basis. Directive 97/7/EC on the protection of consumers in respect of distance contracts. Directive 98/6/EC on consumer protection in the indication of the prices of products offered to consumers. Directive 98/27/EC on injunctions for the protection of consumers' interests. Directive 1999/44/EC on certain aspects of the sale of consumer goods and associated guarantees.

⁷ 2004 Communication, 3 and the Green Paper (2006), 3.

⁸ The activities comprising the diagnostic phase are outlined in the Green Paper (2006), 5-6.

key issues that the future review and any future action would have to address.⁹ In the first place the findings confirmed the fragmentation of the consumer rules, owing to the minimum and sectoral approach to harmonisation.¹⁰ The consumer acquis is thus characterised by diverging levels of consumer protection and many issues are regulated inconsistently between directives,¹¹ resulting in regulatory fragmentation. The differences result in additional transaction costs, and thus deter businesses from conducting cross-border trade.¹² The findings also confirmed, and identified as a key issue, a lack of consumer confidence in purchasing goods and services from businesses established in other Member States.¹³ In part, this can once again be seen to result from fragmentation caused by minimum harmonisation, which means that consumers cannot be sure that the level of protection that they experience at home will be replicated in transactions in other Member States. It can also however, be attributed to practical issues and, at least, the perception that it is harder to resolve problems such as after-sales issues, where a cross-border element exists.¹⁴

The EU's existing regulatory approach clearly undermined the functioning of the internal market. The problems confirmed by the diagnostic phase struck at the heart of the Commission's objectives in the area, and served to undermine both consumer and business confidence in cross-border trade. The findings pointed to the need to review the acquis and to make fundamental changes to regulatory policy in the area. The Commission envisaged that at the end of the review it would be possible to say to consumers, "wherever you are in the EU or wherever you buy from it makes no difference: your essential rights are the same".¹⁵ This goal could not be achieved under the current regulatory approach. The Commission, therefore, set out a number of possible

⁹ Ibid. 6. Noted but not discussed in this section, is the issue that the acquis no longer fully meets the requirements of today's rapidly evolving markets.

¹⁰ Green Paper (2006), 6.

¹¹ Example provided in the Green paper (2006), 6. Also see, Chapter 2, 2.3.2.

¹² Including costs of acquiring relevant legal advice, changing information and marketing material or contracts, or in the event of non-compliance, litigation costs. Green Paper (2006), 6.

¹³ Green Paper (2006), 7.

¹⁴ Ibid. Also see Chapter 2, 2.3.6.

¹⁵ Green Paper (2006), 3.

options for the future revision of the *acquis*, on which the Green Paper sought to collect views from all interested parties.

4.1.2. The Commission's Green Paper: Public Consultation

The Commission's Green Paper and proposals for the review of the *acquis* will be examined from two perspectives. In the first place, the proposals for reform will be considered to ascertain the extent to which they offer an appropriate response to the identified problems. More particularly, it will be asked whether they address the Commission's better regulation aims in conducting the review, and thus simplify the existing regulatory framework in order to enhance both consumer and business confidence. The consultation will then be examined from the perspective of the manner in which the Commission has conducted the debate. The consultation must, therefore, be viewed in light of earlier criticism directed at the Commission in relation to the European contract law communications, particularly with regard to transparency and the wider issues set down in Chapter 3. It is significant in these terms that the Commission itself placed the consultation and analysis of the outcome in the context of its general principles and standards for consulting interested parties.¹⁶ One of the principal aims of establishing such principles and standards was to encourage wider involvement through a more open and transparent consultation process. This was intended to enhance the Commission's accountability¹⁷ and to improve confidence and credibility in both the complex institutions and their policy making.¹⁸ The consultative nature of the debate, through the publication of the Green Paper, is to be welcomed, as it is on the basis of the outcome of this consultation that the Commission would decide on the need for a legislative initiative.

¹⁶ Referred to in Commission Staff Working Paper, Report on the Outcome of the Public Consultation on the Green Paper on the Review of the Consumer *Acquis*, http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/acquis_working_doc.pdf, 2, and taken from the Commission's Communication, 'Towards a reinforced culture of consultation and dialogue – General principles and minimum standards for consultation of interested parties by the Commission' COM (2002) 704 final. This background to the consultation is highlighted and discussed by Rutgers and Sefton – Green, *Revising the Consumer Acquis: (Half) Opening the Doors of the Trojan Horse*, (2008) 2 ERPL, 427, 429.

¹⁷ *Latter Communication*, 3.

¹⁸ *Ibid.* 17.

A first indication of the options for future action to improve the *acquis* was provided in the First Annual Progress Report on European Contract Law in 2005. It held that, should evidence arise from the diagnostic phase of the review that the *acquis* needs to be revised, the Commission could “theoretically” choose between 2 options.¹⁹ On the first count, and in a continuation of the existing vertical approach, it would be possible to maintain the current approach, subject to the individual revision of existing directives or the regulation of specific sectors.²⁰ In the alternative, a more horizontal approach could be envisaged, entailing the adoption of one or more framework instruments. These instruments would regulate common features of the *acquis* and would allow for common definitions across the *acquis* and for the horizontal regulation of the main consumer rights and remedies. The Commission did, however, maintain that it was too early to predict what would ultimately be proposed in the Green Paper and expressed no clear preference.²¹

In the end, little more was brought to the table in 2007 with the publication of the Green Paper, where the Commission presented 3 possible options. The first proposed a vertical approach, under which the existing directives would be amended separately in order to address the identified problems. This would result in the removal of inconsistencies between the directives, while also respecting the specificity of the needs and restraints of each sector.²² However, the disadvantages of this are clear. The volume of legislation would remain and the consumer *acquis* would continue to be regulated in various directives.²³ It would still be possible for Member States to transpose the same issue, although common to several directives, inconsistently into national law.²⁴ Ultimately, a vertical, sector-specific approach cannot achieve the simplification of the regulatory environment that is necessary.

¹⁹ First Annual Progress Report on European Contract Law and the Review of the *Acquis* (2005), 9.

²⁰ The example of a directive on tourism, including provisions of the Package Travel and Timeshare Directives, was given in the latter case.

²¹ See the inaugural speech of Commissioner Kyprianou at the First European Discussion Forum (2005), 3.

²² Green Paper (2006), 8.

²³ Both the advantages and disadvantages of this approach were articulated by the respondents to the Green Paper, see Detailed Analysis of the Responses to the Green Paper, Analytical Report on the Green Paper on the Review of the Consumer *Acquis* submitted by the Consumer Policy Evaluation Consortium, http://ec.europa.eu/consumers/rights/detailed_analysis_en.pdf, 42.

²⁴ Green Paper (2006), 8.

The adoption of a horizontal approach was the key policy innovation advanced for consultation. The Commission's second proposal was a mixed approach which would allow for the adoption of horizontal instrument(s), combined, where necessary, with vertical action.²⁵ This could lead to the improvement of the *acquis* and introduce a more coherent approach, while also recognising that specific regulation of certain areas may still be necessary. In advancing the feasibility of the option, the Commission pointed to the Unfair Commercial Practices Directive,²⁶ which follows this more 'integrated' approach, and indicated the potential to extract issues which are common to the existing directives and to regulate them more systematically in a horizontal instrument.²⁷ It was envisaged that common issues, such as the definitions of consumer and professional, the length of cooling-off periods and the modalities for the exercise of the right of withdrawal, together with the provisions of the Unfair Contract Terms Directive,²⁸ also being horizontal in nature, could form the general part of the horizontal instrument. The second part of the instrument would regulate the contract of sale, as the most common and broad consumer contract, and the Consumer Sales Directive²⁹ would be included within the scope of the instrument to this end. It is clear, therefore, that the Commission envisaged a fundamental shift in regulatory policy, from vertical to horizontal regulation, in order to simplify and rationalise the consumer *acquis* in accordance with the objectives of the review.³⁰ It also had the creation of a very specific instrument in mind, the content of which was already apparent.

With regard to the possible territorial scope of this instrument, the Commission discussed 3 options.³¹ In the first instance, it could be applicable to both domestic and cross-border transactions; in the alternative, exclusively to cross-border transactions; or finally, it could be limited to distance shopping, whether cross-border or domestic, and would replace the Distance Selling Directive. The latter two options can be discounted, as the

²⁵ Ibid.

²⁶ Directive 2005/29/EC concerning unfair business-to-consumer commercial practices in the internal market (UCP).

²⁷ Green Paper (2006), 8.

²⁸ Council Directive 93/13/EEC on Unfair Terms in Consumer Contracts (UCTD).

²⁹ Directive 99/44/EC on certain aspects of the sale of consumer goods and associated guarantees.

³⁰ Green Paper (2006), 8.

³¹ Ibid, 9.

Commission acknowledged,³² as they fail to satisfy the objectives of action. Legal fragmentation would continue, or indeed be increased, if different sets of rules would apply depending on whether the transaction is cross-border or domestic, distance or face-to-face, respectively.³³ This would undermine the consumer and business confidence in trade that the review seeks to instil and would fail to provide the necessary simplification of the regulatory environment. Such a distinction would ultimately undermine the achievements of changing to a horizontal approach in this respect. A clear and justifiable preference for the first option can be inferred from the Commission's discussion, which would allow for the creation of one instrument for all consumer sale contracts within the internal market. Such a broad coverage is clearly preferable to the extent that it would allow for the benefits derived through the adoption of a horizontal instrument to be maximised.

The Commission's final proposal was to maintain the status quo and take no legislative action at all. This would leave the existing regulatory fragmentation in place, with the potential that it could in fact increase with the continued use of minimum harmonisation clauses.³⁴

The proposals, and the questions and issues surrounding them, were formally put forward for consultation in Annex I of the Green Paper. It was felt that the first option, and thus the continuation of the vertical approach, did not require an extended list of questions as these had already been dealt with in the context of the consultations on European contract law and in the activities which accounted for the diagnostic phase of the review proposal.³⁵ Attention was thus focused on a potential change of regulatory policy and the adoption of a horizontal/mixed approach to regulation, in particular a horizontal framework instrument.³⁶ The focus on horizontal issues can be considered as necessary and therefore warranted, to the extent that the adoption of this proposal would provide a suitable means to address the problems identified in relation to the existing *acquis* and

³²Green Paper (2006), 9.

³³Ibid. 9.

³⁴Green Paper (2006). 9.

³⁵Outlined in Section 2.1 of the Green Paper.

³⁶Green Paper (2006), 11.

regulatory approach. Consideration must, however, also be given to the manner in which the Commission conducted the consultation in order to determine the extent to which the Commission met its own wider consultation aims.

The consultation began by asking for opinions on the best approach to be taken to the review, based upon the 3 proposals that had been discussed at length earlier in the Green Paper.³⁷ The phrasing of this question can be criticised as leading,³⁸ as although it presents three options it is clear from the foregoing discussion that the status quo could not continue, and this achieved almost unanimous agreement from respondents, with 98% in favour of some form of EU action.³⁹ It thus appears that certain options, which were in fact not real options, were included for the sake of appearances.⁴⁰ This raises early concerns for the transparency of the Commission's approach and their true intentions in regard to the outcome. Similar criticism can be levelled at question 2, which concerned the preferred scope of a possible horizontal instrument, as the earlier discussion clearly favoured the creation of a horizontal instrument which would apply to both domestic and cross-border transactions.

The third question concerned the level of harmonisation of the revised directives or new instrument. Here, the Commission can be criticised to the extent that they present this as an issue independent of the legislative option chosen to revise the acquis,⁴¹ as the two issues are inextricably linked. It is clear from the fragmentary state of the acquis that the continuation of a vertical approach, on a minimum harmonisation basis, is not maintainable. Despite this, minimum harmonisation was placed alongside full harmonisation as a possible basis of harmonisation for the revised legislation. It was proposed that if minimum harmonisation were preferred it could be combined in the first place with a mutual recognition clause or in the alternative with the country of origin principle. In the first case Member States would retain the ability to introduce stricter

³⁷ Question A1. Note that all options were indicative and non-exhaustive.

³⁸ Rutgers and Sefton Green (2008), 431.

³⁹ Table 3.2. Detailed Analysis of the Responses to the Green Paper, Analytical Report on the Green Paper on the Review of the Consumer Acquis submitted by the Consumer Policy Evaluation Consortium, http://ec.europa.eu/consumers/rights/detailed_analysis_en.pdf.

⁴⁰ Rutgers and Sefton Green (2008), 431.

⁴¹ Green Paper (2009), 10.

rules of consumer protection in their national laws; however, they could not impose those requirements on businesses established in other Member States in such a way as to create an unjustified restriction on the free movement of goods or services.⁴² Such an approach would thus ensure a high level of consumer protection at the national level with the safeguard of common European standards when contracting with a business in another Member State. It would prevent the creation of new obstacles to trade caused by divergent regulation at the national level. In the alternative, where minimum harmonisation could be combined with the country of origin approach, Member States could introduce stricter rules nationally; however, to simplify matters, businesses established in other Member States would only have to comply with the rules applicable in their home country. However, it is clear, and is acknowledged by the Commission, that neither option would aid the simplification of the regulatory environment and fragmentation would continue.⁴³ Although businesses would benefit from increased legal certainty, this would be to the detriment of the consumer, whose confidence would be undermined. Neither option, therefore, provides a tenable approach for the review of the acquis. The same arguments would apply to the Commission's proposal to combine the adoption of a full harmonisation approach with a mutual recognition clause for the issues which, although covered by the legislation, are not fully harmonised. This is intended to avoid the re-creation of barriers, where full harmonisation is not possible.⁴⁴ Even under a full harmonisation approach, therefore, fragmentation would continue to exist in certain areas, but it could be anticipated that the impact would be reduced with a transition to full harmonisation where possible.

In response to the issue of the degree of harmonisation, there is a clear business/consumer divide in favour of full and minimum harmonisation respectively.⁴⁵ A preference as to whether it should be joined by the principles of mutual recognition or country of origin, however, is more difficult to discern, as the Commission's options were greeted with little enthusiasm by respondents. Thus, with regard to those who favoured minimum

⁴² Green Paper (2006), 11.

⁴³ Ibid.

⁴⁴ Green Paper (2006), 11.

⁴⁵ The reasons and implications of which are considered in section 4.1.3.

harmonisation,⁴⁶ the majority opted for minimum harmonisation with no variant attached to it.⁴⁷ This was closely followed by support for “other option”.⁴⁸ This trend was also apparent in regard to the variant to be combined with full harmonisation, as while the majority⁴⁹ was in favour of targeted full harmonisation with mutual recognition as the variant, 21% favoured full harmonisation with another variant. In regard to other potential variants, a high proportion of respondents were in favour of the country of destination principle rather than the country of origin principle, in accordance with Rome I. Indeed, this option is a clear omission in the Commission’s proposals,⁵⁰ which overlooks the relationship between the end proposal and its link with European choice of law rules, which applies the law of the consumer’s habitual residence in regard to consumer protection rules.⁵¹ The inclusion within the proposal of a variant other than the country of destination would be in direct conflict with Article 6(2) of the Rome I Regulation which provides that the law chosen by the parties cannot deprive the consumer of the protection granted by the law of his country of residence. Such a change would, as recognised by the Commission, require legislative amendment to Rome I shortly after its adoption, and would involve a major change in EU consumer policy.⁵² The result, in this respect, is that the status quo must be maintained, and it is questionable, therefore, why the possibility of including such a variant was the subject of discussion.

In evaluating the manner in which the Commission conducted the consultation, concerns do exist. These arise in regard to the transparency of the approach and of the Commission’s true intentions, to the extent that, although perhaps justified on the basis of

⁴⁶ 24% of total respondents, Detailed analysis of response, 48.

⁴⁷ 35%.

⁴⁸ 30%. Minimum harmonisation and mutual recognition or country of origin principle was favoured by 13%, minimum harmonisation and mutual recognition by 12% and minimum harmonisation and country of origin principle by 10%, Detailed analysis of response, 48.

⁴⁹ 52%, for the reasons discussed below, the majority was most probably dominated by businesses, which comprised the largest groups of respondents (150), compared to consumers, who were the second largest group with 53 responses, Detailed analysis of response (2007), 5.

⁵⁰ One which is highlighted by consumer groups, Detailed analysis of response (2007), 50.

⁵¹ Article 6 (1) Rome I Regulation.

⁵² Unsurprisingly, therefore, the resulting proposal for a Consumer Rights Directive does not provide for such a variant and its provisions are without prejudice to Rome I. Proposal for a Directive of the European Parliament and of the Council on Consumer Rights, COM (2008) 614 final, 5 and recital 10.

the identified problems and issues, the Commission had its end object in view. Further, it is felt by some that the Green Paper fails to address and highlight, particularly in light of the relationship between the issues, many important questions. These include the wider issues identified as being central to the debate and the way forward.⁵³ In particular, when it is apparent that the Commission's preferred option is the creation of a fully harmonised, horizontal instrument of consumer contract law, it is a significant omission that the consultation failed to ask whether this was considered to be a suitable or desirable outcome of the review. It is, therefore, unsurprising that following the Green Paper, as well as other references made to the review by the Commission in the wider European contract law project,⁵⁴ what was expected in terms of the resulting proposal was an EU consumer code.⁵⁵

4.1.3. The Outcome of the Public Consultation: A Directive on Consumer Rights

The outcome of the review was a proposal to create a Consumer Rights Directive (CRD). The Commission concluded that the majority of respondents to the Green Paper had called for the adoption of a horizontal legislative instrument applicable to domestic and cross border transactions, based on full targeted harmonisation, and thus of those issues which raised substantial barriers to trade for business and/or deterred consumers from buying cross-border. The horizontal instrument would be combined with the vertical revision of the existing sector-specific directives.⁵⁶ The final proposal seeks to decrease existing fragmentation by regulating the common aspects of the contract of sale for consumer goods⁵⁷ in a systematic fashion and consolidates four vertical directives⁵⁸ in a

⁵³ Ibid. 432 and see Micklitz and Reich, *European Consumer Law – quo vadis?* Comments on the Commission's Green Paper on the Review of the Consumer Acquis (2007)), http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/responses/micklitz_reich.pdf, 15.

⁵⁴ See for example earlier discussion of Commissioner Kyprianou's speech and that of Commissioner Kuneva who said that one of the objectives of her consumer strategy was 'to establish a single, simple set of rights and obligations Europe – wide', 'European Consumer Policy in the 21st Century', speech given at the Challenges and Opportunities for the Transatlantic Agenda Conference (Cambridge, October 2007), cited by Rutgers and Sefton Green (2008), 430.

⁵⁵ See Rutgers and Sefton Green (2008), 430 and Turro, Federation of European Direct Selling Associations (FEDSA) speech to the First European Discussion Forum (2005), 3.

⁵⁶ Consumer Rights Proposal (2008), 5.

⁵⁷ Ibid. 2.

single instrument and set of rules. It seeks to improve the functioning of the B2C internal market by enhancing consumer confidence through a high common level of consumer protection and adequate information about their rights and how to exercise them.⁵⁹ Businesses would benefit from this new confidence, and the simplified contract regime, which would result in an increased willingness by them to engage in transactions which they would otherwise have been reluctant to enter in the past, owing to disparities in national consumer rules. It is, therefore, necessary to examine the proposal with a view to ascertaining the extent to which it meets these objectives, and thus ultimately the Commission's objectives in conducting the review.

To begin with the content of the proposal, it is limited to the key aspects of consumer contract law which are relevant for trade. That is to say, those relevant for traders when they draft their standard contract terms, design their information materials and for the operation of their businesses.⁶⁰ As such, it is not seen as interfering with more general contract law concepts such as the capacity to contract or the award of damages.⁶¹ Indeed, in line with *acquis* review objectives, the proposal is presented as little more than a simplification exercise,⁶² allaying the fears of some business stakeholders who have expressed a desire to limit the scope of the instrument. Some have advanced that the instrument should be limited to key notions of consumer protection, such as common definitions and pre-contractual information, and in that regard the revision should be limited to the harmonisation or alignment of such definitions and not seek to extend the scope of the consumer *acquis*.⁶³ Others, however, have opposed the introduction of a horizontal instrument because there is too little content to regulate. That is to say, it would not be enough to base a horizontal instrument on the limited number of vertical directives consolidated in the proposal. Under this view, the examples given by the Commission, such as a harmonised definition of consumer and professional or of the

⁵⁸ Doorstep Selling Directive (1985/577/EEC), Unfair Contract Terms Directive (1993/13/EEC), Distance Selling Directive (1997/7/EEC), Sale of Consumer Goods and Associated Guarantees Directive (1999/44/EEC).

⁵⁹ Consumer Rights Proposal (2008), 2.

⁶⁰ *Ibid.* 7.

⁶¹ *Ibid.*

⁶² Consumer Rights Proposal (2008), 10.

⁶³ Detailed analysis of response (2007), 44.

period of the right of withdrawal and how to exercise it, do not justify the creation of such an instrument. It is clear, therefore, that whether the horizontal proposal will gain support will depend to a large extent on its scope: while many favour limiting its scope others seek an ambitious instrument from the Commission.

The proposed Directive sets out to consistently regulate certain common aspects of business to consumer contracts and begins in Chapter I⁶⁴ by defining the key terms within the directive, including harmonised definitions of ‘consumer’ and ‘trader’.⁶⁵ In regard to the scope of the directive, Article 3 makes clear that, subject to the conditions within the directive, it applies to sales and service contracts concluded between the trader and consumer, and that certain provisions will extend to apply to areas of otherwise vertical regulation, including package travel, timeshare and financial services.⁶⁶ The Chapter ends by establishing the principle of full harmonisation upon which the proposal is based.⁶⁷

Chapter II⁶⁸ details core information duties which the trader must provide the consumer with prior to the conclusion of any sales or service contract and establishes the consequences of failure to provide such information. The proposal distinguishes between the information requirements which must be complied with in distance and off-premises contracts and those conducted on premise. The effect is that in addition to compliance with Chapter II, traders involved in distance and off-premise transactions must also comply with the additional information requirements provided for in Chapter III.⁶⁹ This is the effect of Article 9, and is without prejudice to the general requirement provided for in Article 5(1) (d), which requires that the arrangements for payment, delivery and performance are provided only where they depart from the requirements of professional diligence. In the case of distance and off-premise contracts, this information must always be provided.⁷⁰ The reason for the distinction is that such information should be more

⁶⁴ Articles 1-4, Subject matter, definitions and scope.

⁶⁵ Article 2 Definitions.

⁶⁶ Article 3 (2) and (3), this extension of scope and relationship between the existing vertical acquis in these areas and the proposal will be discussed below.

⁶⁷ Article 4.

⁶⁸ Chapter II Consumer Information, Articles 5 – 7.

⁶⁹ Chapter III, Consumer information and withdrawal right for distance and off-premises contracts.

⁷⁰ Article 9 (a).

readily apparent in the context of an on- premise transaction as compared to that conducted off-premise.⁷¹ Chapter III provides for the right of withdrawal from such contracts and introduces a major improvement to the current system of consumer protection by providing for a withdrawal period of 14 calendar days in the case of distance and off-premise contracts.⁷² This period presently stands as a seven day minimum harmonisation requirement. Many Member States have thus extended beyond the latter period, leading to the associated fragmentation of consumer protection. This has been exacerbated by the fact that the current directives do not specify whether working or calendar days be used in the calculation, which has meant that Member States have also implemented the minimum period divergently in this regard. The new provision will thus enhance certainty for both businesses and consumers and should lead to a reduction in compliance costs.⁷³

Chapter IV concerns consumer rights specific to sales contracts, including rules on delivery, passing of risk, non-conformity and commercial guarantees.⁷⁴ The chapter is limited to the sale of goods, and as such for the purpose of mixed contracts the chapter will only apply to the goods.⁷⁵ This limitation in scope is subject to criticism. It excludes services from its scope, and together with the definition of goods under the Directive, which is limited to any ‘tangible moveable item’⁷⁶ the chapter fails to provide remedies for faulty services and digital products, and thus to fully simplify remedies for consumer sales and services contracts.⁷⁷

This is part of a wider criticism, concerning the extent to which the proposal regulates contracts for digital services, i.e. downloadable software and data. While the information requirements of chapter II and the rules on unfair contract terms in chapter V apply,

⁷¹ Recital 17.

⁷² Article 12 and for reference as to calendar days, recital, 24.

⁷³ For support for this move, see the UK Department for Business, Enterprise and Regulatory Reform (BERR), in their consultation on the Commission’s proposal, <http://www.berr.gov.uk/files/file48791.pdf> para 70- 74 and also recital 22, Consumer Rights Proposal (2008).

⁷⁴ Articles 21 – 29.

⁷⁵ Article 21 (1), without prejudice to Article 24 (5).

⁷⁶ Article 2 (4).

⁷⁷ The rest of the directive is extended to services.

digital products are excluded from the scope of chapter IV.⁷⁸ This limitation is surprising given that an express objective of action was to review the *acquis* in order to keep apace with new market developments, particularly in the face of the growing importance of digital technology and digital services. These, as the Commission recognised in the Green Paper, raise controversial issues relating to user rights, as compared to the sale of physical goods.⁷⁹ However, the question of whether the scope of consumer sales rules should be extended to cover contracts where digital content services are provided to consumers raised significant debate in response to the Green Paper.⁸⁰ The majority of stakeholder groups were of the opinion that these types of contracts should be covered by the consumer sales rules.⁸¹ The business sector, however, which was comprised by a significant number of digital service providers, stood out in strong opposition to the inclusion of such services within the scope of the proposal. They highlighted the specificity of software in comparison with tangible goods and thus the distinct nature of their service.⁸² Indeed, some were of the opinion that the regulation of digital content could not be undertaken as an extension of the consumer sales provisions, and that it may require the updating of existing instruments or indeed the creation of new specific instruments.⁸³ The debate on the way forward in this respect continues and the Commission has more recently made a call for tenders for a study on consumer problems related to digital content. The study will collect more information on issues such as non-conformity, which would otherwise be governed by Chapter IV of the proposal for tangible, moveable goods.⁸⁴ The approach of the proposed Directive further highlights the need for and the importance of maintaining vertical harmonisation and thus regulation of certain sectors, in conjunction with horizontal instruments where possible and necessary.

⁷⁸ A distinction is created as the purchase of a CD from a website does come within the scope of the Directive, but downloaded music does not, resulting in potential confusion for consumers. For criticism of this distinction and the limitation in scope of the proposal, see House of Lords European Union Committee - Eighteenth Report, EU Consumer Rights Directive: getting it right (2009) <http://www.publications.parliament.uk/pa/ld200809/ldselect/lddeucom/126/12602.htm>, Chapter 4.

⁷⁹ Green Paper (2007), 7.

⁸⁰ Question H1, Green Paper (2007).

⁸¹ Detailed analysis of response (2007), 91.

⁸² *Ibid.*

⁸³ *Ibid.* 92.

⁸⁴ Such issues have more recently been discussed at a conference organised by the Competitiveness Council, together with the Commission: "Consumer right when purchasing digital content", (Stockholm, 4.11.09), http://www.se2009.eu/en/meetings_news/2009/11/4/consumer_rights_conference.

In defence of the proposal, in regard to the review objective of updating the acquis in line with technological developments, the proposal does go some way to adapting the acquis to new sales methods, and is intended to cover all forms of consumers transactions, irrespective of the medium used.⁸⁵ As such it addresses some technological developments by introducing regulation for new channels for B2C transactions, which are not currently covered by consumer acquis, such as on-line ‘e-bay’ auctions.⁸⁶

Returning to the scheme of the proposal, Chapter V of the proposed Directive governs consumer’s rights concerning contract terms. The Chapter broadly reflects the provisions of the current Unfair Contract Terms Directive, applying to those terms which have not been individually negotiated, i.e. standard contract terms. In a marked improvement to the approach of the existing Directive, however, the proposal provides for two lists of unfair terms. Those contained in Annex II, are terms which are to be considered in all case as unfair, while those terms listed in Annex III should be deemed unfair unless the trader can prove otherwise.⁸⁷ This development will improve upon the current position which provides merely an indicative and non-exhaustive list of unfair terms, and thus results in uncertainty.⁸⁸ It is important to note in this respect that the scope of application, and thus impact of this chapter, will be more far reaching than the others. Its provisions and the full harmonisation approach will be extended to apply to the Timeshare and Package Travel Directives as well as to financial services as regards certain off-premises contracts, as part of the extended scope of the Directive.⁸⁹ The expansion reflects that it will remain necessary as part of the review, that the creation of the horizontal instrument be combined with the vertical revision of the existing sector-specific directives (mixed approach).⁹⁰ To this end, with the repeal of the existing Unfair Contract Terms Directive, which would otherwise apply to these areas, the scope of the proposal must necessarily be extended.

⁸⁵ Singleton, Proposed New EU Laws – Consumer Rights Directive (2008) 16 10 (1) IT Law Today, and Taylor and Whitehouse, EC’s proposed Consumer Rights Directive – a welcome move for trading (2009), 17 1 (8) IT Law Today.

⁸⁶ Green Paper (2007), 7, for the definition of ‘auctions’ within the proposal, see Article 2 (15).

⁸⁷ In accordance with Article 32.

⁸⁸ Recital 50.

⁸⁹ Article 3 (2) and (3) of the proposal.

⁹⁰ Consumer Rights Directive Proposal (2008), 5.

To take the review of the Timeshare Directive as an example, although this was part of the original eight directives which were subject to review as a constituent part of the consumer acquis, it has been excluded from the scope of the horizontal instrument. It has instead been subject to vertical review,⁹¹ owing to the limited number of horizontal issues affected by the revision of the Directive.⁹² The characteristics of timeshare and other similar products clearly justify vertical regulation as it raises distinct issues for consumer protection,⁹³ which arise foremost from the nature and complexity of such contracts. In the first place, timeshare products are a combination of a repeated property lease and a service, which gives rise to legal complexity since it is not easy to understand the nature of the rights purchased by consumers, be they rights in rem, personal rights, etc. This is particularly as these rights will be defined differently in the legislation of Member States.⁹⁴ This is exacerbated by the often substantial financial commitment which arises from the contract and the fact that these commitments are often undertaken for a long period of time. Timeshare is also a product which is characterised by the manner in which it is marketed, i.e. away from business premises, such as door to door or at a holiday resort itself, and thus away from the consumers home. This factor alone is felt by some as justifying targeted legislation in this area.⁹⁵ Responses to the Review Green Paper maintained, in light of the foregoing, that an even longer cooling-off period, i.e. than that would be applicable to other distance contracts within the scope of the horizontal instrument,⁹⁶ would be required for such contracts in order to be commensurate with the risk to the consumer.⁹⁷ This view is now reflected in the revised Timeshare Directive,⁹⁸

⁹¹ Similar considerations of a vertical nature apply to the Package Travel Directive (also part of the original review), which has been subject to a two sector-specific public consultation for its review, most recently in November 2009. No proposal has yet been made for its review.

⁹² Commission Staff Working Document accompanying the proposal for a directive on consumer rights Impact Report (2008), http://ec.europa.eu/consumers/rights/docs/impact_assessment_report_en.pdf, 20.

⁹³ For a full overview of the characteristics of timeshare and similar products, see the Commission's consultation paper on the review of the Timeshare Directive, http://ec.europa.eu/consumers/cons_int/safe_shop/timeshare/consultation_paper010606_en.doc, 11.

⁹⁴ Ibid.

⁹⁵ Downes, More about Timeshare: A Revised Directive or a Regulation? Incidence of Other Instruments of Consumer Protection (2008) 4 European Review of Private Law 607, 616.

⁹⁶ Thus in favour of vertical revision and it should be noted that the proposed harmonised 14 day period in the CRD proposal had not yet been agreed.

⁹⁷ Detailed analysis of response (2007), 77.

⁹⁸ Directive 2008/122/EC of the European Parliament and the Council on the protection of consumers in respect of certain aspects of timeshare, long-term holiday product, resale and exchange contracts, Article 6 (1) and in line with the CRD proposal.

where the period provided for the consumer to withdraw from the contract has been extended from 10 to 14 days to reflect the above considerations, under a full harmonisation approach.

In the widest extension of the proposals' provisions, the consumer information duties and withdrawal rights for off-premise contracts, contained in Chapter III, and those information requirements in Articles 5 and 7,⁹⁹ extend to financial services as regards off-premises contracts.¹⁰⁰ Despite the general formulation of this extension, however, in the result the provisions will only apply to specific financial contracts concluded off-premise. Specifically, Chapter III will not apply to off-premise contracts concerning;¹⁰¹ insurance, financial services where the price depends on fluctuations in the financial market outside the trader's control, which may occur during the withdrawal period, as defined in the Directive on the Distance Marketing of Consumer Financial Services,¹⁰² and to consumer credit which falls within the scope of the Consumer Credit Directive.¹⁰³ In practice this means that mortgage credit contracts and consumer credit contracts for less than EUR 200 or more than EUR 75000, i.e. consumer credit contracts falling outside the scope of the Consumer Credit Directive, will be regulated by the CRD.¹⁰⁴

The limited extension of the proposals provisions is intended to fill existing regulatory gaps in this sector, e.g. for contracts falling outside the threshold of the Consumer Credit Directive. The failure of the proposal, however, to positively define those financial service contracts to which it extends, but rather to do so negatively, by reference to the sector-specific *acquis* with which the CRD will continue to co-exist is unfortunate. In

⁹⁹ By virtue of Article 9.

¹⁰⁰ Article 3(2).

¹⁰¹ Article 20 (2).

¹⁰² Article 6(2)(a) of Directive 2002/65/EC of the European Parliament and Council concerning the distance marketing of consumer finance services,. It is questionable whether reference to definitions in the sector-specific *acquis* aids the simplification aims of the proposals.

¹⁰³ Directive 2008/48/EC of the European Parliament and the Council on Credit Agreements for Consumer Contracts. The directive does not apply to consumer credit contracts for less than EUR 200 or more than EUR 75000, Article 2 (2).

¹⁰⁴ Commission's note on The Proposal for a Directive on Consumer Rights: Scope, Relationship with National General Contract law and Relationship with other Community Legislation (2009), http://ec.europa.eu/consumers/rights/docs/note_CDR_en.pdf, 3. N.b. This is a work in progress and the draft does not represent the official views of the Commission.

defining its scope, reference is made to the Directive on Distance Marketing of Consumer Financial Services, and the Consumer Credit Directive.¹⁰⁵ The CRD proposal, therefore, becomes part of a more complex regulatory structure of sector-specific *acquis* governing financial services, and in its current form, uncertainty will likely surround the extended scope of the proposal in this respect. A large number of Member States have, therefore, considered that financial services, due to the complexity of the area and the relationship that exists with specific legislation, should not be covered by the proposed Directive.¹⁰⁶ To this end, the Presidency compromise text on the proposed CRD has proposed removing financial services altogether from the scope of Chapter III.¹⁰⁷ This change would be desirable given the uncertainty that will be created by the extended scope of the proposal in this respect, which cannot be justified by the narrow scope of that extension to a limited number of financial services. The effect, however, will be that the scope and thus impact of the proposal, and the move to full and horizontal harmonisation becomes narrower.

While the move to horizontal regulation was, therefore, intended to address one source of fragmentation and regulate consumer contract law in a more systematic and coherent fashion, it is evident that this has been achieved with varying degrees of success. On the one hand four directives have been consolidated into one. By replacing the Distance Selling and Doorstep Selling Directives, for example, the applicable information requirements and rules on the right of withdrawal for contracts of sale and services are contained within one instrument. These rules, however, exist as the *lex generalis* and co-exist with the sector-specific rules of the *acquis* which have precedence in the case of conflict.¹⁰⁸ Together with continued vertical regulation and review of sector-specific legislation, rules governing the same issue continue to be spread across the *acquis*, and thus the objective of simplifying the regulatory environment is not wholly realised in this respect. This limitation is, however, justified by the limited number of horizontal issues

¹⁰⁵ Article 20 (2) of the CRD proposal.

¹⁰⁶ See Competitiveness Council Conclusions, 4 December 2009, 10, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/intm/111732.pdf.

¹⁰⁷ Article 8 (1) (a) of the Presidency compromise text, Interinstitutional File: 2008/0196 (COD) November 2009, <http://register.consilium.europa.eu/pdf/en/09/st15/st15166.en09.pdf>.

¹⁰⁸ Commission's note on the CRD proposal (2009), 2.

that exists between directives, the need for continued sector-specific regulation in certain areas, and thus the need for the mixed approach that is being pursued. It is also clear that greater convergence is being achieved between the areas under vertical review, and with the Commission's horizontal proposal.¹⁰⁹ The proposed 14 days withdrawal period in the CRD for example, already finds expression under a full harmonisation approach, and for sector-specific reasons, in the revised Timeshare Directive, and the Distance Marketing of Consumer Financial Services Directive. It is also now replicated in the revised Consumer Credit Directive,¹¹⁰ in an attempt to approximate the procedures for the right of withdrawal in similar areas.¹¹¹ While greater coherence is thus being achieved under this mixed approach, the issue is whether this is sufficient to create the simplified and predictable regulatory environment necessary for businesses and consumers to engage in cross-border trade.¹¹²

Further concerns arise from the transition to full harmonisation in the proposal as a response to the other cause of fragmentation: minimum harmonisation. In particular, this change has clear repercussions for consumer protection within the internal market, and the level at which this will be set within the *acquis*.¹¹³ The level will be an important determining factor as regards the extent to which the reviews objectives will be achieved, and should not compromise the accomplishments made to date in this politically sensitive area, which has been achieved through a combination of EU and national law.¹¹⁴ As Member States will no longer be able to maintain or adopt provisions which diverge from the CRD, however, the concern is that the proposal will deprive some consumers of their existing rights. If this is the case then the confidence which the proposal seeks to create for consumers, through the creation of one common set of rules, would be undermined. From the consumer's perspective, therefore, nothing but a high level of protection can be

¹⁰⁹ Although, critically without the input of the (D)CFR, see discussion in 4.3.

¹¹⁰ Article 14.

¹¹¹ Namely with the Distance Marketing of Consumer Financial Services Directive, Recital 34.

¹¹² This issue is addressed further in Chapters 5, 5.3 and 6, 6.4.2.

¹¹³ The level of protection within the CRD Proposal is discussed further in Chapter 6, 6.4.2.

¹¹⁴ For this reason, the *Acquis Group* advances that full harmonisation is not appropriate for consumer sales because of the negative effects which this can have on the current protection of the consumer through provisions made by the Member States, *Acquis Group Position Paper on the Proposal for a Directive on Consumer Rights* (2009) Oxford University Comparative Law Forum 3 at ouclf.iuscomp.org, 4.

accepted,¹¹⁵ and unsurprisingly, in response to the Commission's Green Paper on the review of the acquis, the largest group within the consumer sector preferred the continuance of minimum harmonisation.¹¹⁶

The protection afforded to consumers by the proposal also impacts upon businesses ability and desire to engage in cross-border trade. Too high a level would undermine the economic benefit that they seek to derive from the move to full harmonisation. It is anticipated that businesses will benefit from much lower administrative costs as a result of the move, and that compliance costs will be cut by up to 97%,¹¹⁷ where they comply with the fully harmonised information requirements set out in the proposal, as an integral part of the sales or service contract.¹¹⁸ This reduction in costs will not only be significant for those businesses engaging in cross-border trade,¹¹⁹ but also those who are currently only trading domestically, but that are considering expansion.¹²⁰ A move to full harmonisation thus offers a significant opportunity for such businesses. It is seen however, to impact negatively on those businesses only trading domestically, as they will be subject to what is viewed as the small 'one-off' costs of adaptation to the new regulatory regime.¹²¹ These costs must however be considered in light of the net effects of the proposal in other respects.¹²² If the level of protection is established too high, however, higher costs for businesses will result once again, reducing the benefits which are anticipated from the full harmonisation approach. Costs arising from this would invariably be passed on to the consumer which will undermine the stimulating effect on trade that the Commission believed that the proposal would have.¹²³ The move to full

¹¹⁵ The EU is bound to achieve a high level of consumer protection in the proposal, Article 169 TFEU.

¹¹⁶ 31%, Detailed analysis of responses (2007), 48.

¹¹⁷ Press Release of 8 October 2008 (Brussels), Consumers: Commission proposes EU-wide rights for shoppers, <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1474&format=HTML&aged=0&language=EN>.

¹¹⁸ CRD Proposal (2008), 8 and Article 5 (3).

¹¹⁹ Commonly with one or two other M.S. See, Eurobarometer 224 (2008), 28.

¹²⁰ Particularly as retailers who are already trading cross-border are less concerned by the regulatory differences compared to those who have no experience of such activity, Eurobarometer 224 (2008), 27.

¹²¹ CRD Proposal (2008), 8.

¹²² On the winners and losers of the proposal, see generally, the Impact Assessment Report Accompanying the Proposal (2008), 40.

¹²³ Detailed analysis of responses (2007), 35.

harmonisation may, therefore, detrimentally impact upon the interests of businesses and consumers alike.

In the result, however, and as expected, greater concern and opposition has arisen in regard to a loss of protection in the CRD. This arises not only in terms of the current (national) level of protection, but also in regard to the nature and content of those rights. The UK government has, for example, expressed concern in regard to the loss of the immediate right to reject under the proposal, and has sought amendment to allow for the national right to reject faulty goods for a short and reasonable period to be retained in the UK.¹²⁴ In order to address such concerns, and to clarify how the proposal will affect the existing consumer protection levels in the Member States, the Commission has produced a comparative table identifying where there would be a change in the level and/or nature of protection.¹²⁵ The table provides examples of where the level of consumer protection will increase in some Member States, but this is joined by the fact that the provisions will often maintain the status-quo, or result in a loss of protection. For example, while the proposed EU-wide 14 days cooling off period for distance and off-premises contracts reflects the current level of protection in 9 Member States, it leads to an increase in protection in 15, but a loss of protection in 2 Member States.¹²⁶ This outcome is unavoidable with the adoption of a full harmonisation approach and demonstrates the difficulty in reaching agreement on an acceptable level of protection, even where there is a consensus among some Member States. While some consumers will gain from certain provisions, others will invariably lose out as a result,¹²⁷ and this may well serve to undermine consumer confidence in the new regime.

¹²⁴ Law Society EU Update on Consumer Protection (September 2009), 13. Discussed further below. Similar concerns arise in regard to the guarantee for hidden faults under the French domestic system. See, the Commission's note on the CRD proposal (2009), 5.

¹²⁵ Available at; http://ec.europa.eu/consumers/rights/docs/comparative_table_en.pdf (October, 2009). N.b. The comparative table does not purport to provide an exhaustive analysis of the effects of the proposal on national laws, which would require a thorough screening of the national laws and is intended as a living document, 1.

¹²⁶ Comparative table (2009), 7.

¹²⁷ Article 12 CRD, providing for the starting point of the withdrawal period for off-premises contracts is an example of where there is a loss in protection, maintenance of the status quo in certain Member States, but no increase, comparative table (2009), 7.

Remedies for non-conformity are an area where consumer protection would in fact be reduced under the proposed full harmonisation approach.¹²⁸ In the first place we have encountered the UK concern in regard to the loss of the immediate right to reject. Under Article 26 of the CRD, the trader must, in the first instance, remedy the lack of conformity either by way of repair or replacement.¹²⁹ This is unless the trader can demonstrate that this remedy would be unlawful, impossible or would cause them a disproportionate effort. Then, or subject to the additional circumstances further outlined in Article 26,¹³⁰ the consumer may choose to have the price reduced or the contract rescinded.¹³¹ This two-stage hierarchy of remedies under the proposal maintains the position under the existing *acquis*, in the Consumer Sales Directive.¹³² The detrimental and complained off effect in terms of consumer protection therefore arises from the move to full harmonisation, as this suggests that the Member States cannot retain their sales remedies within the scope of the Directive. As such Member States, such as the UK, would no longer be able to provide that the consumer can immediately demand their money back in the case of non-conformity, and this would have a negative effect on the legal situation for consumers in such Member States.¹³³

This provision is further criticised from the perspective of consumer protection, as it places the right to decide between repair and replacement with the trader. This reverses the current *acquis*¹³⁴ where the choice lies with the consumer, in the interest of the latter party.¹³⁵ The reversal clearly shifts the balance in favour of the trader,¹³⁶ and gives rise to the view that what is being created in the CRD is a business driven instrument. It has

¹²⁸ See, Twigg-Flesner, *Fit for Purpose? The Proposal on Sales in: Modernising and Harmonising Consumer Contract Law*, Howells and Schulze, Munich: Sellier, 2009, 159.

¹²⁹ Article 26 (2).

¹³⁰ Article 26 (4), See Twigg-Flesner (2009), 159.

¹³¹ Article 26 (3).

¹³² Article 3 (3).

¹³³ Discussed by Howells and Schulze, *Overview of the Proposed Consumer Rights Directive*, in: *Modernising and Harmonising Consumer Contract Law*, Howells and Schulze, Munich: Sellier, 2009, 19. This result finds little support. See for example, Beale, *The Draft Directive on Consumer Rights and UK Consumer Law – Where Now*, in: *Modernising and Harmonising Consumer Contract Law* (above), 291 and 293. Beale argues there that the consumer should be given a right to reject non-conforming goods immediately, rather than having to first go through the hierarchy provided under the proposal.

¹³⁴ Article 3 (3) of the Consumer Sales Directive.

¹³⁵ See, Howells and Schulze (2009), 20.

¹³⁶ Twigg-Flesner (2009), 159.

been highlighted, however, that the result is indicative of the problems associated with pursuing consumer rights within the context of the internal market, and with Article 114 TFEU as the legal basis, as the interests of the consumer will always have to be balanced against those of the trader.¹³⁷

This balance is, however, at the cost of the consumer confidence which the proposal sought to enhance.¹³⁸ A particular concern that arises in regard to the proposal is a loss of consumer protection where the previously minimum levels of protection under the *acquis*, are made the ‘maximum’ under the proposal.¹³⁹ An example¹⁴⁰ is Article 28 of the CRD proposal, which provides that the consumer must inform the trader of the lack of conformity within two months from the date on which they detected the lack of conformity if they are to be entitled to the remedies detailed in Article 26. The Consumer Sales Directive, however, only provides that Member States may provide that, in order to benefit from their right, the consumer must inform the seller within this period. The transition of this provision to a maximum harmonisation basis will thus lead to a reduction in protection in those Member States who did not enact this provision, and thus provided for a longer period.¹⁴¹ It is noted that this will not only have a negative effect on the position of consumers, but that the two month notification period also has practical implications which may also have a negative impact on cross-border trade. It is considered that it will act to discourage consumers from acquiring goods when they are abroad, as if they cannot return defective goods within that period, they will be denied a remedy under the proposal.¹⁴²

It is clear, therefore, that the CRD proposal does not always realise its objectives. While a move to full harmonisation is clearly in the interest of businesses,¹⁴³ to the extent that it

¹³⁷ Ibid.

¹³⁸ While also reducing business reluctance to trade cross-border. Discussed in 4.1.3 and Consumer Rights Proposal (2008), 2.

¹³⁹ Howells and Schulze (2009), question fundamentally how a maximal harmonisation approach can enhance consumer confidence, when it seeks to set the existing minimum as a maximum, 8.

¹⁴⁰ Discussed, Ibid.

¹⁴¹ For example, the consumer in Belgium or Poland has the period of one year within which to notify the trader. See further the comparative table (2009), 15.

¹⁴² Howells and Schulze (2009), 8.

¹⁴³ Provided that the level of protection is not too high.

creates a more simplified regulatory environment and will address their reluctance to engage in cross border transactions, the resulting removal or reduction of important consumer protection rights will not increase consumer confidence.¹⁴⁴ Beale concludes that the “draft is less about creating confident consumers who will be prepared to shop across borders and thus contribute to the development of the internal market than it is about making it easier for businesses to supply consumers”.¹⁴⁵

In terms of the concern expressed by the UK, the Commission has clarified¹⁴⁶ that it is not the intention in fully harmonising the specific consumer remedies to preclude Member States from retaining their traditional contract law remedies. The impact of full harmonisation on this topic should, therefore, be rather limited.¹⁴⁷ As such, in most Member States, as the consumer rights remedies co-exist with the traditional contract law remedies, the consumer in the UK would retain the choice between the use of the harmonised consumer sales remedies or the right to reject. The result, however, in a concession¹⁴⁸ made to the national contract systems, is that full harmonisation of consumer sales remedies is not realised, and a dual regime, reliant on both European and national contract law, is created.¹⁴⁹ The result, more generally, will be uncertainty as to what falls within the scope of the Directive, and thus subject to full harmonisation, and what rules Member States are free to maintain, i.e. higher levels of protection.¹⁵⁰ The dividing line is certainly not clear, and the CRD creates a pretence as to the full and horizontal nature of the regime created therein. This will be detrimental also for

¹⁴⁴ The Law Commission expressed concern that the potential loss of the “right to reject” under UK law would reduce consumer confidence, House of Lords, European Committee, Eighteenth Report, EU Consumer Rights Directive: getting it right, (2009), para 162.

¹⁴⁵ Beale (2009), 289. While conceding that despite some aspects of the draft giving cause for serious concern, consumers would remain fairly well protected. And even if it will do little to increase consumer confidence, it might increase consumer welfare if it encourages businesses to enter cross-border consumer contracts, in terms of greater choice and competition.

¹⁴⁶ Commission’s note on the CRD (2009), 5.

¹⁴⁷ Ibid 5-6.

¹⁴⁸ This being just one example of a concession or compromise being made by the CRD proposal in this respect, see discussion in Chapter 5, 5.3.

¹⁴⁹ The Commission’s note on the CRD (2009) highlights that a number of Member States have expressed doubts about the practicality of the dual regime that it is created, with some seeking the exhaustive harmonisation of consumer remedies for faulty goods, including a right to reject, although this is not presently the case, 5.

¹⁵⁰ Beale (2009), highlights these concerns further in regard to the regulation of unfair terms, and the effect of full harmonisation on the “blacklisted terms”, 294.

businesses, and will undermine the benefits that they are intended to derive from the proposal.¹⁵¹

The extent to which the proposal can achieve the simplified regulatory environment necessary for businesses and consumers contracting in the internal market is thus once again open to question. While the CRD proposal results in some substantive improvements,¹⁵² it is clear that the proposal does not fully realise the Commission's objectives in conducting the review of the consumer acquis. This can be principally attributed to the narrow scope and targeted nature of the proposed instrument. While confined to key aspects of consumer contract law relevant for trade, the impact of the regulatory move to horizontal and full harmonisation is limited to four directives. Although the proposal's provisions are extended to the area of financial services, the regulatory impact of this extension would again will be limited, and uncertainty would likely result from the proposals failure to define positively those financial services to which it extends. In the area of financial services, as with the existing sector-specific acquis in general, the proposal's provisions will form part of the wider, fragmented EU regulatory framework, which will continue to be regulated and reviewed on a vertical basis. While greater coherence is being achieved by the mixed approach to harmonisation, it is questionable whether this is sufficient. Further criticism has been directed at the proposal's failure to fully simplify an important area of consumer contract law, namely remedies. Chapter IV excludes both services, and digital products¹⁵³ from the scope of its provisions, and the consumer remedies contained therein will co-exist with national contract law remedies. A wholly simplified and predictable regulatory framework does not, therefore, result from the proposal. Despite the move to full and horizontal harmonisation, fragmentation of the regulatory environment will continue.¹⁵⁴ It is doubtful that in its present state, the CRD provides a sufficient regulatory response to obstacles for trade at this level, and that, therefore, it poses the most appropriate way forward for European contract law.

¹⁵¹ The relationship between the CRD and national law, and the extent to which this undermines full harmonisation is considered further in Chapter 6, 6.4.2.

¹⁵² For example the full harmonisation of the withdrawal period.

¹⁵³ Failing, in part, to satisfy the objective of updating the acquis in light of new market developments.

¹⁵⁴ The causes and effects of the fragmentation are discussed further in Chapter 6, 6.4.2.

4.2. The Common Frame of Reference

4.2.1. The Proposal and Objectives

While the review of the *acquis* and the horizontal approach of the CRD are intended to address the cause of internal inconsistency within the *acquis*, and thus one source of fragmentation at this level, this was only part of the response. The Commission also proposed the creation of a CFR to address the problem, which arises from the use of sectoral harmonisation, with the result that the existing piecemeal legislation lacks coherence and consistency. Similar situations are regulated inconsistently between directives and the *acquis* is characterised by the use of abstract terms which are often undefined and considered too broad.¹⁵⁵ This not only undermines the coherence of the *acquis* as a whole, but also creates problems at the national level, for the implementation and application of such measures. Inconsistency also exists, therefore, at the national level. There is a clear need for aligned and consistent EU rules, including fully harmonised definitions, to improve the consistency of the *acquis* and to facilitate the move to a more coherent horizontal approach. The creation of a CFR, establishing common principles, model rules and terminology for European contract law is thus seen by the Commission as an important instrumental step towards the improvement of the contract law *acquis*.

The principal objective and purpose of the CFR is to act as a legislative ‘toolbox’ for the Commission, as a means to review the existing *acquis*, and to assist in the creation of future measures.¹⁵⁶ The CFR should thus remedy and avoid in future the existing internal inconsistency, and will simplify the *acquis* by providing clear definitions of legal terms and fundamental principles.¹⁵⁷ In this way, it will avoid the presently conflicting results, and terms will be defined in a consistent manner. This will also aid consistent application of the *acquis* at the national level.¹⁵⁸ There is, therefore, a clear relationship between a

¹⁵⁵ For detailed criticism of the sectoral approach, see Chapter 2, 2.3.2.

¹⁵⁶ 2003 Communication, para 62.

¹⁵⁷ *Ibid.* para 57 and 64.

¹⁵⁸ 2003 Communication, para 57.

CFR and the review of the *acquis*, to meet the respective objectives of action. The ‘useful synergies’ between the two initiatives have been highlighted.¹⁵⁹

Beyond the principal legislative function, it is also envisaged that the CFR could be used to achieve a higher degree of convergence between the contract laws of the Member States.¹⁶⁰ Thus, as a legislative toolbox it could be used by national legislators as a point of reference and assistance when transposing directives, and could be drawn on when they enact legislation in the area of contract law which is not currently regulated at EU level.¹⁶¹ In the same way, it may assist and inspire national courts when interpreting and applying EU rules. Any resulting convergence in national contract systems can then be viewed as a by-product of the CFR’s legislative function.¹⁶² It is, however, envisaged by the Network of Excellence that the CFR, at least in its draft form, may act independently as a text from which inspiration may be gained for the development of private law issues. This would be in the same way that PECL influenced many higher courts in Member States, as well as bodies responsible for the reform and modernisation of national contract laws.¹⁶³ Therefore, even if limited to an academic text, the Draft CFR (DCFR) may contribute to an ‘informal’ Europeanisation of private law.¹⁶⁴

The third envisaged function of the CFR is to act as a basis for reflection on whether non-sector specific measures, such as an optional instrument, may also be required to solve the problems in European contract law.¹⁶⁵ The CFR is thus viewed as an attempt to formulate relevant rules and principles which would form the content of such an

¹⁵⁹ See for example, the inaugural speech of Commissioner Kyprianou, at the First European Discussion Forum (2005), 4. The relationship between the two initiatives is considered further in 4.3.

¹⁶⁰ As well as leading to convergence with the contract laws of appropriate third countries, 2003 Communication, paragraph 62.

¹⁶¹ *Ibid.* paragraph 60 and 2004 Communication, 5.

¹⁶² On this possibility and the potential impact of the CFR on national systems of contract law which may not only lead to convergence but also to tension between the European and national levels of regulation, see Hesselink, *The idea of codification and the dynamics of Europeanisation – the Dutch Experience*, (2006) 12 (3) *European Law Journal* 279, and Loos, *The influence of European Consumer Law on General Contract Law and the Need for Spontaneous Harmonisation*, (2007) *European Review of Private Law* 515.

¹⁶³ DCFR Outline Edition (2009), para 8, 7.

¹⁶⁴ *Ibid.* 10. The Network, however, highlights that this could only occur if the content of the draft text can convince those involved in the development of contract law at the national level, to draw upon it.

¹⁶⁵ 2003 Communication, paragraph 62.

instrument.¹⁶⁶ The issue that arises, however, is whether one instrument can accommodate all these purposes, as the risk is that by attempting to fulfil several diverse roles the final instrument may fall short of expectations.¹⁶⁷ The Network of Excellence has approached the DCFR as the development of an academic text, a legislative toolbox for the review of the *acquis* and as an optional instrument.¹⁶⁸ It is maintained that it has been continuously borne in mind that the text will undergo a political process before it can assume the latter roles and the drafting process has sought to facilitate progress to this end. The extent to which this has been achieved however, remains to be considered. The purpose of the next section is, therefore, to consider the suitability of the final draft from the perspective of its ability to undergo development into a political text, and then to serve as the basis of the Commission's proposals. A wider evaluation of the DCFR is not intended.¹⁶⁹

4.2.2. The Draft Common Frame of Reference: The Outline Edition

The DCFR outline edition¹⁷⁰ takes PECL as its starting point and foundation.¹⁷¹ It builds upon it to incorporate the *acquis communautaire* with the addition of new contractual model rules in this regard. In a similar vein to PECL, which incorporates rules applying to private law rights and obligations in general,¹⁷² the DCFR extends such coverage beyond the law on contracts.¹⁷³ Specifically, the DCFR extends to cover non-contractual obligations arising from unjust enrichment, tortious liability and benevolent intervention

¹⁶⁶ Ibid. paragraphs 64 and 95.

¹⁶⁷ For this concern, see Lim (2008), 4.

¹⁶⁸ DCFR Outline Edition (2009), from 36. On the CFR as the basis of an optional instrument, see, 46, para 80.

¹⁶⁹ I.e. the discussion is concerned with the choices that have been made in the creation of the harmonised instrument as regard to, for example, the structure, style, scope, and terminology, and is not intended as an evaluation of the content of the provisions therein.

¹⁷⁰ Published in January 2009, it appears without comments and notes in order to promote the wider dissemination and discussion of the text, which could be undermined by the volume of the complete edition. The Commission received the final text including the explanatory and illustrative commentary on each model rule in December 2008. DCFR Outline Edition (2009), 5, para 3.

¹⁷¹ PECL consisting of rules on formation, authority of agents, validity, interpretation, on the contents of contracts, performance, non-performance and remedies, both for non-performance specifically and those that apply in general, DCFR outline edition (2009), 23.

¹⁷² Ibid. Including rules on plurality of parties, on the assignment of rights to performance, on set-off and on prescription.

¹⁷³ DCFR Outline Edition (2009), 23.

in another's affairs. It also includes matters of movable property, such as transfer ownership, proprietary security and trust law.¹⁷⁴ The result, as the Network concedes, is an instrument that is considerably broader than that envisaged by the Commission's Communications. However, they justify their approach in terms of its future uses, which they maintain have a direct bearing on its coverage.¹⁷⁵

Regarding the CFR's function as a legislative toolbox, it was clear that the draft must cover the fields of application of the existing directives under review. It also had to extend to the *acquis* likely to be reviewed in the future, including those areas where further harmonisation may be considered, even where there is no immediate proposal for new legislation.¹⁷⁶ It was felt that all the general part of contract should also be covered in the CFR, in its role of providing definitions of the terms and concepts referred to in the *acquis*.¹⁷⁷ There are so few topics which are not at some point referred to in the directives, or at least presupposed by them, that it was considered simpler to include the whole of the general law of contract rather than to omit any areas.¹⁷⁸ In a similar vein, it is maintained that non-contractual, as well as contractual, rules are referred to or presupposed in the *acquis*. The consumer *acquis* often presupposes rules on unjust enrichment and the rules on pre-contractual information refer to or presuppose rules which in many Member States systems' are classified as tort.¹⁷⁹ Such areas should, therefore, be included, not because they are likely to be the subject matter of EU regulation in the near future, but because the existing legislation presumes that national systems provide the appropriate rules, without knowing whether they do so in a way which is compatible with EU legislation.¹⁸⁰ The inclusion of such rules will thus have instructional value, both for the EU legislator in devising legislation and for Member States, in its implementation. A clear link between the extended scope of coverage to

¹⁷⁴ Book I includes a list of areas which are excluded from its intended scope of application, I. - 1:101: Intended field of application.

¹⁷⁵ DCFR Outline Edition (2009) 40, para 66.

¹⁷⁶ *Ibid*, paragraph 68.

¹⁷⁷ DCFR Outline Edition (2009), 42, para 69.

¹⁷⁸ *Ibid*.

¹⁷⁹ DCFR Outline Edition (2009), 42, para 69.

¹⁸⁰ *Ibid*.

include non-contractual obligations and the CFR's future use as a legislative toolbox is thus made.

Guiding the Network's approach has been the desire to avoid the creation of a fragmented text, replicating a major fault in the existing *acquis*. In cases of doubt, therefore, areas have been included rather than excluded.¹⁸¹ Although this approach is to be welcomed in these terms, such coverage clearly has implications for how the draft text can be utilised by the Commission to create the political CFR. The current scope does not accord with that of the much narrower focus of the Commission, as is readily apparent from the review of the *acquis*, which was limited to eight directives. The draft text, however, extends to areas which some feel have no direct relationship with contract law, notably benevolent intervention in another's affairs. It is therefore questioned how the draft can be revised in order to limit its impact to general contract and consumer law without a considerable and careful process of unpicking the relevant parts.¹⁸² The ability of the political institutions to utilise the draft text as the basis for the CFR is a critical issue in the analysis of the draft text, and one which is also clearly influenced by the structure and style of the draft instrument.

In terms of structure, the subject matter of the draft text has been divided into ten Books, each broken down into chapters, sections, sub-sections and articles.¹⁸³ Book I provides the general provisions and is intended to act as guide for the reader on how to use the text.¹⁸⁴ It outlines the intended scope of application of the draft, and how its rules should be interpreted and developed. It further provides that the definitions found in Annex I apply for all purposes unless where the context otherwise requires.¹⁸⁵ Book II, entitled

¹⁸¹ DCFR Outline Edition (2009), 42, para 70.

¹⁸² Whittaker, The 'Draft Common Frame of Reference', An Assessment Commissioned by the Ministry of Justice, United Kingdom, (2008).

http://www.justice.gov.uk/publications/docs/Draft_Common_Frame_of_Reference_an_assessment.pdf 4.

¹⁸³ For a general overview of the structure, see the DCFR Outline Edition (2009), 25.

¹⁸⁴ *Ibid.* para 43.

¹⁸⁵ Note that we find some key definitions in Book I including "consumer" and "business" (1:105) and "in writing", "signature" and similar expressions (1:106 and 107), which are replicated in the definitions found in Annex I. Note also that we find definitions of 'good faith and fair dealing' and 'reasonableness' (1:103 and 104) also in this section, the relevance of their specific reference here will be discussed below,

Contract and other juridical acts, begins with general provisions¹⁸⁶ and the articulation of a right of non-discrimination.¹⁸⁷ It goes on in its seven remaining chapters to address marketing and pre-contractual duties, formation, rights of withdrawal, issues of representation, grounds of invalidity, the interpretation of contracts and, finally, their content and effects, including the regulation of unfair contract terms.

A significant feature of Book II is that it introduces the concept of juridical acts, which runs throughout the book and which is defined distinctly from a contract. A contract is defined as an agreement which is intended to give rise to a binding legal relationship or to have some other legal effect. It can be a bilateral or multilateral juridical act.¹⁸⁸ A juridical act, on the other hand, is taken to be any statement or agreement, whether express or implied from conduct, which is intended to have legal effect as such and may be unilateral, bilateral or multilateral.¹⁸⁹ In the form of unilateral acts these will be one sided promises, and legal acts which are intended to have legal effects.¹⁹⁰ For the most part and in a bilateral or multilateral form, however, they will be contractual agreements.¹⁹¹ In light of the future uses of the CFR it is, therefore, questionable why the concept of juridical acts is used, as once contracts are removed from the concept it is left with little value. In terms of the legislative toolbox, it is clear that the concept bears no relevance to the present *acquis* nor is it likely to do so in the future, and nor will it be necessary for an optional instrument, which would be the chosen law of the parties to a contract.¹⁹²

¹⁸⁶ The general provisions provide definitions and principles which apply for the purpose of this chapter.

¹⁸⁷ Book II.-2:101. The right of a person not to be discriminated against on the grounds of sex or ethnic or racial origin in relation to a contract or other juridical act the object of which is to provide access to, or supply, goods or services which are available to the public.

¹⁸⁸ Defined in II.-1:101 (1).

¹⁸⁹ II.-1:101 (2).

¹⁹⁰ See, Collin's book review of the DCFR Outline Interim Edition, (2008) 71 (5) *Modern Law Review*, 840. In English law an example would be a promise contained in a deed, see Whittaker (2008), 78.

¹⁹¹ As is conceded by the draft text itself which in terms of defining a 'contract', categorises it as 'a bilateral or multilateral juridical act', II. - 1:101 (1).

¹⁹² See, Whittaker (2008), 6 and 79, who notes that there is no explicit example of a 'unilateral juridical act' in the *acquis*, and considers that the use of the concept is indicative of a codifying approach rather than one that is tailored to the needs of the CFR's future uses.

Book III, entitled Obligations and corresponding rights, extends the coverage of the draft text to cover contractual and non-contractual obligations and corresponding rights. Together with Book II, it covers the existing material within the PECL, subject to the scope of those rules being extended to cover non-contractual obligations. It is thus within these seven chapters that we find the rules on performance, remedies in the case of non-performance, plurality of debtors and creditors, the assignment of rights, set-off and merger and prescription. The content of Books II and III, and the division of the PECL material between them, amounts to a structural feature in the draft text. It seeks to create a distinction between, on the one hand, contract as a type of agreement and thus a juridical act in Book II and then, as a legal relationship, giving rise to reciprocal obligations and rights, both contractual and non-contractual, in Book III.¹⁹³ The division of the material in this way has, however, been criticised, as while it is conceded that the later chapters, dealing with set-off and prescription, are common to all obligations, contractual or otherwise,¹⁹⁴ the rules on performance and non-performance apply mainly to contracts.¹⁹⁵ This is implicit in the Network's explanation of the structural division, which is discussed primarily in terms of 'contract' and not non-contractual obligations.¹⁹⁶ It is thus argued that, in accordance with PECL, the chapters on performance and non-performance should have been contained in Book II. Instead, the draft text buries these contractual rules within the treatment of obligations generally and obscures the relationship of these provisions with those in Book II.¹⁹⁷ This will not assist the Commission in its future development of the political text.

This criticism, although directed at the structure of the text, is clearly derived from the extended scope of the draft to deal also with non-contractual obligations and the decision to deal with both in one Book.¹⁹⁸ Treating contractual and non-contractual obligations

¹⁹³ A structural division which the Network maintain is implicit in PECL itself, Draft Common Frame of Reference (2009), 27, para 45.

¹⁹⁴ See for example, Lando, *The Structure and Legal Values of the Common Frame of Reference*, paper delivered to the SECOLA conference, (2007), 4. On file with author.

¹⁹⁵ *Ibid.* 5, although accepting that they do in some cases apply to non-contractual obligations.

¹⁹⁶ Draft Common Frame of Reference (2009), 27, para 45.

¹⁹⁷ Whittaker (2008), 98.

¹⁹⁸ DCFR Outline Edition (2009), 28, para 46.

separately was rejected structurally as it made the text cumbersome.¹⁹⁹ It was maintained by the Network²⁰⁰ that, since questions concerning the modalities of performance and remedies for non-performance for non-contractual obligations arose frequently, it was advantageous not to have to repeat default rules in every provision for a non-contractual obligation,²⁰¹ nor to include detailed cross-references to earlier Articles. The rules in Book III are thus framed in general terms so as to apply to both, unless an Article applies only to contractual obligations, in which case this exception would be clearly stated.²⁰² The Network have advanced that this will be the exception and not the rule²⁰³ and clearly the treatment of contractual and non-contractual obligations together, and thus the structural division, can only be justified if this is the case.²⁰⁴ In terms of the chapters concerning performance and remedies for non-performance, however, many rules apply exclusively to contracts and explicitly state this. An example of rules that can only apply to contracts is the section outlining the creditors' right to termination of the contract in the event of non-performance, which amounts to 4 subsections and 14 Articles, encompassing the grounds for termination, the scope and exercises of the right, its effects and the restitution of benefits received by performance.²⁰⁵ A further example is the right to reduce the price, in section 6, where the restriction in scope to contract follows from the word “price”.²⁰⁶

In other Articles, the limited application to contractual obligations and relationships is implicit. For example, Section 4 of Chapter 3 concerning the right to withhold performance of reciprocal obligations. Although the Article does not talk of contractual obligations explicitly, given that it is the contractual relationship that gives rise to

¹⁹⁹ Ibid.

²⁰⁰ Subject to those comments of Lando (2007), 4 discussed above.

²⁰¹ Ibid. Among those non-contractual obligations where such questions are expected to arise, and to which Book III applies are, obligations arising out of unilateral promises, pre-contractual obligations and those arising by operation of law to pay damages for loss caused to another, or out of benevolent intervention in another's affairs, or to reverse an unjust enrichment.

²⁰² DCFR Outline Edition, (2009), 28, para 46.

²⁰³ DCFR Interim Outline Edition (2008), 23, para 48.

²⁰⁴ See generally Lando (2007) 5, who argues that these exceptions within the text are not few.

²⁰⁵ III. - 3:501–514.

²⁰⁶ III.-3:601. For further examples, see DCFR Outline Edition (2009), 28, para 46.

reciprocal rights and obligations,²⁰⁷ it is difficult to envisage when this provision will apply to anything other than a contractual relationship.²⁰⁸ The conclusion to be drawn is that the Articles applying only to contractual obligations are not mere exceptions. The Commission, using the draft text to create a contractual legislative toolbox, is faced from the beginning with an “incomprehensible logic”.²⁰⁹ They must find provisions, which in the vast majority of cases only apply to contracts, in a book which treats them equally with other obligations. It can therefore be contended, on this basis, that the current draft text is not a suitable basis for a contractual toolbox.²¹⁰ Further, the extent to which the Network of Excellence has justified its decision to treat contractual and non-contractual obligations together, and the structural division that has been undertaken, are questionable in these terms.

The content of the draft has also been heavily influenced by its sources. It is primarily based upon PECL and has undertaken a largely faithful replication of its provisions, subject to the influence of the scope and structure of the text already discussed. In particular this has meant that the rules in Book III taken from PECL have been extended to apply to obligations in general, despite being drafted originally for contracts and the earlier conclusion that, in practice, they will apply only to contractual obligations. Minor changes in the structure of the text are also evident. For example, although Chapter 4 of Book II on formation generally follows Chapter 2 of PECL in terms of both structure and content, there are a number of notable exceptions. Although PECL deals with terms that are not individually negotiated and the ability of parties to invoke these within its chapter on formation,²¹¹ in the DCFR they will be found in a separate section of Chapter 9 in Book II,²¹² governing the content and effects of contracts. This change in structure and dedication of a whole section to the regulation of such terms reflects the new significance attached to their regulation in B2C contracts, which was not reflected in the earlier PECL,

²⁰⁷ Which is seen as the defining features of a contract, DCFR Outline Edition (2009), 27, para 45.

²⁰⁸ N.B. Parallel to provisions on withholding performance in PECL, Article 9:201.

²⁰⁹ Lando (2007), 5.

²¹⁰ Although the Network maintain that if a CFR were to be confined to contract, it would be very easy to use the model rules in Book III for that purpose and that for most this would require no alteration, DCFR Outline Edition (2009), 28, para 46.

²¹¹ PECL, Chapter 2, Section 1 Article 2:104.

²¹² Section 4.

and indicates the incorporation of the *acquis* into the draft text. Including these provisions within the chapter governing the content and effects of contracts, rather than regulating them at the formation stage, can also be considered a structural improvement. Other improvements are evident in the placing of the rules governing negotiation and confidentiality duties and liability for breaches of such. Whereas these were previously considered within the formation chapter of PECL,²¹³ they are now found in Chapter 3, Section 3 of Book II, governing marketing and pre-contractual duties. This improvement is not merely structural, given that both duties apply at the pre-contractual and thus pre-formation stage, but again reflects the incorporation and impact of the *acquis communautaire*. The introduction of positive pre-contractual information duties, which were not included within PECL, has been a key feature of the consumer *acquis*.

A further clear deviation from PECL, which results from the scope of the draft, is the introduction throughout Book II of separate sections to deal with juridical acts other than contract. Chapter 4, for example, has a separate section on formation for other juridical acts: specifically, the requirements for a unilateral juridical act.²¹⁴ As the draft provides distinct and separate sections for juridical acts, this aspect cannot be overly criticised in terms of undermining the draft text's utility as the basis for a contractual toolbox, as the provisions for contract can be easily discerned. It may still, however, be open to the earlier criticism regarding why juridical acts were included within the scope of the draft in the first place.

The most prominent difference in the PECL, both in terms of content and structure, has therefore been the need to accommodate the *acquis communautaire* within the text, which formerly did not contain consumer provisions. The effect has been to introduce new, consumer protection driven, rights and obligations derived from the *acquis*. Thus a right of withdrawal is introduced in consumer contracts negotiated away from business premises. This replicates the rights of withdrawal which have been recognised in the

²¹³ PECL Chapter 2, Section 3, 2:301 and 302.

²¹⁴ Chapter 4, Section 3. The requirements for a bilateral act being those of contract in the preceding section.

acquis,²¹⁵ and which would now come within the scope of the general right detailed in Article 5:201 of Book II of the DCFR.²¹⁶ The latter provision therefore presents an opportunity to compare the provisions of the CRD with those of the DCFR in so far as the incorporation of the acquis in the DCFR is concerned.

We find that the CRD proposal makes a distinction between off-premise contracts,²¹⁷ distance contracts for the sale of goods, and distance contracts for the provision of services as regards to the start of the withdrawal period. The period starts from a different specified date in each of the 3 instances. This reflects the existing and sector-specific approach of the acquis²¹⁸ in the Distance²¹⁹ and Doorstep Selling²²⁰ Directives which would be replicated, and consolidated in Article 12 (2) of the CRD. Article II.-5:103(2) DCFR, however, lists those 3 times found in the acquis but provides that unless otherwise provided, the period will begin at the latest of those possible times.

The way in which the DCFR abandons the sector-specific approach fixed by the acquis as to the starting point should be welcomed. The CRD proposal has been criticised in this respect for maintaining the status-quo of the existing acquis, and for failing to address problems that arise from the unjustified distinction that it makes between contracts concerning goods and services in the case of distance contracts. While in the case of services the period of withdrawal runs from the date of the conclusion of the contract, in the case of the sale of goods, it will be from the later point when the consumer acquires material possession of the goods ordered. In contrast, in the case of off-premise contracts, the withdrawal period shall begin from the day when the consumer signs the order form. In practice this means that the starting point under the CRD will normally be the moment that the contract is concluded,²²¹ except for the distance sale of goods. While this

²¹⁵ The Doorstep and Distance Selling Directives.

²¹⁶ A more specific right of withdrawal has been given in the case of timeshare contracts in Article 5:202. For justification for the separate treatment of timeshare contracts, see Section 4.1.3.

²¹⁷ I.e. Doorstep selling.

²¹⁸ The start of the withdrawal period within the existing acquis is discussed in detail by Loos, Rights of Withdrawal, in: *Modernising and Harmonising Consumer Contract Law*, Howells and Schulze, Munich: Sellier, 2009.

²¹⁹ Directive 97/7/EC, Article 6.

²²⁰ Directive 85/577/EEC, Article 5.

²²¹ Loos (2009), 253.

distinction and later starting point may seem justified in allowing the consumer to ascertain the nature and functioning of the goods,²²² it may equally be justified in other cases.²²³ The CRD also fails to address ambiguities that can arise from the goods/services distinction.²²⁴ Loos provides the example of the distance selling of prepaid mobile phones, where the consumer buys both the good, i.e. the mobile phone, and the service to make use of the mobile phone for a certain period.²²⁵ Under the existing *acquis*, and indeed the proposed CRD, it is not clear when the withdrawal period would start: when the phone is delivered under the goods rule, or when the contract is concluded, as per the service rule. The latter ambiguity is overcome by the approach of the DCFR as it will be at the latest of the starting points listed therein that the withdrawal period will begin.²²⁶

Despite the noted difference between the instruments in their approach to the starting point, there is in fact little substantive difference between the provisions in terms of those points which will be determinative of the withdrawal period,²²⁷ and both clearly draw on the existing *acquis* in these terms. However, while the approach of the DCFR can be seen to improve the coherence of the existing *acquis*, the CRD focuses on the consolidation of the existing rules. This may be one area, therefore, where the CRD proposal could draw on the DCFR in order to ensure greater coherence of the *acquis*.²²⁸

More generally, the extent to which the DCFR abandons the limitation of scope of application fixed by the directives and generalises the rules of the consumer *acquis*,²²⁹

²²² Discussed *Ibid.* 254.

²²³ Loos (2009), 252 and 254, who maintains that there is no objective justification for a distinction between the starting points for the delivery of goods and provision of services on the basis of a distance contract, and thus the Commission has failed to take the opportunity to harmonise the rules on cooling off periods.

²²⁴ *Ibid.* 253 and 255.

²²⁵ Loos (2009), 252.

²²⁶ Although it does maintain the rule that in the case of a contract for the delivery of goods, the time of receipt of the goods will be determinative for the start of the withdrawal period, Article II.-5:103(2) (c).

²²⁷ Article II.-5:103(2) (b) provides for the time when the entitled party receives from the other party adequate information on the right to withdraw, which follows the existing approach of the Doorstep Selling Directive, Article 5. The CRD on the other hand refers in the case of off-premise contracts to when the consumer signs the order form, which will include the standard withdrawal form. This, however, implies that the consumer will normally have been informed of the existence of the right of withdrawal, as per the DCFR, when they sign the order form. See Loos, 254-5.

²²⁸ The influence of the DCFR on the CRD proposal is considered further below in Section 4.3.

²²⁹ E.g. as it created a general right of withdrawal from the sector-specific rights still to be found in the CRD proposal.

should have been anticipated as a development in line with the Commission's regulatory move towards full harmonisation and a horizontal approach. The DCFR seeks to identify how the sectoral provisions may be applied so as to eliminate gaps and assist the 'horizontal approach'.²³⁰ Concerns arise, however, where the rules are generalised and extended to apply also to commercial transactions. One example is the creation of a general duty of disclosure on businesses, to provide such information concerning goods and services as the other person can reasonably expect.²³¹ In the case of B2B contracts, and in assessing what information the other party can reasonably expect to be disclosed, the test to be applied is whether failure to provide information would deviate from good commercial practice.²³² In regard to B2C contracts, where the business has a duty not to give misleading information, that is to say not to misrepresent or omit material facts, the test of information to be given is that of what the average consumer²³³ could expect to be given to make an informed decision on whether to conclude a contract.²³⁴ In this way a lower threshold is put in place for the business in terms of the information which must be supplied to the consumer. However, while the draft attempts to make a distinction so as to encroach less on party autonomy in B2B contracts, the result is nevertheless, that disclosure is to be the general rule even in commercial transactions.

The DCFR takes a similar approach to the regulation of unfair terms which have not been individually negotiated²³⁵ although, again, a higher threshold for intervention is clearly put in place for the regulation of standard terms in commercial contracts.²³⁶ A further limitation to contractual freedom does, however, potentially arise in the context of B2C contracts, as the DCFR leaves it open to regulate the fairness of all contract terms which are provided by businesses, even those individually negotiated by the parties.²³⁷ The issue has been one of extensive debate,²³⁸ as the Study Group would prefer

²³⁰ DCFR Outline Edition, (2009), 38 para 63.

²³¹ Book II.-3:101. Specific duties to provide information to consumers are provided in the following Articles.

²³² II.-3:101 (2).

²³³ To be distinguished from the consumer who is at a particular disadvantage, Article 3:103.

²³⁴ II.-3:102 (1).

²³⁵ Book II, Chapter 9 Section 4: Unfair terms.

²³⁶ Discussed further in Chapter 6, 6.4.1.

²³⁷ Square brackets found in II.-9:403.

²³⁸ Draft Common Frame of Reference (2008), 38 para 79.

comprehensive scrutiny of all contract terms in such contracts. The Acquis Group, however, in line with the approach of the consumer acquis itself, considers that only standard terms should be regulated in these terms, and thus seeks to maintain some degree of party autonomy for B2C contracts. In practice, the Network of Excellence considers that the consequence of removing the words “which has not been individually negotiated” will probably have little impact, as most terms supplied by businesses will not be individually negotiated.²³⁹ In any case, they consider the issue a delicate one which requires a political decision.²⁴⁰

The regulation of standard and individually negotiated terms demonstrates a more general difficulty that has faced the Network of Excellence collectively in giving effect to freedom of contract. This was to be the guiding principle of the CFR²⁴¹ and, indeed, is the starting point of the DCFR.²⁴² The issue is the extent to which this freedom can and should be restricted, particularly beyond the B2C context.²⁴³ From one perspective²⁴⁴ and given that the scope of the protective provisions in the acquis were limited to the consumer,²⁴⁵ it could have been inferred from this original scope, that the terms of commercial contracts should continue to be largely unregulated. In most cases there is no incompatibility between contractual freedom and the needs of justice.²⁴⁶ However, there are recognised cases where restrictions on contractual freedom are justified and thus contracts will not be enforced. This is primarily where one party is in a weaker position, owing to inequality in bargaining position or information,²⁴⁷ but also in classic cases of procedural unfairness such as mistake, duress, fraud or those which involve unfair exploitation.²⁴⁸ In such cases, the contracts will not be enforced – not only because one

²³⁹ DCFR Outline Edition (2009), 46, para 79.

²⁴⁰ Ibid.

²⁴¹ The principle should only be restricted with good reason, 2003 Communication, 16.

²⁴² Book II.-1:102, Parties are free to make a contract or other juridical act and to determine its contents (subject to any applicable mandatory rules).

²⁴³ Related to the issue of how to incorporate the consumer driven acquis into the commercially guided PECL.

²⁴⁴ Collins (2008), 842.

²⁴⁵ Although the acquis has also extended protection in some cases to SMEs, see discussion in Chapter 6, 6.2 and 6.4.1.

²⁴⁶ DCFR Outline Edition (2009), Principles, 62, para 3.

²⁴⁷ Ibid. 63, para 3.

²⁴⁸ DCFR Outline Edition (2009), Principles, 65, para 6.

party was not freely agreeing to contract, or was misinformed which means that they have not exercised their fundamental freedom of contract²⁴⁹ - but also to ensure that the needs of justice are met in the given situation.²⁵⁰

A particular way in which justice is ensured is through the principle of good faith and fair dealing,²⁵¹ which is readily apparent throughout the provisions of the DCFR. Specific and more general duties, which cannot be excluded or limited, fall upon the parties to act in accordance with good faith and fair dealing from the negotiation stage,²⁵² through to performance.²⁵³ In this way and in justifiable circumstances the party's freedom of contract is clearly restricted. Discussion, however, has surrounded the manner in which to give effect to such restriction. The Network of Excellence maintains that any interference with freedom of contract should be kept to the minimum that will solve the problem, while providing the other party, the business, with sufficient guidance so as to be able to arrange their practices within these parameters.²⁵⁴ While in some cases this may require, as we have seen, the introduction of information duties, this may not always be sufficient. In other cases, the problem may require the elaboration of precise rules or even mandatory rules. However, with a view to keeping interference with the parties' freedom of contract to a minimum, it is sometimes seen that a flexible 'fairness' test to protect the weaker party may suffice.²⁵⁵ To this end the DCFR uses objective standards and general principles, such as 'fairness' and 'good faith and fair dealing' throughout, as a means of regulating contractual agreements.

Contrary to the Network's contention that this approach should interfere less with the parties' freedom of contract, the use of such provisions has been criticised for widely

²⁴⁹ Ibid. 86, para 42.

²⁵⁰ DCFR Outline Edition (2009), Principles, 65, para 6.

²⁵¹ Ibid, 85, para 42.

²⁵² An obligation exists to negotiate in good faith, Book II. - 3:301 (2).

²⁵³ Book III.-1:103: A person has a duty to act in accordance with good faith and fair dealing in performing an obligation, in exercising a right to performance, in pursuing or defending a remedy for non-performance, or in exercising a right to terminate an obligation or contractual relationship.

²⁵⁴ DCFR Outline Edition (2009), 68, para 11.

²⁵⁵ Ibid.

curtailing the scope of contractual agreements and thus of doing the exact opposite.²⁵⁶ Much discussion surrounded the original provision in the interim outline edition of the text relating to party autonomy in Book II, as it provided that although parties would be free to make a contract and to determine its contents, this freedom would be subject to the rules on good faith and fair dealing.²⁵⁷ Freedom of contract was from the outset subject to an obligation to act in good faith, leaving what is seen as a relatively low threshold for interference in the agreement that the parties have made.²⁵⁸ In view of what is described as confusion surrounding the reference to good faith in the provision, although clearly it can be understood in terms of criticism of this initial and far-reaching incursion on contractual freedom, the reference to good faith has been removed from the provision.²⁵⁹ As has been demonstrated, however, the principle of ‘good faith and fair dealing’ still plays a pronounced role in the scheme of the DCFR. Thus in a further change following the review of the interim outline edition, we now find in Book I a new definition of ‘good faith and fair dealing’.²⁶⁰ This is included by the Network, at this juncture of the draft, in order to reflect the importance of the principle within the text.

In terms of style, reference to objective standards and general principles such as good faith can be seen to reflect the use of such general principles in the earlier harmonised provisions of PECL.²⁶¹ Indeed, the need to rely on broad and general principles is inherent in the goal of harmonising instruments, which attempt to establish common principles, model rules and a shared terminology.²⁶² While their inclusion to this end is therefore unavoidable, their use does give rise to concern²⁶³ in terms of their often vague

²⁵⁶ Eidenmüller et al. *The Common Frame of Reference for European Private Law – Policy Choices and Codification Problems* (2008) 28 *Oxford Journal of Legal Studies* 659, 678.

²⁵⁷ DCFR, Interim Outline Edition (2008), II. – 1:102 (1).

²⁵⁸ Eidenmüller et al (2008), 679. The authors concern is that this provision goes far beyond the scope of judicial scrutiny of contracts recognised in the law of the majority of European states and thus undermines the primacy of the contractual freedom principle.

²⁵⁹ DCFR Outline Edition (2009), 20, para 28.

²⁶⁰ I.1:103. A developed version of a definition which formerly only appeared in the Annex of Definitions, DCFR Outline Edition (2009), 19, para 27.

²⁶¹ For a comparison of the DCFR and PECL in this respect see, Collins (2008), 841, who notes that the DCFR articulates such principles in more guarded terms, see for example, III.–1:103 (3), which describes the consequences of breach of the duty of good faith and fair dealing in performing an obligation.

²⁶² Collins (2008), 842.

²⁶³ For a general overview of concerns surrounding the use of vague and ambiguous terms within the DCFR, see the evidence of Vogenauer to the House of Lords EU Committee, 12th Report Session 2008 –

and ambiguous nature, which results in uncertainty. This may undermine the realisation of the objectives in creating the CFR, and in particular its ability to aid the consistent transposition and application of the *acquis* at national level and thus to achieve a high degree of convergence between the contract laws of the Member States. For example, Member States do not share a common understanding of, nor make provision for, all legal concepts. The objective standard of good faith is not a general requirement in all systems, notably the common law system. This means that it will not always, therefore, be read into provisions and it will be necessary for the European legislator in the future, where they want the principle to apply, to include express provisions on the issue.²⁶⁴ Even where this is done, however, the interpretation of the requirement may vary between Member States, as the possibility will remain that national courts will interpret the CFR and the *acquis* provisions in line with national conceptions of principles. Thus, what may be regarded as being in accordance with good faith, or as good commercial practice, in one national system may not be the same as that in another.²⁶⁵ The use of general standards and principles may, therefore, make it difficult to achieve the degree of uniformity in application for which the Commission strives through the CFR.²⁶⁶

The use of objective standards and general principles can also undermine legal certainty for contracting parties.²⁶⁷ As the Network acknowledges, although justice requires – and one party's contractual security will be enhanced by – the other's duty to act in accordance with good faith and fair dealing, this will come at the price of uncertainty and insecurity for the party upon which the duty falls, owing to the open-ended nature of the concept.²⁶⁸ The protection of the weaker party through such concepts is clearly at the cost of predictability which is essential to contracting, where parties want clear and transparent rules.²⁶⁹ The use of such concepts may, therefore, also impact upon the

2009, European Contract Law: The Draft Common Frame of Reference, published 10th June 2009, page 31 of report and Q. 51- 52 of evidence.

²⁶⁴ DCFR Outline Edition (2009), 43, para 72, as was necessary in the Unfair Contract Terms Directive, Article 3 (1).

²⁶⁵ Collins (2008), 842.

²⁶⁶ *Ibid.*

²⁶⁷ Eidenmüller et al (2008), 677.

²⁶⁸ DCFR Outline Edition (2009), Principles, 76, para 23.

²⁶⁹ Highlighted by Vogenauer in evidence to the House of Lords EU Committee (2009), Q. 48.

suitability of the existing DCFR as the source of rules for an optional instrument. This is particularly where they apply in the commercial context, where the risk is that freedom of contract would be unduly marginalised.²⁷⁰ At the same time the combined effect of the use of such opened-ended concepts and the generalisation of the *acquis* provisions to B2B contracting, may be seen as producing a more balanced result and one that is more attuned to the consideration and needs of social justice in contracting.²⁷¹ From this perspective, even in a B2B contract, the economically weaker party will be better protected.²⁷² There is thus justification for this extension in regulation of commercial contacts, while it has also been shown that the incursion on contractual freedom will be less intrusive in this context than for B2C contracts.

It has been shown more generally that the choices of the Network of Excellence, in terms of the scope and structure of the draft, have resulted in serious misgivings with regard to the suitability of the draft text to satisfy its principal objective as a legislative toolbox to improve the *acquis communautaire*. In particular, the choices bear directly on how the Commission is to utilise the draft text to produce a political text to that end, i.e. to create common European definitions, model rules etc. The DCFR may, in fact, demand a great deal from those participating in the political process to produce the final CFR, and clearly the ability of that instrument to fulfil those initial objectives will depend on the views and more recent objectives of those involved in the selection process, which remain to be considered.

4.2.3. The Development of the Political CFR

The Commission received the final version of the DCFR in December 2008. The final instrument will be developed under a different Directorate-General, as DG Justice, Freedom and Security (JFS) has inherited the task from the Health and Consumer Affairs Directorate. The completion of the CFR project will thus be undertaken in the broader context of civil law. The first statement by DG JFS on how they plan to advance with the

²⁷⁰ With detrimental effects for larger businesses, see Chapter 2, 2.3.4, and Chapter 6, 6.4.1.

²⁷¹ Vogenauer (2009), Q. 43.

²⁷² As a means, in particular, to protect SMEs, see Chapter 6, 6.4.1.

CFR was made in the proposal for the Stockholm Programme and their five year plan for justice and home affairs. The proposal places the CFR project back within the wider objective of supporting economic activity in the internal market²⁷³ and thus of assisting businesses that are prevented from engaging in trade owing to the differences in Member States' contract laws. The project is no longer limited to the consumer-orientated focus that existed under DG SANCO, and while the CFR as a legislative toolbox remains the principal proposal, wider uses are once again being envisaged.²⁷⁴ The European Council has maintained, in view of the Stockholm proposal, that the CFR should form a set of fundamental principles, definitions and model rules to be used by lawmakers at Union level to ensure greater coherence and quality in the lawmaking process. This reaffirms the Council's position on the future uses and development of the CFR,²⁷⁵ and the Commission was invited to submit a proposal on a CFR to that end.²⁷⁶ The Commission is thus involved in a selection process to determine those parts of the DCFR that will prove useful in its legislative toolbox function. The issue that arises, is what can be expected to result from this process.

In terms of the content of this instrument, the Council considers that it should focus on the existing *acquis* and on matters which are likely to be the subject of future legislation.²⁷⁷ While this is subject to the caveat that, as an evolving legislative tool, it will be necessary for the CFR to be revised regularly so as to adapt it, in particular, to the changing scope of the EU *acquis*, the scope of the latter is a clear parameter in this regard.²⁷⁸ The final instrument can thus be expected to be considerably shorter, in both

²⁷³ The current financial and economic crisis in the EU appears to be leading their agenda under Stockholm in this respect and may thus have an effect on the outcome, see the Evidence of Jonathan Faull's, Director-General, JFS, to the House of Lords on the Draft Common Frame of Reference (2009), Q. 156.

²⁷⁴ See, Communication from the Commission to the European Parliament and the Council, An area of freedom, security and justice serving the citizen (Proposal for the Stockholm Programme), COM (2009) 262/4, Section 3.4.2 and page 31, discussed below.

²⁷⁵ Consolidated version of the conclusions of the Council on guidelines on the setting up of a Common Frame of Reference for European Contract law (2009).

²⁷⁶ Stockholm Programme – An open and secure Europe serving and protecting the citizen (17024/09), 2 December 2009, <http://register.consilium.europa.eu/pdf/en/09/st17/st17024.en09.pdf>, 33.

²⁷⁷ Consolidated Council conclusions (2009), para 15.

²⁷⁸ *Ibid*, para 16.

length and coverage,²⁷⁹ than the draft text, but a comprehensive contractual instrument can still result. In order to be an effective tool for better law making, the Council considers that it could cover both general and consumer contract law²⁸⁰ and this would include all relevant aspects of contractual relations, from the pre-contractual phase to performance or default in performance.²⁸¹ It has also not been ruled out that other special contracts falling within the *acquis*, outside the area of consumer contracts, could be included within the CFR.²⁸² The fact that the process is also now being undertaken in the wider context of civil law suggests a broader outcome than the original consumer driven instrument.

A comprehensive contractual instrument will be necessary from the perspective of the other envisaged uses of the CFR. This is readily apparent from the manner in which we now see DG JFS contemplating the use of the CFR, which is as a basis upon which to create tools to encourage cross-border trade.²⁸³ In the first place, it could serve as the basis upon which standard contract terms and conditions²⁸⁴ could be drawn up between individuals and, in particular, between small businesses.²⁸⁵ Consideration is also being given to the development of cross-border trade through the adoption of an optional instrument of contract law.²⁸⁶ Support continues for the use of the CFR as the basis for such an instrument, and thus for the development of the CFR to this end.²⁸⁷ With this use in mind, there is support for the optional instrument to be based on the wider DCFR, suggesting a more comprehensive final CFR than that limited to the toolbox function.²⁸⁸

²⁷⁹ The consolidated Council conclusions (2009) speaks only of contract and Faull's made clear, that in comparison with the draft text, the final instrument will not go beyond the wider category of contract law, Q. 129. He did however reserve some judgment on the issue at that early stage (March 2009).

²⁸⁰ Consolidated Council conclusions (2009), para 10.

²⁸¹ *Ibid.* para 10.

²⁸² Although at a later stage, Consolidated Council conclusions (2009), para 14.

²⁸³ Proposal for the Stockholm Programme (2009), 31.

²⁸⁴ The proposal to create standard contract terms had been abandoned while the project was under the control of DG SANCO, see discussion in Chapter 2, 2.4.

²⁸⁵ Commission's Proposal for the Stockholm Programme (2009), 3.4.2. Considered further in Chapter 5, 5.3.

²⁸⁶ Stockholm Programme (2009), 13.

²⁸⁷ Discussed in Chapter 6, 6.1.2.

²⁸⁸ European Parliament, Resolution of 3 September 2008 on the common frame of reference for European contract law, para 12. Although the existing and future legislative agenda will probably still serve as a parameter for the content.

The European Parliament has thus warned on this basis that the overall coherence of the optional instrument should not be jeopardised in the selection process.²⁸⁹ While the envisaged functions of the CFR, therefore, impact upon the scope and content of the future instrument, the extent to which the wider proposals will ultimately bear on the content of the political CFR remains unclear. The potential for the final instrument to fulfil such functions, and thus support economic activity in the internal market should not however be overlooked in the selection process.²⁹⁰

In terms of the legal effect of the CFR, and returning to its legislative toolbox function, the institutions have favoured a non-binding set of guidelines to be used by the lawmakers on a voluntary basis, as a common source of inspiration or reference in the law making process.²⁹¹ To this end, it is envisaged that the instrument could be appended to any future legislative proposals or communications by the Commission in the area of contract law to ensure that it will be considered by the EU legislature.²⁹² The issue that arises, however, is whether the CFR, in a non-binding form, would be attributed sufficient force to satisfy the objectives of action: i.e. to improve the *acquis* by overcoming its existing inconsistencies and inherent fragmentation. This will largely depend upon the resulting instrument, and whether the EU institutions are prepared to make use of it in the legislative process. The Council made this point expressly in reference to their preference for non-binding guidelines, and highlighted the need to involve all EU institutions in the process, in order to ensure optimum conditions for the use of the CFR. Clearly, if the CFR were adopted by only one of the institutions, its significance would be reduced.²⁹³ It has further been highlighted by both the Council and European Parliament that the instrument will have to be capable, as a legislative toolbox, of regular revision so as to ensure that it reflects both changes in the *acquis* and

²⁸⁹ Ibid.

²⁹⁰ The ability of the proposals, on the basis of the CFR, to support economic activity is considered further in Chapter 5, 5.3 and specifically Chapter 6 in the case of the optional instrument.

²⁹¹ Consolidated Council conclusions (2009), para 32 and the view is endorsed by the European Parliament Resolution of 3 September 2008, para 7.

²⁹² European Parliament Resolution of 3 September 2008, para 10.

²⁹³ Consolidated Council conclusions (2009), para 34.

developments in national contract law.²⁹⁴ In particular, it should be adapted in line with the changing scope of the *acquis*. This may, in future, allow for the potentially narrow scope of the initial instrument, i.e. in the legislative toolbox function, as a necessary short term action, to be widened in line with changing and potentially broadening political and legislative objectives of the Union, and the wider contract law and internal market project as it develops.²⁹⁵

4.3. The Relationship Between the *Acquis* Review and the CFR

The relationship between the review of the *acquis* and the CFR was clear. In order to increase the coherence of the *acquis* and thus simplify the regulatory environment, the Commission would revise the *acquis* in the area, and proposals arising from the review, i.e. the resulting CRD proposal, would take into account a CFR.²⁹⁶ The 2004 Communication envisaged that the agreed definitions and model rules in the elaboration of the CFR would be tested for practicability²⁹⁷ in the field of consumer protection in the context of the review of the *acquis*. The *acquis* review, and the content thereof, would then feed into the development of the CFR.²⁹⁸ In this way, the creation of a CFR was seen as an intermediate step towards improving the quality of the EU *acquis* in this area and thus to meeting the objectives of action.²⁹⁹ It later became clear, however, that the parallel work on the CFR would not delay the consumer *acquis* review.³⁰⁰ In 2005³⁰¹ the Commission prioritised in the CFR workshops, issues related to consumer contracts and thus the main substance of the CRD, including consumer sales, pre-contractual information, unfair terms and the right of withdrawal, in order to ensure the CFR's timely input into the review.³⁰² The *Acquis* Group was also central to the Commission's review

²⁹⁴ Council conclusions on the setting up of a Common Frame of Reference for European contract law, Doc. 15306/08, 28th November 2008, para 14 and European Parliament Resolution 3rd September 2008, para 6.

²⁹⁵ I.e. in the longer-term, for the CFR to be developed for the wider envisaged uses of the instrument.

²⁹⁶ 2003 Communication, 2.

²⁹⁷ 2004 Communication, pages 3 and 12.

²⁹⁸ First Annual Progress Report, 5.

²⁹⁹ 2003 Communication, para 53.

³⁰⁰ Commissioner Kyprianou (2005), 4.

³⁰¹ See, the First Annual Progress Report (2005), 5.

³⁰² For discussion on the prioritisation of the consumer *acquis* see, The Second Progress Report on the Common Frame of Reference COM (2007) 447 final, 2.

of the initial eight consumer directives that resulted in the creation of the EC consumer law compendium, which acts as the knowledge base of the review.³⁰³ The CFR researchers' findings and draft text on these issues then served, in part, as input into the review Green Paper and the questions posed therein.³⁰⁴

Despite the relationship between the two initiatives and the directly relevant work of the Acquis Group, there was negligible reference to the CFR in the Green Paper, with a mere reference only to the CFR and its researchers.³⁰⁵ We also find that no reference is made to the DCFR in the resulting CRD proposal, despite, in both cases, the DCFR being available to the Commission at the relevant time.³⁰⁶ This is not to say however, that the ongoing work on the DCFR did not more informally feed into the CRD proposal;³⁰⁷ the influence of the DCFR can be found within the instrument. Schulte-Nölke³⁰⁸ notes, for example, similarities in content in regard to off-premise contracts,³⁰⁹ passing of risk in sales contracts and in the transparency requirements for non-negotiated contract terms. The lack of formal acknowledgement of the involvement of the DCFR in the CRD has, however, lead to scepticism in regard to the relationship between the instruments and the said influence of the DCFR,³¹⁰ and for some to conclude that the result is a "relationship of non-relations."³¹¹ There is a feeling that that the Commission has "put the cart before

³⁰³ Schulte-Nölke and Twigg-Flesner, available on the Commission's Consumer Affairs webpage, http://ec.europa.eu/consumers/rights/cons_acquis_en.htm.

³⁰⁴ Second annual progress report, 2, and Beale, *The Nature and Purpose of the Common Frame of Reference*, (2008) 1 *Juridica International* 10, 12.

³⁰⁵ Green Paper (2006), 18.

³⁰⁶ Hesselink, *The Consumer Rights Directive and the CFR: two worlds apart?* (2009), 4. A briefing note prepared for a European Parliament expert hearing (IMCO Committee) concerning the proposal for a directive on consumer rights, available at <http://www.jur.uva.nl/csecl/news.cfm/5F7839CD-1321-B0BE-A41B920971C302EC#p2>, 1.

³⁰⁷ See Whittaker, *A Framework of Principle for European Contract Law?* (2009) 125 *Law Quarterly Review* 616, 646, who refers to Faull's (2009) who confirms, from the Commission's perspective, that use was made of the DCFR in the CRD proposal, Q.136.

³⁰⁸ Who highlights that the Commission frequently made clear orally that the DCFR was influential on the CRD proposal, see Schulte-Nölke, *Scope and Role of the Horizontal Directive and its Relationship to the CFR*, in: *Modernising and Harmonising Consumer Contract Law*, Howells and Schulze, Munich: Sellier, 2009, 41.

³⁰⁹ Discussed below.

³¹⁰ See, for example, generally, Hesselink (2009), and Howells and Schulze, *Overview of the Proposed Consumer Rights* (2009), from 3.

³¹¹ Micklitz, Reich, *Crónica de una muerte anunciada: The Commission proposal for a "Directive on consumer rights"* (2009) 46 *Common Market Law Review* 471, 473.

the horse”³¹² in proposing the CRD at a time when the CFR was still being prepared³¹³ and while it should have served, in its function as a legislative toolbox, as the formal and transparent basis for such a significant proposal following the *acquis* review.

A review of the CRD proposal demonstrates³¹⁴ that while it makes a number of amendments and innovations which are to be welcomed,³¹⁵ ultimately the draft is not a completely new piece of legislation.³¹⁶ It can be seen to follow the structure and content of the existing directives,³¹⁷ in an attempt to consolidate the four directives under review into a horizontal instrument. This objective appears to have been sought in some cases over the simplification aims of the review, and the need for coherence in the *acquis*.³¹⁸ The result is that provisions of the CRD also require greater coherence and clarity and can be seen to fall short of the DCFR in this respect which attempted, in line with its objectives, to create a more coherent contract law.³¹⁹

It has been demonstrated in regard to the starting point of the withdrawal period, for example, that there is little substantive difference in the provisions of the CRD and DCFR, both of which draw in terms of content on the existing *acquis*.³²⁰ The difference between the instruments lies in the perspectives that they take.³²¹ The CRD on the one hand distinguishes the applicable starting point according to the type of contract concerned, i.e. off-premise, a distance contract for the sale of goods or one for the

³¹² At least while the project has been lead by DG SANCO, House of Lords Report on the DCFR (2009), 62, Q. 136.

³¹³ Howells and Schulze (2009), 11.

³¹⁴³¹⁴ As this chapter has but also see generally, Schulte-Nölke and Howells and Schulze (2009).

³¹⁵ For example, the horizontally harmonised withdrawal period.

³¹⁶ Schulte-Nölke (2009), 39.

³¹⁷ Schulte-Nölke (2009) highlights that very often the content and wording of the existing directive have been given preference over the DCFR, 41.

³¹⁸ Howells and Schulze (2009) advance, for example, that the proposal, in terms of structure of the information and formal requirements, appears content to cut provisions out of the existing directives and paste them together in a new directive, albeit in a new order, 12.

³¹⁹ *Ibid.*

³²⁰ Discussed in 4.2.2.

³²¹ De Booy, Mak and Hesselink, A Comparison Between the Provisions of the Draft Common Frame of Reference and the European Commission’s Proposal for a Consumer Rights Directive, How the CFR Can Improve the Consumer Rights Directive, A Study for the European Parliament’s Committee on Legal Affairs (JURI) (2009), 21. Although they highlight that the application of the respective rules will likely lead to similar outcomes.

provision of services. The DCFR on the other hand, provides for a general right of withdrawal in contracts negotiated away from business premises and details the starting points irrespective of the type of contract. This allows the DCFR to rationalise the *acquis* rules to offer a more horizontal and coherent approach to withdrawal, while also overcoming difficulties which arise from the sector-specific approach of the existing *acquis* and the CRD, in regard to the distinction made between distance contracts for goods and those for services.³²² The issue of withdrawal is therefore one area where greater coherence could be achieved in the *acquis* by drawing on the CFR in its toolbox function.

It is also within this area that we see the influence of the DCFR on the CRD but within the limits of the existing approach of the *acquis*. A noted point of similarity³²³ has been the approach to off-premise contracts. The CRD is thought to considerably extend the scope of the term ‘off premise’ contracts in comparison to that of the current *acquis*, under the Doorstep Selling Directive,³²⁴ and in this respect follows the DCFR which refers to contracts negotiated away from business premises.³²⁵ It has been discussed, however, that unlike the CRD, the DCFR brings under the latter head, without distinction, both off-premise and distance contracts, in a horizontal approach. The CRD is, therefore, criticised for failing to consider this approach, and for choosing to maintain a distinction between distance and off-premise contracts. Maintaining this distinction, once again³²⁶ results in what is considered to be unnecessary ambiguity.³²⁷ The CRD does not offer a solution to the problem of mixed off-premise and distance marketing strategies and as such it has been advanced that it would have been easier in this respect to have followed the generic approach of the DCFR, which applies to all contracts not concluded on business premises.³²⁸

³²² Discussed in 4.2.2.

³²³ Schulte-Nölke (2009), 41. Noted above.

³²⁴ Article 2 (8) CRD. Discussed by Howells and Schulze (2009), 10, who note that the new definition will now extend to contracts concluded on the street or on public transport.

³²⁵ Article II.-5:201 DCFR.

³²⁶ As in the case of the goods/services distinction.

³²⁷ Schulte-Nölke (2009), 36.

³²⁸ *Ibid.*

The concern moving forward is, therefore, that while the proposed CRD provides for a full harmonisation and horizontal approach, it represents a framework for the future development of the contract law *acquis* in this area. The shortcomings of the proposal however highlight that opportunity still exists for improvement of this framework and the CFR would provide a good basis for this. The existence of the CRD proposal now suggests, however, that it will inform the development of the CFR to ensure consistency with the *acquis*. Indeed, the Council's Committee on Civil Law Matters has been instructed with the task of considering how the provisions of the proposed CRD should be reflected in the CFR, in order to ensure consistency between the two instruments.³²⁹ To this end, the Committee considers that it would be desirable during the setting up of the CFR to follow and to take into account the negotiation of the proposed Directive; the result may therefore be that the DCFR is changed in order to be consistent with the CRD.

From the foregoing it is clear, however, that there would be little value in a CFR which simply incorporates the CRD, and thus reflects the *acquis* as it will stand.³³⁰ In line with the original intention of the CFR in its toolbox function, the model rules of the CFR would have to recommend improvements to the *acquis* derived rules, which the EU legislator could draw upon in the future.³³¹ The foregoing examples from the DCFR on the issue of withdrawal demonstrate where the CFR could present model rules to advance a more horizontal approach to the *acquis*, and overcome existing limitations in the continued sector-specific approach.³³² If the recommendations were supported by

³²⁹ Consolidated Council conclusions (2009), paragraphs 18 and 19.

³³⁰ Twigg-Flesner makes this point in relation to the initial task of developing the DCFR, with the existing *acquis* as a source. It applies equally now, however, in light of the relationship between the CFR and CRD. See Twigg-Flesner, *The Europeanisation of European Contract Law: Current Controversies*, New York: Routledge-Cavendish, 2008, 147 and 153.

³³¹ It has, however, been envisaged that the CFR would contain a number of model rules on issues, so as to point out those areas where there is more than one answer to a particular problem, *Ibid.* The DCFR has, however, been criticised from this perspective as it does not aim to provide a series of options which the legislator may choose in deciding which rules or definitions should be used in future legislation. Rather the DCFR seeks to set out a coherent set of rules for governing contracts which is more related to its function as the basis of an optional instrument, Whittaker (2009), 646.

³³² Also eliminating the gaps and overlaps that currently exist. As envisaged by the Network of Excellence, DCFR Outline Edition (2009), 38, para 63.

explanations and reasons for deviations from the existing *acquis*, the open discourse that was intended between the two projects could result.³³³

More generally, there is still a need for a CFR as a European contractual framework of model rules, principles and terminology. While the CRD seeks to create a basis for the future development of European consumer contract law, it cannot fully serve in this function owing to its narrow scope and ‘targeted’ nature, which means that it also maintains the sector-specific approach based on the existing *acquis*. This means that while it has been shown that greater convergence in the *acquis* is being achieved by the accompanying vertical review, the CRD does not provide a sound basis for the review as it stands, and the risk is continued fragmentation. In order to ensure future consistency and coherence in the *acquis* it would, therefore, be desirable to utilise the CFR as the basis of a legislator’s toolbox in the future, as envisaged above. The CRD also interacts with issues of national contract law, which remain outside the scope of the proposal, and which threatens the coherence of the regulatory framework created in the CRD.³³⁴ For example, the CRD refers to national law for the provision of remedies in the case of failure to provide information.³³⁵ In contrast, the DCFR provides for such remedies within its own system and could, therefore, in order to result in a more complete and coherent system of European contract law, provide the CRD with a background of general contract law rules which could be read with the CRD.³³⁶

It is clear that in terms of the way forward, and in particular for the coherence of the regulatory response to obstacles arising from the state of contract law at the European level, good reasons exist for utilising the CFR in its toolbox function. It may, therefore, be hoped that the two initiatives may once again inform each other as originally envisaged, and thus that the CFR could further inform the *acquis* review in the future.

³³³ This would overcome in part the criticism levelled by Whittaker (2009), as the model rules of the DCFR would exist as alternatives to the existing approach, including the new provisions of the CRD.

³³⁴ The relationship between the CRD and national law will be considered in Chapter 6, 6.4.2. 4.1.3. discussed the creation of a dual regime under the CRD, dependant on both European and national contract law for consumer sales remedies.

³³⁵ Article 6 CRD proposal.

³³⁶ De Booy, Mak and Hesselink (2009), 15.

Chapter 5

The International Analogy

This chapter considers the European harmonisation debate in general, and the European Commission's proposals in particular, from the perspective of existing harmonisation efforts at the international and corresponding regional levels. It considers the extent to which these levels of regulatory activity can be regarded as being based on the same premise as the internal market and, ultimately, how this has resulted in the creation of harmonised transnational commercial law governing cross-border trade. A point of discussion is to consider what the European debate can learn from the international regulation of trade in general and in particular in terms of the approach, nature, form and effect of regulation at these levels. Since the traditional focus of the European harmonisation debate is the creation of a harmonised contractual instrument, the chapter moves on to consider what the EU can draw from existing harmonised instruments in creating a European law of contract. Central to the chapter, therefore, is a case study on the United Nations Convention on the International Sale of Goods. In light of the findings, the chapter goes on to consider how the international analogy can assist the understanding of the regulatory approach that must be taken to European contract law and the regulation of trade in the internal market.

5.1. International Context

The international dimension to the European contract law harmonisation debate is clear. The rationale of harmonisation at the European level can be equally observed at the international level, where divergences and ongoing competition between legal systems exist on a pronounced 'global' scale. Resulting inconsistencies between contractual systems inevitably increase risk in international transactions, in much the same way as identified for the internal market. Indeed, some point to the response at the international level to overcoming the problems to cross-border arising from domestic regulation as

evidence of obstacles to trade arising from contract law for the Internal Market. This then serves as a basis to justify further harmonisation activity at the European level.¹

The response at the international level has been an influx of private and commercial unified instruments, which in turn interact with the private law rules at the European level, both national law and the *acquis communautaire*. As a result, the search for coherence at the European level is simultaneously further complicated by the potential application of a number of non-national legal sources derived from this level. This may be the CISG, the Unidroit Principles of International Commercial Contracts (UPICC), or the application of trade usages and customs; *lex mercatoria*.² The effort of facilitating trade worldwide and in overcoming the limitations identified as arising from the diverging national systems of contract law can be seen to be undertaken at a variety of levels; nationally, regionally and internationally, by a variety of actors, and it is achieved through a variety of means of regulation; be it binding or facultative instruments, contractually incorporated rules and trade terms created by international organisation or by means of business made regulation, i.e. standard terms and conditions.³

Harmonisation activity at the international level is not, however, merely a response to the substantive differences between national legal systems which act to hinder trade. It is also considered to be necessary in light of more intrinsic inadequacies and perceived failures of national regulation. Thus, principally, it is advanced that a transnational commercial law has emerged due to the fact that an international transaction cannot be treated in the same way as a domestic one.⁴ Although this has not been presented as a significant argument in favour of harmonisation in the European debate, the unsuitability of national law as a means of cross-border regulation is evident at this level, in particular in terms of content; namely that national rules which are intended for domestic transaction are not

¹ Goode, Response to the 2001 Communication, 1.

² Kenny, 'The 2004 Communication on European Contract Law: Those magnificent men in their unifying machines' (2005) *European Law Review* 724, 726.

³ For sources of transnational commercial law, see *Transnational Commercial Law, Text, Cases and Materials* Goode, Kronke, McKendrick (Oxford ; New York : Oxford University Press) 2007, 25.

⁴ Goode et al. (2007), 19.

necessarily well adapted to the regulation and needs of cross-border trade.⁵ To this end, it is possible to criticise the technique of using harmonised private international law rules to overcome potential conflicts between national contractual provisions in international transactions.⁶ Although it has been shown that, where parties are of equal bargaining power the choice of the appropriate applicable law can be an effective way of overcoming obstacles arising from divergences,⁷ criticism at this level is directed at the effect of the choice. This will be to subject an otherwise international contract to a national contractual system which may well be unsuited to the international context of the transaction.⁸ As Schmitthoff notes; “The apotheosis of private international law is a side-effect of an exaggerated notion of the national state. It is an attempt at localising an international legal relationship in a national legal system. As such, it runs counter to the object and purpose of the international relationship”.⁹

Others question more generally the merits of national regulation, noting in particular, information failures, by which states have insufficient knowledge in order to identify the causes of problems requiring action and thus to design solutions that are appropriate. Regulation is then further undermined by those who are subject to it, who are insufficiently inclined to comply.¹⁰ The international level has thus witnessed a substitution of individual state regulation, including through means of choice of law, for the creation of a uniform system of trade regulation. The international market and its participants are not, however, being governed solely through traditional means of intergovernmental cooperation, and thus the conventions and model laws created by organisations such as UNIDROIT and UNICITRAL, who are officially mandated to develop legislative instruments and to contribute to private and commercial law reform at international level.¹¹ They are increasingly joined by a range of actors in the

⁵ Chapter 2, 2.1.3 and 2.3.4.

⁶ Goode et al. (2007), 19.

⁷ Chapter 2, 2.3.4.

⁸ Chapter 2, 2.1.3.

⁹ Schmitthoff, in Horn, Norbert and Schmitthoff (eds), *The Transnational Law of International Commercial Transactions* (Kluwer, Denventer, 1982), 22.

¹⁰ Black, *Decentring Regulation: Developing Strategies of Self Regulation* (2001) *Current Legal Problems* 103, 106.

¹¹ Goode et al. (2007), 201.

harmonisation of private law at this level: non-governmental organisations, international trade organisation,¹² trade specific and professional organisations,¹³ technical committees etc. Market participants themselves also contribute to the regulation of the market, through the exercise of the high degree of contractual freedom that they enjoy in the commercial sphere.¹⁴

A corresponding development to the international regulation of markets is regionalisation, that is to say, the creation of harmonised laws to establish a framework for the development of regional markets, based on states linked by a geographical area.¹⁵ The US can be considered as one of the world's most important single markets, and much of its success can be attributed to the facilitation of trade between states by the Uniform Commercial Code, consisting of uniform legal rules relating to the most important commercial transactions. In contrast, to take the EU and the creation of the single market as a further example of regionalisation, it has been shown that harmonisation in this context has been accompanied by legal fragmentation. There has been a failure at this level to manage the existence of multi-level governance in the market, which has undermined the EU's integration objectives and search for coherence. Thus, not only is there supranational regulation of the market and its participants through the EU, but also national and international regulation, all of which interact and in many cases conflict. So, in the B2C context, despite harmonisation by the EU in the area of contract law, significant differences remain in national contract systems, with which the *acquis* interacts, but which remain outside of the scope of the directives. Thus the internal market has not yet reached the stage where a contract of sale between parties in different Member States can be treated as if they were contracting within a single state.¹⁶ The creation of such a regulatory framework is, however, the end now sought by the European harmonisation debate,¹⁷ through the proposed CRD and reflection on the

¹² First and foremost the ICC.

¹³ e.g. the formulation of standard term contracts, by bodies such as GAFTA (Grain and Feed Trade Association).

¹⁴ Chapter 2, 2.3.4.

¹⁵ Goode et al. (2007), 23.

¹⁶ Goode, *Commercial Law*, London: Penguin, 2004 (3rd ed.), 856.

¹⁷ Chapter 4, 4.1.1.

creation of a harmonised optional instrument of European contract law.¹⁸ Any future action at the European level will, therefore, have to ensure coherence between the varying levels of regulation that exist in the internal market. The issue becomes one of how this is to be achieved in Europe, and more particularly what can be learnt in this respect from the current regulation of trade at the international level.

5.2. Levels and Forms of Regulation

This section considers the current approach to harmonisation at the international level, through analysis of the Convention on the International Sale of Goods (CISG). It considers the nature of, and approach to harmonisation at this level as well as the form and effect of the harmonised instrument. This is, however, preceded by a general discussion highlighting the key characteristics of harmonisation and other regulatory activities at these levels

5.2.1.1. Approach and Nature

The aim of harmonisation at the international level, has been the facilitation of trade through the creation of a harmonised, although not at this stage unified, set of rules governing specific contracts, and specific components of transactions. Significantly, there has been no binding attempt at this level to harmonise the general part of contract, subject to the existence of the Unidroit Principles of International Commercial Contracts, which forms a non-binding restatement of general contract law designed for use at the international level. The nature of a cross-border contract, in particular the contract of sale, is characterised by a multiplicity of parties, a number of independent yet interrelated contracts and different jurisdictions. This means that international contracts are not always realised and so the focus of harmonisation attempts has been the creation of an international business transaction law.¹⁹ As such, there has been a piecemeal and sector-

¹⁸ That would contain harmonised European sales rules, 2004 Communication, 21.

¹⁹ Sappideen, Harmonising International Commercial Law Through Codification (2006) Journal of World Trade 425, 428.

specific approach to harmonisation in the areas of transport, banking, arbitration and e-commerce, among others,²⁰ which are associated with the principal commercial contracts.

In the nature of harmonisation attempts at this level we can thus discern a commercial, as opposed to contractual, focus. It is, thus, the law of commerce and professionals, to the exclusion of consumer law that has been the concern of harmonisation activity at the international level.²¹ This is clearly evident in the scope of existing harmonisation activities and the resulting instruments. For example, the United Nations Commission on International Trade Law (UNCITRAL) is responsible for modernising and harmonising the rules of international business. Their work encompasses the international sales of goods; being the creators of the CISG, as well as other harmonised instruments and rules on international payments, the international transport of goods, insolvency, and international commercial arbitration and conciliation, among others. The archetypal commercial transaction is the sale and supply of goods, illustrated by the existence of the CISG, as a codified instrument dedicated solely to this commercial transaction. There are, however, many other types of contracts associated with the contract of sale: contracts for carriage of goods, financing of sale, insurance, equipment and leasing. The potential scope of commercial law is clearly reflected in the US UCC, which provides uniform rules relating to what are perceived as the most important commercial transactions. Harmonised law relating to the sale and leasing of goods, bank deposits, negotiable instruments, letters of credit and documents of title, secured transactions and investment securities are all found within the regional code.

However, as highlighted, inter-governmental cooperation is only one source of harmonised commercial rules existing at these levels. Regard should also be given to regulation through international trade organisations, notably the International Chamber of Commerce (ICC), which demonstrates a different approach to bringing about greater uniformity in international transactions. The standard contract, although adopted principally as a matter of practicality, as there will be little time for negotiation on precise

²⁰ See Bonell, Do we need a Global Commercial Code? (2000) *Uniform Law Review* 469, 470.

²¹ Sealy & Hooley, *Commercial Law*, London: Butterworth's, 1999 (2nd ed.), 4.

terms of agreement beyond those related to the subject matter and price, has become an essential feature of commercial law internationally, and the ICC has been at the forefront of their development. Today, their standard terms are adopted so widely as to be considered as non-parliamentary statutes, the prime example being the international rules for the interpretation of frequently used trade terms known as the Incoterms. Rather than forming a complete model contract to govern typical international sales transactions, these rules have the more modest but significant aim of partial standardisation of terms relating to the delivery of goods and the allocation of costs. They are intended to create a common language and infrastructure for trade and a considerable amount of the ICC's success has been attributed to the restriction of their aims in formulating rules like the Incoterms. These aims, to consolidate existing trade practices, rather than pursuing harmonisation for its own sake, are considered better in practical terms than theoretical improvements.²²

Success in the formulation of uniform commercial rules at international and regional levels has thus been largely attributed to the pursuit of realistic, achievable aims,²³ as is evident in the limitation of the scope of harmonisation to commercial law. This is the case for two reasons. Firstly, it is clear that commercial law has lent itself well to standardisation and harmonisation, as it is concerned with a large number of transactions in which participants can be considered as regular players, so that the transactions are typical and on the whole repetitive.²⁴ Secondly, they have been confined to commercial transactions, as those involving consumers are already highly regulated and, in particular, are dominated by mandatory rules.²⁵ The rules contained in successful harmonisation instruments thus consist almost entirely of dispositive rules, i.e. those which parties are free to vary or exclude. This is principally attributed to the difficulty in reaching agreement for inclusion of mandatory rules which can prevent instruments coming to fruition in the first place. Having regard to the internal market, however, and to the future

²² Schmitthoff, *Commercial Law in a Changing Economic Environment*, London: Sweet & Maxwell, 1981 (2nd ed), 19.

²³ Goode, *Contract and Commercial Law: The Logic and Limits of Harmonisation* (2003) Vol. 7.4. *Electronic Journal of Comparative Law*, I 3.

²⁴ See, Sealy and Hooley (1999), 5.

²⁵ Goode (2003), I 3.

approach to European contract law at this level, it is clear that such a limitation in scope, so as to include within a harmonised instrument only dispositive and commercial rules, is not a tenable response to the identified obstacles. In consideration of the creation of a single regulatory framework to support trade in the internal market, however, the foregoing nature and approach of existing harmonisation presents clear parameters which must be reflected upon.²⁶

5.2.1.2 Form and Effect

The existing body of uniform international commercial law has been seen to be derived from a variety of sources.²⁷ At one level, legal instruments which are the product of intergovernmental cooperation can be seen to exist at the international and regional levels, and may have different binding effects. One possible combination is an international harmonised instrument which is intended to be legally binding on those Contracting States which are party to the Convention, such as the CISG²⁸. Another combination is a regional instrument, which is not intended to be binding and thus forms a model law which States can either adopt in full, not at all, or in a varied state. These are important means by to achieve harmonisation of commercial law across regions, and the most noteworthy example is the US UCC. This points to an intermediary category, and a further option which the EU has considered for the form and nature of a harmonised instrument.²⁹ Restatements, produced by scholars, result from comparative research seeking to develop common contract principles based on the most common solution found in national contractual systems. Their creation is often motivated by the desire to find the best rules from across the Member States, thus ensuring both harmonisation and improvement of the law.³⁰ Such instruments constitute soft law and are therefore not legally binding. They can, however, be used by parties at the drafting stages of contracts, where they can incorporate those rules which they believe to constitute the best solution

²⁶ Section 5.3.

²⁷ See Generally, Goode et al. (2007), 25.

²⁸ Although contracting parties in Contracting States can contract out of the Convention, Article 6 CISG.

²⁹ 2001 Communication, Option II: Promote the development of common contract law principles leading to more convergence of national laws, which became the proposal for the CFR.

³⁰ Goode et al. (2007), 37.

for their needs, and are also influential for national courts and legislatures in applying and developing the law. At the international level, an important example is the Unidroit Principles of International Commercial Contracts; the EU also has its own important source of common rules in the PECL and, notably, now in the DCFR.³¹ It is clear that the PECL and, in its extended form, the DCFR, is an important resource upon which the EU and the creators of a European contract law should draw.³²

At another level, international trade has benefited from the standardisation of trade terms. Such attempts can be classified into groups,³³ the most important being contractually incorporated non-legislative standardised trade terms, derived from international trade organisations. In terms of legal effect, terms such as those contained in the ICC Incoterms may, depending on the jurisdiction, have customary or even statutory force. For example, under English law they will only have binding effect if the parties have incorporated them into the contract and thus adopted them as the common rules which will determine the respective contractual duties and obligations of the buyer and seller. This is also the case with the Uniform Customs and Practice for Documentary Credits (UCP), which are formulated by the ICC as rules governing the use of documentary credits.³⁴ These standardised rules will usually be incorporated by express wording of the documentary credit to the effect that its use, i.e. the rights and obligations of the parties to the letter of credit, is to be governed by the uniform customs and practice for documentary credits. However, such is the universal use of these contractual trade terms that, even in the absence of incorporation, they will be considered incorporated as a matter of business practice since they are so globally used by banks.³⁵ The result is that trade is being carried out internationally on the basis of the same legal terms, irrespective of the political, ideological or economic policies of the national states.³⁶ Parties will be buying

³¹ See Chapter 4, 4.2.1. and 4.2.2. on the restatement function of the (D)CFR.

³² See generally Chapter 4, 4.2 and 4.3. Ultimately, however, it is unlikely that the adoption of a restatement alone could result in the necessary coherent and predictable framework that is required for trade in the internal market. See discussion in 5.3.

³³ Murray, Schmitthoff's Export Trade: The Law and Practice of International Trade (11th ed.) London: Sweet & Maxwell, 2007, 833.

³⁴ Described by Goode as the most successful harmonising measure in the history of international commerce. (1992) *Lloyds Maritime and Comparative Law Quarterly*, 190.

³⁵ Goode (2004), 951.

³⁶ Conclusion of Schmitthoff (1981), 19.

goods under the terms of the Incoterms and payment will be made under documentary credits, the use of which is governed by the UCP, and in turn the goods will be carried under standard form charter parties, bills of lading or airway bills, and will be insured on standard terms whilst in transit.

In addition, trade will often be supported by standard contract forms relating to specified international transactions, which dominate international trade in commodities and capital goods.³⁷ A significant source of such contracts is trade associations, such as GAFTA,³⁸ meaning that commodities will often be bought and sold under common terms and conditions. GAFTA has a range of 80 standard forms of contract with clauses covering, amongst others: quality, condition, warranties and guarantees; shipping documents and appropriations; payment terms; default and damages. In terms of effect, they will only apply where adopted by the parties as the rules governing their contract, subject to variation by agreement. The foregoing examples illustrate harmonisation through the freedom of traders to regulate their affairs by contract, in the sense that they are avoiding the application of unsuitable and conflicting national laws through the adoption of rules of international trade and professional organisations.³⁹ This is also achieved through the formulation of their own standard contractual terms and conditions, which are a further source of standardised terms when frequently incorporated into contracts between parties and intended to apply to all transactions between them.⁴⁰

A distinctive feature of commercial law, as opposed to classical contract law, is that its content includes extra-legal usages, customs and codes of behaviour in the business community, often encompassed under the designation *lex mercatoria*. There is, however, some uncertainty as to what the latter encompasses as source of law for international trade.⁴¹ Some advance a narrow definition confining *lex mercatoria* to the unwritten customs and practices of merchants being, thus, the result of spontaneous activity on their

³⁷ Murray (2007), 834 & 839.

³⁸ Grain and Feed Trade Association, as well as others, e.g.. the Federation of Oil, Seeds and Fats Association (FOSFA), or the Cocoa Association of London Ltd.

³⁹ See Cremades and Plehn, The new *lex mercatoria* and the harmonisation of the laws of international commercial transactions, (1983) Boston University International Law Journal 323.

⁴⁰ Murray (2007), 834.

⁴¹ And of course whether it is a source of international law at all, which does not fall within the scope of this discussion.

part, in adopting a particular usage.⁴² For others, *lex mercatoria* encompasses not only those unwritten trade rules but is used as an umbrella for all of the foregoing non-national sources of law. Thus Teubner advances that *lex mercatoria* as a body of law has its source in worldwide commercial practices, standardised contracts, the activities of global economic associations, codes of conduct and awards of international arbitration courts.⁴³ What is clear is that *lex mercatoria*, in whatever form and content, is regarded as an important non-national source of international trade law.⁴⁴ A further important feature of international trade, which has supported the use and thus the creation of a uniform international trade law, must also be noted. This is international commercial arbitration, particularly to the extent that it allows arbitrators to refer to such non-national sources of law, which means that trade is removed to a significant extent from the constraints and limitations of national law.⁴⁵ Such developments, which evidence dissatisfaction with national regulation of trade, cannot be overlooked by those involved in the European contract law debate.⁴⁶

Returning to the Commission's proposals for the review of the *acquis*, the creation of a CFR and the potential adoption of an optional instrument of European contract law on this basis, it is, however, necessary to return to an existing example of a harmonised instrument at the international level. This is done with a view to identifying both the success and potential limitations of this regulatory approach.

5.2.2. International Harmonisation Case Study – The United Nations Convention on the International Sale of Goods (CISG)⁴⁷

Literature assessing the success of this harmonised instrument commonly points to the fact that the Convention is in force in 74 States worldwide,⁴⁸ encompassing most of the

⁴² Goode et al, (2007), 38.

⁴³ Teubner, *Global Law without a State*, Teubner ed. Aldershot; Dartmouth, 1996 Chapter 1, 9.

⁴⁴ Also see, Goode et al. (2007), 35.

⁴⁵ Ibid. 22.

⁴⁶ Concluded in Chapter 2, 2.3.4.

⁴⁷ Adopted in 1980, and entered into force on 1 January 1988, for a full text:

<http://www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf>.

⁴⁸ On the status of the instrument see,

http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html.

major trading nations of the world, suggesting that the Convention regulates a significant number of international sales contracts.⁴⁹ It is, however, simultaneously submitted⁵⁰ that the perceived success and global reach of the Convention can be misleading. In the first place, there are many states that have failed to ratify the Convention, which will impact upon the sphere of application of the harmonised rules. Further, it is submitted that it cannot be considered to form a comprehensive code governing international sales transactions.

As with the application of any uniform contract law, the applicability of the Convention will depend on the existence of a specific link between the contract, the parties, or the place relevant in respect of the contract and a Contracting State and its law.⁵¹ Thus the CISG provides that the Convention will apply to contracts of sale of goods between parties whose places of business are in different states, when either the states are Contracting States or when rules of private international law lead to the application of the law of a Contracting State.⁵² A number of issues for the application of the Convention arise from this article. The first concerns the nature of the contract at issue, which must be one for the sale of goods. This is defined by Article 3 as those for the supply of goods to be manufactured or produced to the exclusion of contracts for services.⁵³ Next, it is clear that for the Convention to apply the parties to the contract must also have their places of business in different states. This constitutes the international element of the sales contract but also means that the Convention will not apply to domestic sales transactions and one may wish to question why this distinction has been made. The approach is advanced on the basis that international sales give rise to problems not arising in the domestic context, in particular the problems posed by conflict of laws for international sales, which do not arise in domestic transactions. Further, it is often the

⁴⁹ Goode et al, (2007), 258.

⁵⁰ See Ferrari, What Sources of Law for Contracts for the International Sale of Goods? Why one has to look beyond the CISG (2005) *International Review of Law and Economics* 314, 315.

⁵¹ Ibid. 327.

⁵² Article 1 (1) (a) & (b).

⁵³ Article 3 (2).

preferred solution in regard to scope, as it is less of an intrusion on national sovereignty.⁵⁴ However, it is clear that limiting the scope of application of harmonised rules to those contracts involving a cross-border element can in fact lead to greater fragmentation of markets as businesses would be forced to apply the law of a Member State to domestic transactions but a harmonised system of law to all others.⁵⁵

Finally, for the Convention to apply there must be a connecting factor between the contract and a Contracting State. This can occur in one of two ways. Firstly and uncontroversially, it will apply where the states in which the respective businesses are located are party to the Convention, i.e. Contracting States. In the second situation, effect will be given to the harmonised rules of the Convention through rules of private international law which lead to the law of a Contracting State. This position has proved more controversial, as it indirectly extends the scope of application of the Convention's rules, which may result in unfair surprise. For example, if parties in two non-Contracting States choose what they believe to be the domestic law of a Contracting State as the law applicable to their contract, this may result in the application of those rules contained in the CISG. This can be seen to go against their intention to have their contract governed by the purely domestic rules of their chosen contractual system.⁵⁶ As a result, under Article 95 of the Convention Contracting States possess a reservation to exclude the application of Article 1 (1) (b). The effect is that in such situations the national court at issue would not be bound to apply the Convention as part of the national law, where the application of choice of law leads to the law of a Contracting State. An interesting example of the use of this reservation is the US exercise of their reservation seemingly to preserve as much as possible the applicability of its own UCC. However, one cannot overlook that although the Contracting State may have good reason for taking this position, which may in fact be in the interest of parties from non-Contracting States, the

⁵⁴ Goode et al, (2007), 261. In regard to intrusion on state sovereignty this may not be such a concern in the context of the internal market if an optional harmonised instrument is preferred, as this would not replace national laws, but would merely exist in addition to. See, 5.3 and Chapter 6, 6.3.

⁵⁵ See Von Bar, Swann, Communication on European Contract Law: Joint Response of the Commission on European Contract Law and the Study Group on a European Civil Code (2003) European Review of Private Law 595, 602.

⁵⁶ See Bernasconi, The Personal and Territorial Scope of the Vienna Convention on Contracts for the International Sale of Goods (Article 1), (1999) Netherlands International Law Review 137, 3.3.3.3.

effect will be to considerably reduce the frequency with which the Convention will be applied. The reservation allows for the application of other sources of law to govern international sales transactions and this acts to undermine the goal of creating an international sales code.⁵⁷

In addition to Article 95, an exception which is considered to be of diminishing practical significance as the number of Contracting States rises,⁵⁸ the scheme of the Convention contains a number of other provisions which call on courts of a Contracting State to take into account other sources of law.⁵⁹ For example, Article 90 recognises the increasing number of substantive uniform law conventions and thus the possibility that more than one may be applicable to the same contract and, thus, that conflict may arise. It therefore provides that where a Contracting State is also party to another international agreement which contains provisions concerning matters governed by the CISG, then the latter will apply, provided that both parties have their respective places of business in states party to the former agreement. The Convention thus gives way to the application of another source of law, which ultimately undermines its harmonising effect. Another example is the reservation created under Article 92, which was intended to allow some Contracting States⁶⁰ to rely on their regionally harmonised rules of sales contracts rather than the provisions of the CISG. The effect of this provision is that these States are not bound by, nor is their national law replaced by, the Convention's provision in relation to the formation of contract and the rights and obligations of the parties falling under it. A party that has its relevant place of business in a State that has made an Article 92 declaration is considered as having its place of business in a non-Contracting State for the purposes of those parts excluded.⁶¹ Thus, in providing for the possibility of reservations and for the explicit application of other sources of law, it can be initially concluded that it is not sufficient for contracting parties to rely solely on the rules of the Convention for the import and export of goods worldwide. This inference is confirmed by consideration of the substantive scope of the CISG.

⁵⁷ Ibid. 3.3.3.4.

⁵⁸ Goode et al, 262, who make it clear that the principal connecting factor is now Article 1 (1) (a).

⁵⁹ On these circumstances, see generally Ferrari (2005), 317 – 322.

⁶⁰ Denmark, Finland, Norway and Sweden.

⁶¹ See Ferrari (2005), 320.

The Convention deals with a specific part of international commercial law; the sale of goods, and thus, in so far as the applicable general part of contract law is concerned, the Convention refers to the respective laws of the Contracting States and thus the diverging rules at this level.⁶² The substantive scope of the CISG is further limited by a significant exclusion in Article 4, which provides that the Convention shall only govern the formation of the contract of sale and the rights and obligations of the seller and buyer arising from such a contract. It explicitly removes from its scope matters relating to validity of the contract and the effect which the contract may have on the property in the goods sold. As noted⁶³ it is surprising to have excluded these issues from the substantive scope of the Convention given the significance of both as defining characteristics of a contract of sale, that is to say, the existence of a valid contract under which property is to pass from seller to buyer. But the reason for their exclusion is said to be pragmatic, as the law relating to the validity of contracts and the passing of property was considered to vary so considerably between States that it would have been an excessively difficult task to have formulated uniform rules. The ability to harmonise thus clearly has limits and, given the need to have such rules harmonised, it is frustrating that these rules are left outside the scope of the Convention.

It is clear that, even where the Convention does apply, there is still considerable scope for the application of other national sources of law and, thus, uncertainty and the associated additional transaction costs. Ferrari⁶⁴ maintains that the CISG creates a false sense of certainty as to the applicable law, that is to say that the presumption that this is the application of a universal set of contract rules for sale, under a comprehensive, codified instrument, is actually dangerous and costly to international traders' interests. It can lead to greater transaction costs in light of the need to identify the potentially applicable sources and, as such, it could be advanced that the CISG has failed to fully realise the practical benefits that it is in fact pursuing and is merely adding another source and level of rules into the mix. This criticism, however, is not unqualified and it is conceded that

⁶² Article 7 (2). The instrument is thus dependant on national law outside of its narrow scope, like the CRD proposal, see discussion in Chapter 4, 4.1.3 and Chapter 6, 6.4.2.

⁶³ Goode et al, 271.

⁶⁴ Ferrari (2005), 323.

the contracts and substantive rules that the Convention does cover can be considered a success. This is also the case where the instrument's scope and potential to allow for the application of other sources of law are actually understood and provided for by the contracting parties.⁶⁵

As for the nature of the provisions contained within the Convention, it consists wholly of dispositive rules. The Convention expressly provides for the parties to exclude the application of the Convention in full - being opt-out in form – or to derogate from or vary any of its provisions.⁶⁶ The absence of mandatory rules in the instrument, although those of the Contracting States continue to apply, is an important concession made by its drafters to ensure its acceptance.⁶⁷ Indeed, the prevalence of defaults in the Convention and similar instruments demonstrates the very nature of the harmonisation process: requiring agreement and support for the substantive content by States with different economic, social and political ideologies. The resulting provisions are thus often perceived as the product of negotiation and compromise, rather than what best meets the commercial needs of the market and its participants.⁶⁸ Gillette and Scott⁶⁹ note that this compromise may take several forms. It may, as discussed, take the form of limiting the application of the instrument's provisions. It may also result in a tendency to formulate vague rules and standard defaults, so as to reduce the risk that Contracting States will take offence. This approach vests considerable discretion in the subsequent interpreters, be they courts or legislatures, which results in uncertainty and can thus further jeopardise the anticipated harmonising effect of the instruments.⁷⁰ At worst, it is anticipated that compromise will result in omissions,⁷¹ disagreements being resolved by placing the rule in the comments or leaving it to the Courts to fill in the gaps. In terms of omissions, one could of course point to the exclusion of matters of validity or the passing of property

⁶⁵ Walt, *The CISG's Expansion Bias: A Comment on Franco Ferrari* (2005) *International Review of Law and Economics* 342.

⁶⁶ Article 6, subject to Article 12.

⁶⁷ Farnsworth, *Modernisation and Harmonisation of Contract Law: An American Perspective* (2003) *Uniform Law Review* 97, 103.

⁶⁸ *Ibid.* 106 and Gillette & Scott, *The Political Economy of International Sales Law* (2005) *International Review of Law and Economics* 446, 460.

⁶⁹ *Ibid.* 461.

⁷⁰ A concern that arises in regard to the DCFR, see Chapter 4, 4.2.2.

⁷¹ Farnsworth (2003), 105.

from the content of the CISG. Farnsworth notes that another fundamental omission in the case of the CISG is penalties, a matter which involved significant differences between the common law and other legal systems and which would have required the inclusion of a mandatory rule.⁷²

The resulting content of harmonised instruments is, therefore, the product of clear constraints, both political and practical, in the harmonisation process. This is also a clear danger for a harmonised instrument of contract law at European level as, with the minor exception of the requirement of writing, we are yet to see a nation ratify a mandatory rule of general contract law, in a binding or non-binding international harmonised instrument.⁷³ However, given the distinctive problems created by mandatory rules, particularly those of consumer protection, and the intention behind any harmonisation at European level being to improve the functioning of the internal market, the exclusion of mandatory rules cannot be accepted in this context, at least in regard to those rules governing B2C contracts.

Despite the foregoing criticism of the Convention in terms of its limited commercial nature, limitations in its scope of content, the potential for the application of other sources of law, and the prevalence of dispositive over mandatory rules; it must be contended that the CISG still represents a significant example of harmonisation and, more particularly, its limits for those advancing the European project.

The international analogy ultimately demonstrates that diversity, in terms of sources of law and trade rules, is not in itself a bad thing. International trade regulation is a collaboration of levels, sources and actors, yet it is considered, as an organised whole, to form a harmonised transnational commercial law.⁷⁴ It has been demonstrated that the CISG, as a binding, uniform body of rules governing international sales, makes provision for the application of other sources of law to parties' contractual agreements, and as such

⁷² Ibid. 104.

⁷³ Farnsworth also notes reluctance on the part of the Unidroit principles to impose mandatory rules in the scheme of the instrument.

⁷⁴ Indeed it is the subject matter of books; "Transnational Commercial Law", Goode et al, (2007).

creates its own hierarchy of sources in establishing which are to take priority over its provisions. At the international level, therefore, the inevitable interaction between sources of commercial law and rules is accepted and accommodated and, as a result, complete uniformity of commercial law has not yet been achieved.⁷⁵ A condition however, if the harmonising effect and benefits of such are not to be undermined, is that the scope and interaction of systems of law must be transparent and understood, if a coherent solution is to be achieved.

5.3. The EU Regulatory Response

How, then, does the international analogy assist the understanding of the regulatory approach that must be taken to European contract law? The EU is now looking to create a simplified regulatory environment in order to enhance business and consumer confidence in the internal market by overcoming the limitations of the existing regulatory approach. The solution is perceived as a direct response to the fragmentation of contract law caused by minimum and sectoral harmonisation, which seemingly demands a full and horizontal regulatory response. The proposed CRD therefore seeks to regulate the common aspects of the contract of sale for consumer goods in a systematic fashion.⁷⁶ In contrast, therefore, to the foregoing examples of trade regulation, the facilitation of trade within the internal market is first and foremost directed by the EU at B2C transactions. The commercial focus of international regulation is not reflected at EU level, where the response necessarily includes mandatory rules of consumer protection. Such rules are absent at the former levels, where preference for dispositive rules has been adopted, owing to apparent difficulties in reaching agreement on the content of such rules between states with different social and political backgrounds.⁷⁷

However, by analogy with the foregoing examples, although moving towards a horizontal approach with the consolidation of four consumer directives, the CRD is targeted in its

⁷⁵ Although is the subject of debate, with proposals to consolidate the existing proliferation of rules at the international level to form a global commercial code, see Schmitthoff (1981), 29 – 31.

⁷⁶ CRD Proposal (2008), 2 and discussed in detail in Chapter 4, 4.1.3.

⁷⁷ The nature of the task is reflected in Chapter 3, 3.2.

nature. It seeks to regulate those issues which raised substantial barriers to trade for business and consumers and, more particularly, those relevant to traders in operating their businesses and in drafting standard contract terms.⁷⁸ This has then been combined with vertical revision of the existing sectoral directives, which remains desirable,⁷⁹ and no attempt has been made to harmonise the general law of contract. In this respect, national contractual systems remain largely intact and, by analogy with the limited substantive scope of the CISG,⁸⁰ it will be necessary to refer to national law on issues such as the validity of the contract or the award of damages.⁸¹ It is immediately apparent that the CRD may not provide a sufficiently simplified and transparent regulatory environment. Further, the CRD will co-exist with the sector-specific *acquis*, becoming part of a more complex regulatory framework at the European level.⁸² As a result, the proposal is not a comprehensive and systematic regulation of all consumer rights; rather, it consolidates four directives, and while accompanied by vertical review, greater coherence is being achieved at this level, this is not full coherence.⁸³

Remaining differences between contract rules at the national level itself creates obstacles for the proper functioning of the internal market, which significantly also extend to B2B transactions. As the *acquis* will also continue to interact with these rules, outside the scope of the directives, it is clear that this level also requires a regulatory response, which has been presented as the optional instrument.⁸⁴ Indeed, despite there being no binding and comprehensive harmonised instrument of general contractual principles at either international or regional level, it is possible that an optional instrument, based on the (D)CFR, could present a more comprehensive means by which to achieve the necessary simplified regulatory framework that is sought for B2C and B2B transactions in the internal market. The Commission envisaged that an optional instrument could cover the

⁷⁸ CRD Proposal (2008), 7.

⁷⁹ Discussed in Chapter 4, 4.1.3.

⁸⁰ Discussed in 5.2.2.

⁸¹ The relationship between the CRD and national law and the implications of this for the regulatory response is considered in detail in Chapter 6, 6.4.2.

⁸² Discussed in Chapter 4, 4.1.3.

⁸³ Evidence of Twigg-Flesner to the House of Lords European Committee, in the Eighteenth report, EU Consumer Rights Directive: getting it right (2009), Q.5. The issue in this chapter is why this is the outcome and is discussed further below

⁸⁴ Chapter 2, 2.5.

general part of contract as well as the law relating to specific contracts considered to be of economic importance to the internal market, including contracts of sales, services and insurance.⁸⁵ As a basis for discussion of the content of such an instrument, therefore, in addition to rules of general contract law, the DCFR contains rules governing the specific contracts of sales, services, mandate contracts, commercial agency, distribution, franchising, and loans and leasing.⁸⁶ A series of optional instruments could, thus, govern the whole contractual relationship for specific contracts.⁸⁷ In this way, the need for horizontal regulation within the internal market would not rule out the possibility of vertical regulation of specific contracts which is inherent at the international level. An optional instrument of this nature would present greater scope for coherence between the varying levels of regulation existing in the internal market. Whether or not the CFR itself can support such a comprehensive framework will depend on the outcome of the political process and, thus, whether or not the CFR is created with this purpose in view.⁸⁸

As to the form and effect of the regulatory instrument, the fragmentary state of European contract law can, to a considerable degree, be attributed to the use of minimum harmonisation and directives as the preferred regulatory approaches. This has meant that Member States have been left with a considerable degree of discretion, being bound only by the end to be achieved⁸⁹ and the need to safeguard a minimum level of protection. While both regulatory approaches are important means of integrating European law into national systems, their use has put at risk the uniform application and implementation of the rules throughout the Member States. Thus it is clear that only a binding instrument, akin to the CISG, could ensure the degree of uniformity which is currently necessary within the internal market. In order, also, to support the move to full and horizontal harmonisation, this suggests that a regulation, as a directly applicable, binding instrument which would ensure the implementation of the harmonised instrument in its entirety across the Member States is the preferred legal instrument. This conclusion, however,

⁸⁵ 2004 Communication, 20.

⁸⁶ Book IV Specific contracts and rights and obligations arising from them, DCFR Outline Edition (2009).

⁸⁷ This possibility is discussed in detail in chapter 6, 6.4.

⁸⁸ i.e. in addition to the toolbox function which suggests a more limited instrument in terms of content, see discussion in Chapter 4, 4.2.3.

⁸⁹ Directives are only binding to the end to be achieved, Article 288 TFEU (ex 249 EC).

casts further doubts on whether the CRD, in the form of a directive, can create the required simplified regulatory environment. Member States will retain discretion in how to implement the CRD into national law, and this will not necessarily be in a self-standing piece of national legislation but, rather, may be implemented in piece-meal fashion across the sector-specific legislation implementing the now consolidated directives.⁹⁰ The single, although incomplete, applicable framework that exists at EU level may not therefore be transparent at national level, which will undermine the intended harmonising effect and thus the certainty and confidence that the proposal is intended to create for businesses and consumers.

The simplification aims would further necessitate that the harmonised instrument apply not only to cross-border transactions, but also to domestic. This is necessary in order to avoid the creation of a dual regime for those trading both domestically and cross-border, who would otherwise continue to suffer from the fragmentation of contract law. For this reason, the CRD applies also to domestic contracts⁹¹ and, clearly, in terms of economies of scale for businesses the harmonisation effect will be optimised as a result. This, however, is not the approach of all harmonised instruments, for example the CISG, whose limitation in scope to cross-border transactions is considered to be less of an intrusion on national sovereignty.⁹² This is just one concession made by such instruments in order to ensure acceptance by Contracting States. Clearly, the choices made as to the form, nature and effect of harmonised instruments impact upon the national contractual systems and, more particularly, national regulatory autonomy. This is especially so when full and binding harmonisation is sought. Thus while to date a great deal has been achieved by the EU within the *acquis*, including the creation of binding, harmonised mandatory rules of consumer protection not reflected in the international analogy, this has been facilitated by some deference to Member States' regulatory autonomy, and notably the use of minimum harmonisation. The more ambitious objective of creating a single regulatory framework in the CRD, and the transition to full harmonisation, has however resulted in compromise on the part of the harmonised instrument. This is readily apparent

⁹⁰ This regulatory limitation is highlighted by Twigg-Flesner (2009), Q.9.

⁹¹ CRD proposal (2008), 9.

⁹² 5.2.2.

in the instrument's targeted nature and limited scope and, thus, the continued applicability of other sources of law, both the residual sector-specific *acquis* and the national contractual systems. The compromise is also apparent in the choice to implement the CRD in the form of a directive, rather than a regulation. Therefore, the regulatory choices that have been made, because of the political and practical constraints of harmonisation, have served to undermine the simplification aims.

The implementation the CRD in the form of a regulation would, however, have indicated that consumer law is no longer a matter for national regulation and this would be politically unacceptable for Member States.⁹³ The protection of consumers within national systems is a politically sensitive issue, which reflects the balance that is reached between freedom of contract and social justice within the state. It is an expression of a nation's values, which are threatened by full and directly applicable harmonisation.⁹⁴ Thus, although the regulation of consumer law has largely become an issue for the European level, through the adoption of directives, Member States have retained the ability to intervene when there has been a need.⁹⁵ The benefit of the traditional regulatory approach was, therefore, that it recognised that consumer law, but contract law in general, is a product of Member States' socio-economic, cultural and political backgrounds. The effect of minimum harmonisation is, thus, not regressive on national systems and allows Member States to develop national law to reflect changes and developments at national level, akin to the model law. Ultimately, however, while there are apparent advantages to maintaining minimum harmonisation as the regulatory response at this level, it has been shown to be a regulatory compromise in itself. It has resulted in the existing fragmentation of the *acquis*, and as such cannot sufficiently simplify the regulatory environment.

The regulatory objective in these terms may, however, be realised through an optional instrument of European contract law which, owing to its optional nature, would not have

⁹³ Twigg-Flesner (2009), Q.9, and QQ.36-37.

⁹⁴ The threat serves as an argument against (mandatory) harmonisation of European contract law, Chapter 3, 3.2.

⁹⁵ Twigg-Flesner (2009), Q.9, and QQ.36-37.

to result in compromise. Under the optional regime, harmonised rules would co-exist in parallel with national contractual systems, which would remain untouched. The regulatory form would thus not represent a threat to national contract law, nor to Member States' regulatory autonomy, and regulatory competition between the national systems would thrive with a new source of inspiration in a 28th contractual regime.⁹⁶ Thus although political decisions would still have to be made, they could result in a more ambitious, comprehensive, directly applicable and binding instrument, applying to both cross-border and domestic contracts.⁹⁷ This would be achieved without compromise on the part of either the instrument, and thus the EU, or by the Member States. The optional instrument may thus represent the most appropriate way forward for the attainment of the regulatory objectives.

With a single and comprehensive framework of European contract law in place there would also be scope for the creation of standard terms and contracts. The successful development of standardised trade terms to overcome the application of unsuitable and diverging national contract law at the international level has not been wholly reflected within the internal market.⁹⁸ Both individual businesses and trade associations have been developing such rules with varying degrees of success, and the Commission's proposal in the 2003 Communication to promote the elaboration of EU-wide standard terms and conditions was a direct response to the obstacles arising from diverging national law on the inclusion and application of such terms. It was such divergence between national contract law, and ultimately the lack of a harmonised European contract law, which led to the abandonment of the proposal.⁹⁹ The facilitation of cross-border trade through standard contracts has, however, regained support. The development of such contracts was the intention behind the CRD in the B2C context.¹⁰⁰ Support also comes from the Commission and European Parliament for the elaboration of voluntary standard contracts for use by businesses on the basis of the CFR as a means by which to support wider

⁹⁶ See Chapter 3, 3.1.

⁹⁷ Subject to the EU's competence to enact such instrument(s). Discussed in Chapter 6, 6.2.

⁹⁸ Discussed in Chapter 2, 2.3.4.

⁹⁹ Discussed in Chapter 2, 2.4.

¹⁰⁰ CRD Proposal (2008), 8.

economic activity in the internal market.¹⁰¹ The existence of a harmonised European contract law be it through the CRD,¹⁰² an optional instrument, or as the basis for development, the CFR, would enable businesses and trade associations in Europe to successfully develop standard contracts. This is not to say that the EU should overlook achievements at the international level and the significant standardisation of trade terms by international trade organisations, notably the ICC, which will continue to be used by commercial parties in the internal market. It has, therefore, been maintained in this respect that the Commission need not “reinvent the wheel”, and should recognise and make use of what already exists at the international level, as standard terms and conditions used in transactions between the EU Member States cannot be separated from that work.¹⁰³

5.4 Conclusion

The foregoing discussion highlights an underlying and ongoing debate regarding the appropriate level at which trade should be regulated.¹⁰⁴ Given the prominence and success of the CISG internationally, for example, it can be questioned whether Europe should look to the creation of a European sales law which is separate and distinct from the latter Convention.¹⁰⁵ The existence of an additional instrument at regional level comparable to the CISG requires consideration of the conventions' relationship and relative applicability, thereby risking a lack of clarity and thus confusion for market participants as to the applicable law. The result for some is the belief that the effect of harmonisation at the regional level may in fact be to weaken the process of harmonisation

¹⁰¹ Commission's Proposal for the Stockholm Programme (2009), 13 and 31. Although the proposal talks of the work done on creating a CFR, and thus does not discount the use of the DCFR, if the political CFR is too narrow in its 'toolbox' function to support such a role. The European Parliament talks directly of standard contracts being adopted on the basis of the CFR, European Parliament resolution of 25.11.09 on the Stockholm programme, para 101. The Council has rejected the CFR consisting of a set of STC's which could be chosen by parties. This does not, however, appear to rule out the CFR as a 'toolbox' acting in future as the basis for development, Council Consolidated Conclusions (2009), 4.

¹⁰² At least within the scope of the targeted instrument, where full harmonisation has been achieved.

¹⁰³ Bernitz, *The Commission's Communications and Standard Contract Terms*, in *The Harmonisation of European Contract Law* (Vogenauer & Weatherill eds.) (2006), Chapter 10, 192.

¹⁰⁴ Goode et al. (2007), 262.

¹⁰⁵ As McKendrick (2006) does, 29.

at the international level.¹⁰⁶ The value of harmonisation at the European level, however, lies in the distinct market integration goals held by the EU and, thus, the completion of the unique regional market which it seeks. It is clear that, while there is not a harmonised European law of contract, we do not have a single market, and the benefits of such cannot be realised. In practical terms, therefore, action must be taken at this level to organise the diversity of sources of contract rules which is inherent in the internal market – those derived from the Member States, the *acquis communautaire*, and the application of internationally harmonised rules – to create a single simplified regulatory framework supporting the internal market and its participants: businesses, in particular SMEs, and consumers alike.¹⁰⁷

The protection of the weaker party has not been shown to be a shared concern of international instruments directed at the regulation of trade. Such instruments are characterised by their commercial focus, and their absence of mandatory protective rules, which mean that they would not be fit for purpose within the internal market. Yet the foregoing discussion presents important regulatory examples upon which the EU can draw in meeting its objectives. It has demonstrated the range of regulatory choices that are available to this end in terms of approach, nature, form and effect. More particularly, the discussion has demonstrated where the limits of harmonisation lie in both practical and political terms. Harmonised instruments have been shown to be the result of negotiation and compromise, and the CISG cannot be considered as creating a fully harmonised regime for the transactions within its scope. Such compromises are already evident in the Commission's proposed CRD but, in articulating the way forward, it is clear that they cannot be wholly accepted if the objective of regulatory simplification is to be achieved. While a possible alternative exists for the attainment of this aim in an optional instrument, this proposal must be considered further.

¹⁰⁶ Goode et al (2007), 24.

¹⁰⁷ The creation of such a framework is considered further in Chapter 6.

Chapter 6

The Optional Instrument

The third proposal arising from the Commission's 2003 Communication was to examine whether distinct problems, arising for the proper functioning of the internal market from the divergence in national contract laws, required non sector-specific solutions and, in particular, the creation of an optional instrument of European contract law.¹ This proposal is not, however, distinct from those already discussed in order to improve the coherence and consistency of the *acquis communautaire*, and thus the identified problems in that respect. The CFR was to form the basis for the development of such an instrument and was thus an attempt to formulate the rules and principles which would be included within it.² The Commission envisaged that the creation of such an optional system could facilitate the exchange of cross-border goods and services in the internal market³ by providing contracting parties with a body of neutral rules which would be particularly adapted to cross-border contracts in the internal market. The Commission undertook, at that stage, to reflect upon the opportuneness of such an instrument in parallel to the wider project, while also making clear that the results of their examination could only be expected some time after the finalisation of the CFR.⁴

This chapter will begin by considering the case for the adoption of such an instrument⁵ and will present the state of play to ascertain support for the proposal. It will then examine the constitutional thresholds which the proposal must surpass for its adoption, before considering how effect would be given to such an instrument within the existing EU framework. It concludes that the proposal provides the most appropriate way forward, that is to say the most suitable and desirable solution to the existing obstacles to cross-border trade arising from the current state of European contract law, and examines more

¹ 2003 Communication, 2.

² *Ibid.*, paragraphs 64 and 95.

³ 2003 Communication, para 91.

⁴ *Ibid.* para 54.

⁵ In particular one attuned to the needs of SMEs.

specifically how such instruments could facilitate cross-border contracting in both the B(SME)2B(SME) and B(SME)2C contexts.

6.1. The Proposal and State of Play

6.1.1. The Proposal

An optional instrument of European contract law is first and foremost a direct response to those obstacles identified as arising for the internal market from the divergent state of contract law at the national level. It is thus a response to the internal market hypothesis which called for the harmonisation of national contract systems as a means by which to overcome the resulting uncertainty and associated transactions costs that currently act to deter cross-border trade in both the B(SME)2C and B(SME)2B(SME) context. While such harmonisation has not received unequivocal support, the optional nature of the proposed instrument is a distinct attribute. It means that the objective of facilitating trade can be realised within a simplified regulatory framework which also respects Member State regulatory autonomy,⁶ preserves the national contractual systems and their socio-cultural and political backgrounds, and thus maintains regulatory competition.⁷ The optional instrument therefore appears to be an appealing regulatory solution for the internal market.

The optional instrument would provide contracting parties with an autonomous system of contract law. While its content is linked to that of the CFR, a comprehensive instrument including general contract law and the law for specific contracts which are of importance for cross-border trade has been envisaged.⁸ Such an approach would remove the need to refer to the diverging provisions of contract law at the national level, and contracting

⁶ The importance of which is discussed in Chapter 5, 5.3.

⁷ The wider benefits of the optional nature of the instrument are discussed in Chapter 3, 3.1 and 3.4.

⁸ 2004 Communication, 20.

parties would be free to choose the instrument as a law better suited to their legal and economic needs.⁹

In this way, the proposal overcomes inadequacies in the existing national approach to facilitating cross-border trade and, in particular, choice of law.¹⁰ In the first place, the availability of such an instrument would overcome the criticism that the effect of choice of law is to localise, inappropriately, an otherwise international transaction. While national contract rules are intended for domestic transactions, they are not designed for the regulation and needs of cross-border trade. It is considered, therefore, that parties would benefit from a modern body of rules particularly adapted to cross-border contracts in the internal market.¹¹ As such it is envisaged that the instrument could provide the parties, the economically stronger and weaker, with an acceptable and adequate solution as to the applicable law without insisting on the necessity to apply one party's national law over the other.¹² The Commission thus envisages the creation of a neutral contractual regime, i.e. not being the national law of either party,¹³ or at least initially,¹⁴ being familiar to one party to the disadvantage of the other. It will thus form a common law between the parties. The instrument could, therefore, address the uncertainty that can exist for parties as to the content of the applicable law where, owing to inequality of bargaining power in the operation of the choice of law system, the stronger party is able to impose their preferred choice of law. This can be particularly detrimental to the interests of SMEs in the B2B context as they will lack necessary knowledge of the governing law, and will be unable to obtain legal advice in this regard on a cost effective basis.¹⁵ It is thus clear that the 'neutrality' of the instrument¹⁶ as such would be

⁹ I.e. A more suitable law than would have been determined by private international law as the applicable law to the contract, 2003 Communication, para 90.

¹⁰ Highlighted in Chapter 2, 2.4 and Chapter 5, 5.1.

¹¹ 2003 Communication, para 90.

¹² Ibid.

¹³ Or preferred choice of national law.

¹⁴ While with use parties will become familiar with the rules in the same way as they are familiar with their national contract laws, 2003 Communication, 91.

¹⁵ As the weaker party, Chapter 2, 2.3.5. Also see, 6.4.

¹⁶ The 'neutrality' of the proposal in these terms is highlighted by Hesselink, Rutgers and De Booys, *The Legal Basis of an Optional Instrument of Contract Law, A Short Study for the European Parliament*, (2008), 8.

particularly important in facilitating the active participation of SMEs in the internal market.¹⁷

While the review of the *acquis* and the resulting proposal for a CRD are, therefore, responses to obstacles to B2C cross-border trade, the optional instrument presents an opportunity to also facilitate cross-border trade in the B2B context. More particularly, it provides an opportunity to assist SMEs who, while constituting 99%¹⁸ of businesses within the internal market, presently fail to operate effectively within it. The needs of this group must be attended to in terms of the regulatory response, and the provisions of the optional instrument must therefore further¹⁹ address the existing imbalance in their trading capabilities in the B(SME)2B(SME) context.²⁰

It has been shown that it is where parties' contractual freedom is limited that greater obstacles to trade arise.²¹ SMEs in particular, but also the wider business group, would, therefore, benefit from the inclusion of harmonised mandatory rules within the instrument. This applies to B(SME)2B(SME) transactions, but creates a more significant obstacle to cross-border trade in the B(SME)2C context, owing to the mandatory nature of consumer protection rules. It is thus envisaged that the optional instrument would also apply to B(SME)2C transactions, and to this end would include mandatory rules of consumer protection, as an exception to the guiding principle of the instrument; contractual freedom. The inclusion of such rules within the instrument would make it a very valuable tool, particularly if the applicable mandatory rules of consumer protection were to be only those contained in the instrument. This would overcome the major obstacle caused in this context from the application of the choice of law regime, which will apply the law of the consumer habitual residence where the trader targets their activities at the consumer's home state. A significant disincentive to contract with consumers in other Member States would thus be removed for businesses, and consumers would benefit from the willingness of businesses to contract. This would, however,

¹⁷ 2003 Communication, para 91.

¹⁸ http://ec.europa.eu/enterprise/entrepreneurship/sme_policy.htm.

¹⁹ I.e. beyond the benefit for SMEs of the neutrality of the proposal in this regard.

²⁰ Discussed in Chapter 2, 2.3.5. and 2.4.

²¹ Chapter 2.4.

depend on the ability of the instrument, once chosen as the applicable law, to exclude the application of conflicting mandatory rules.²²

If this could be achieved in the B(SME)2C context then the optional instrument, where chosen as the applicable law, could also present a means by which to overcome one source of fragmentation of the *acquis communautaire*: the divergent rules and levels of consumer protection provisions across Member States, which has arisen from minimum harmonisation. Thus, although the optional instrument starts as a proposal to overcome obstacles to cross-border trade arising from divergent national contract law, it is apparent that this could also overcome obstacles at EU level. As such, it could achieve a result similar to that sought by the *acquis* review²³ and the proposed CRD with which it shares the objective of creating a simplified regulatory environment to facilitate trade in the internal market via full harmonisation.²⁴ However, since the optional instrument would also apply to B2B transactions, and to this end assist SME's, it is a more all-round regulatory response to the current obstacles. Whether the creation of such an instrument is possible and, thus, whether such objectives can be realised must, however, be considered.

6.1.2. The State of Play

The proposal met with support from the European Parliament, which called for the elaboration of a body of rules based on the CFR to be offered to contracting parties, who would have the option of using it voluntarily on an opt-in basis. Beyond the creation of a body of general contract rules, it was felt that substantial benefits, both to the effective functioning of the internal market and in terms of increased cross-border trade, would arise from the creation of specific optional instruments in the areas of consumer and insurance contracts. The European Parliament thus advanced that these sectors should be

²² Acknowledged by the Commission in the 2004 Communication, 21.

²³ Chapter 4, 4.1.2.

²⁴ Where chosen as the applicable law.

an early priority and called on the Commission to proceed in this direction.²⁵ The Council received the proposal with some caution, calling for continued reflection on the need for such a measure and for this to be pursued in close collaboration with Member States.²⁶ In this way, the Council's position reflected the uncertain and divided opinions articulated by national governments in their responses to the Action Plan. While some welcomed the proposal as an innovative solution to the existing legal conflicts in cross-border contracting,²⁷ other responses were negative,²⁸ and several expressed reservations about the potential complexity of the preparatory work required, which meant this was not a short term proposal.²⁹ Fundamental questions also arose in terms of the competence of the EU to adopt such an instrument. In particular, the need for it to comply with the principles of proportionality and subsidiarity was highlighted.³⁰ Businesses too, that is to say those who could benefit greatly from the adoption of such an instrument, reserved their position on whether an optional instrument would be useful until work on the CFR was complete.³¹

The general reaction to the initial proposal therefore highlighted a need to both clarify and justify the creation of such an instrument. This was evident in the 2004 Communication where the Commission reiterated that it would continue to examine whether an optional instrument was required to solve problems in the area.³² It was also reflected in the general parameters that were presented in this Communication, to be taken into account during the discussion on the opportuneness of such an instrument.³³ In particular, questions that had to be considered included the identification of the problems that were being addressed, consideration of the overall policy objectives in terms of desired impacts, what would happen in a 'no change' scenario and the degree to which

²⁵ European Parliament Resolution on the Communication from the Commission – A More Coherent European Contract Law – An Action Plan, P5_TA (2003), 0355, 14.

²⁶ Council Resolution on "A More Coherent European Contract Law", OJ 2003/C 246/1, 2 para 3.

²⁷ Response of Portuguese Government, discussed in the Summary of Responses to the 2003 Communication, http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/analyticaldoc_en.pdf, 14.

²⁸ In particular that of the UK Government, Ibid. 14.

²⁹ Simultaneously expressed along with support by the Portuguese Government, 14.

³⁰ Response of the Danish Government, 14.

³¹ Summary of Responses (2003), 16.

³² 2004 Communication, 8.

³³ Ibid. Annex II.

other solutions, both more and less ambitious, already offered adequate solutions to the existing problems. The creation of an optional instrument of European contract law was not, therefore, at this stage presumed and appeared as residual, to the extent that the problems to which it would be directed could be solved by other options. Following the 2004 Communication, therefore, only minor reference was made to the Commission's reflection. In the first annual progress report, the use of a so-called '28th regime' of contract law was only discussed in the context of the possible creation of such instruments in the insurance and mortgage contract sectors.³⁴ No reference was made to the ongoing reflection in the second progress report on European contract law, which focused upon the elaboration of the CFR and the prioritisation of consumer acquis contract law issues that had occurred in that context.³⁵

While the European contract law project was under the control of DG SANCO, this meant the prioritisation of work on the CFR and, more particularly, the completion of the review of the acquis and the creation of the resulting CRD proposal to that end. However, with the project now under the responsibility of DG JFS we see, in the wider context of justice and home affairs, a renewed interest in the idea of a '28th' legal regime in order to support economic activity in the internal market.³⁶ It is thus once again viewed as a means of putting contractual relations on a more secure footing for overcoming the existing difficulties experienced by traders in the internal market, which continue to prevent them from benefiting fully from the opportunities that are on offer.³⁷ The original rationale and need for such an instrument retains its validity, and it is now pertinently seen as a tool to assist businesses to overcome the current economic crisis.³⁸ The optional instrument is therefore the single, directly applicable, legal framework that is necessary for contracting in the internal market.³⁹

³⁴ First Annual Progress Report on European Contract Law and the Acquis Review (2005), 12.

³⁵ Second Progress Report on the Common Frame of Reference (2007).

³⁶ Commission Proposal for the Stockholm Programme (2009), 3.4.2.

³⁷ Ibid.

³⁸ Communication from the Commission, Europe 2020 (2010), 18-19. Demonstrates an ongoing and long term commitment by the Commission to pursue the proposal.

³⁹ Proposal for the Stockholm Programme (2009), 3.4.2.

The Commission's ongoing and long-term commitment to progressing towards an optional instrument of European Contract law⁴⁰ is shared by the European Parliament. It has recently advocated that the political CFR should result in an optional and directly applicable instrument, which contracting parties could choose as the governing law of their contract.⁴¹ Thus the involvement of the CFR, as originally intended, in the elaboration of an optional instrument remains a possibility.⁴² Even the Council - which has unreservedly rejected other possible uses of the CFR, including as the basis for a European civil code,⁴³ in favour of the preferred toolbox function⁴⁴ - has not explicitly foreclosed the possibility of the CFR acting as the basis of an optional instrument.⁴⁵ The way forward to pursue this proposal therefore remains open.

6.2. Constitutional Thresholds

While the EU Treaties do not provide specific competence for the EU to harmonise private law, the basis of EU intervention in the area of contract law has traditionally lain in its harmonisation programme pursued under Article 115 TFEU (ex 94 EC) and more frequently Article 114 TFEU (ex 95 EC). This has allowed for the approximation of the laws of Member States which directly affect the establishment or functioning of the internal market. As such, in accordance with Article 5 TEU (ex 5 EC) and the principle of conferral (i.e. that the Union can only take action within the limits conferred upon it in the Treaties, to attain the objectives set out therein) a measure adopted under Article 114 TFEU must genuinely have as its object the improvement of the conditions of the internal market. That the EU has no general power to regulate the internal market was confirmed in *Tobacco Advertising*;⁴⁶ a mere finding of disparities between national rules is not sufficient to justify recourse to Article 114 TFEU. The differences must have a direct

⁴⁰ Europe 2020 Communication, 19.

⁴¹ European Parliament resolution of 25 November 2009 on the Communication from the Commission to the European Parliament and the Council – An area of freedom, security and justice serving the citizen, Stockholm programme P7_TA-PROV(2009)0090, para 99.

⁴² On this function of the CFR, see Chapter 4, 4.2.3.

⁴³ Or as an instrument consisting of a complete set of standard terms and conditions of contract law.

⁴⁴ Consolidated Council Conclusions on the setting up of a Common Frame of Reference, (2009), 3

⁴⁵ Ibid.

⁴⁶ Case C-376/98 *Germany v Parliament and Council* [2000] ECR I-8419.

effect on the functioning of the internal market and it must be shown that the approximation of laws genuinely has as its object the improvement of these conditions. Where such obstacles to trade can be shown to exist, Article 114 TFEU authorises the EU legislature to intervene by adopting appropriate measures, in compliance with the legal principles in the Treaties or identified in case law, in particular the principles of proportionality and subsidiarity.⁴⁷ The proposal must overcome all of these hurdles if an optional instrument is to be adopted.

It has been advanced, in light of the Commission's Action Plan and the results of the Clifford Chance Survey, that divergence between Member States' contract laws do create obstacles to trade within the market. Although it has been shown that their effect is not to exclude trade, the differences do significantly deter the pursuance of cross-border contracting. They thus distort the functioning of the market and stand in the way of market completion. As such it is possible to conclude that the harmonisation of national contract laws, at least those integral to cross-border trade, is necessary and that the EU would have competence to this end. It is, however, unlikely that Article 114 TFEU can in fact serve as the legal basis of an optional instrument, owing to the optional nature. The Court of Justice of the EU has drawn a distinction, in deciphering the correct legal basis for harmonisation measures, between those measures which approximate the existing laws of the Member States (i.e. the harmonising directives typical of the existing *acquis communautaire* in the area) and those which create a new system of rights co-existing with national systems, as is inherent in the nature of the current proposal.

The distinction was drawn in the case of *Re: SCE*,⁴⁸ concerning the legal basis of Regulation (EC) No.1435/2003, which laid down a single statute applicable to the European Cooperative Society (SCE).⁴⁹ The regulation created a new legal form, distinct from a national cooperative society, in order to remove barriers to trade resulting from divergent national law and regulation. It sought to allow such companies to carry out the organisation of their companies on an EU-wide scale, in much the same way as is

⁴⁷ Article 5 TEU (ex 5 EC).

⁴⁸ Case C- 436/03 *European Parliament v The Council* [2006] ECR I-3733.

⁴⁹ Council Regulation (EC) No 1435/2003 on the Statute for a European Cooperative Society (SCE).

envisaged by an optional instrument of contract law. The instrument was adopted on the basis of Article 352 TEFU (ex 308 EC); however, the European Parliament maintained that it should have been adopted on the basis of Article 114 TFEU. The European Parliament advanced a broad interpretation of ‘approximation’ used in that Article, so that the provision encompassed not only measures seeking to remove barriers arising from divergence in national law, but also measures aiming at overcoming territorial boundaries of the national legal order, so far as necessary for the establishment and functioning of the internal market.⁵⁰ To this end, they maintained that the approximation of the laws of Member States could also be achieved by supplementing national law through creating new European legal forms.⁵¹ The Council, on the other hand, advanced that ‘approximation’ necessarily implied substitution for national provisions and the Court agreed. The regulation, which left unchanged different national laws, could not be regarded as having the aim of approximating the laws of the Member States applicable to cooperative societies, but rather its purpose was to create a new legal form in addition to the national forms and to this end it had been correctly adopted on the basis of Article 352 TFEU.⁵²

The result is that, although the internal market integration threshold of Article 114 TFEU is in all likelihood surpassed, the proper legal basis for an optional instrument is Article 352 TFEU. Termed as the flexibility provision,⁵³ the Article provides the EU with competence to act to attain one of the objectives of the Treaties but only where the Treaties have not otherwise provided the power to do so, for example, in Article 114 TFEU. It is on this basis⁵⁴ that the EU has created such private law forms as the *Societas Europea* (European Company) and the EU Trade Mark, which exist in addition to the various national forms and which provide the parties with a choice between the two.⁵⁵ They thus share key features with a proposed optional instrument. It is also pertinent to note that they have all been adopted as regulations, and this would be the preferred form

⁵⁰ *Re: SCE*, para 21.

⁵¹ *Ibid.* Para 20.

⁵² *Re: SCE*, para 44.

⁵³ See, Chalmers, Davies and Monti, *European Union Law*, 2nd edition, Cambridge: Cambridge University Press, 2010, 214.

⁵⁴ But under the earlier provision of Article 308 EC.

⁵⁵ See, Hesselink et al. (2008), *Legal basis study*, 34.

of an optional instrument as a directly applicable, binding alternative. This would ensure the implementation of the instrument in its entirety and the future uniformity of its provisions between Member States. While Article 352 TFEU forms an extensive Treaty basis, it has been somewhat narrowed from the earlier provision of Article 308 EC⁵⁶ which did not define those Treaty objectives to which the Article refers. The objectives are now stated in Declaration 41 to the Lisbon Treaty and include the establishment of the internal market,⁵⁷ characterised by the abolition of obstacles to the fundamental free movements, including goods and services.⁵⁸ This further confirms that the latter Article can serve as the legal basis for the adoption of an optional instrument, which has as its object the improvement of the conditions and functioning of the internal market.

As to the optional instrument that can be adopted on this legal basis, to the extent that divergence in national contract rules create obstacles to trade, a comprehensive contractual instrument can be anticipated. This accords with the CFR forming the basis of the instrument, and the intention that the CFR is to cover all stages of contractual relations.⁵⁹ In this way the optional instrument could overcome the limited substantive scope of the CRD.⁶⁰ The ability to comprehensively regulate issues of general contract law on this legal basis could then support sector-specific instruments, at least those of importance to the internal market.⁶¹ Optional instruments would then be expected to govern the whole contractual relationship. However, this would also require the inclusion of rules from those areas of law with which the law of contract interacts.⁶² For example, an optional instrument governing the contract of sale could also include rules of property law, in so far as the passing of property in the goods forms an integral part of the contract. The inclusion of rules outside of the contractual scope of the optional instrument

⁵⁶ Owing to what is considered to be an overly ambitious interpretation of the Article as a legal basis. See, Chalmers et al, (2010), for how the provision has previously been interpreted, from 214.

⁵⁷ Article 3 (3) TFEU.

⁵⁸ Article 23 TFEU (ex Article 14 EC).

⁵⁹ See 4.2.3.

⁶⁰ Discussed in 4.1.3 and 5.3. Thus the optional instrument would contain rules on validity and the award of damages, which the CRD leaves to national law.

⁶¹ 2004 Communication, 20, and 4.2.3 and 5.3.

⁶² The content of the optional instrument is considered further in 6.4.

would be justified where national divergence in such rules creates obstacles to trade,⁶³ and thus their inclusion would facilitate the proper functioning of the internal market.⁶⁴ Greater incorporation of the rules of the DCFR could thus be justified in the optional instrument than that which is envisaged for the legislative toolbox.⁶⁵ As stated, however, the clear limitation is that those rules beyond the initial contractual scope must be directly relevant to the internal market objective, if their inclusion is to be justified on this legal basis.

As a regulatory response to the existing obstacles to cross-border trade, the optional instrument would apply to both B(SME)2C and B(SME)2B(SME) contracts. The issue that arises, however, is whether Article 352 TFEU could serve as the legal basis for an instrument of such width. The contract acquis has to date focused on the B2C relationship and, specifically, the protection of the consumer. This has been adopted for the most part on the basis of Article 114 TFEU with the aim of market completion.⁶⁶ There is therefore little doubt that the optional instrument governing B(SME)2C contracts could be adopted on the latter article, save for its optional nature, which means that Article 352 TFEU provides the necessary legal basis. While the contract acquis has been more limited in the commercial context, there is good reason to think that an instrument applying to B(SME)2B(SME) contracts could also be adopted on this legal basis. In the first place, the optional legal forms of the SCE and European Company (SE) have both been adopted on the basis of this Article, with the intention of assisting companies to pursue their activities on an EU-wide scale. Obstacles arising for businesses operating in the internal market have therefore prompted legislative action at the EU level, and a number of significant measures have been adopted in the commercial context⁶⁷ on the basis of

⁶³ The 2004 Communication confirms that significant obstacles appear to arise from the interaction between contract and property law in the Member States, 11. See further, Chapter 2, 2.3.1.

⁶⁴ As well as reducing the need to refer to national law where the optional instrument applies. On the need for this extended approach to be taken to optional instruments see the discussion in 6.4.

⁶⁵ This was also suggested in Chapter 4, 4.2.3.

⁶⁶ Hesselink (2007), SMEs in European Contract Law, 20.

⁶⁷ One such example is the Commercial Agency Directive which contains rules intended to protect self-employed commercial agents (Council Directive 86/653/EEC on the coordination of the laws of the Member States relating to self-employed commercial agents), discussed by Hesselink, *Ibid.* 8. The directive was, however, adopted on the basis of Article 115 TFEU (ex Article 94 EC); as Article 114 TFEU was introduced post the adoption of this directive by the Single European Act.

Article 114 TFEU. More specifically, it is possible to draw upon the existing *acquis* to allow for the creation of an instrument attuned to the needs of SMEs on this basis. For example, the Directive on Combating Late Payment in Commercial Transactions⁶⁸ sought to address the administrative and financial burden that is placed on businesses, and in particular SMEs who suffer from a weak bargaining position in such circumstances, which results in and from, ⁶⁹excessive payment periods and late payment.⁷⁰

While the latter directive recognises the need to address the imbalance in the case of SME's, they are treated within the wider business category. In contrast to consumers, the *acquis* has not sought to treat SMEs as a distinct group for regulatory purposes,⁷¹ despite the apparent need to so. It is acknowledged, for example, that SMEs may sometimes be in a similar situation as consumers⁷² when they buy certain goods or services. The Green Paper on the review of the *acquis* thus raised the question of whether SMEs should benefit to a certain extent from the same protection provided for consumers.⁷³ This now appears to be the direction in which the *acquis* is developing. For example, the Citizen's Rights Directive,⁷⁴ which forms part of the telecoms reform package, and was adopted on the basis of Article 114 TFEU, provides that the provisions on contracts therein should apply not only to consumers but also to other end users, primarily micro-enterprises and SMEs, which may prefer a contract adapted to consumer needs,⁷⁵ where they so request.⁷⁶

⁶⁸ Directive 2000/35/EC on combating late payment in commercial transactions.

⁶⁹ I.e. administrative and financial burdens.

⁷⁰ Directive on Combating Late Payment in Commercial Transactions, recital 7. See discussion of the directive in Schulte-Braucks and Ongena, *The Late Payment Directive – a step towards an emerging European Contract Law* (2003) *European Review of Private Law* 519, 524.

⁷¹ Hesselink (2007), 8.

⁷² Hesselink (*ibid.* 20) maintains that the case for harmonising contract law for the benefit of SMEs may in fact be stronger than that for consumers. SMEs are more likely to be repeat players and thus more affected by the existing divergence in contract law.

⁷³ Green Paper on the review of the consumer *acquis* (2007), Q. B1.

⁷⁴ Directive 2009/136/EC of the European Parliament and of the Council of 25 November 2009 amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services, Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector and Regulation (EC) No 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws, O.J. L 337/11 pp 11-36.

⁷⁵ *Ibid.* Recital 21.

⁷⁶ Recital 21. The consumer contract provisions will thus not automatically apply and this reservation is intended to avoid unnecessary administrative burdens for providers and the complexity related to the definition of SME. It highlights the issue of how to extend protective measures to SMEs within the optional

This suggests that an optional instrument which is adopted with the objective of facilitating cross-border contracting for SMEs, while also applicable to the wider B2B context, could, save for the optional nature of the instrument, be adopted on the basis of Article 114 TFEU. Article 352 TFEU thus presents the proper legal basis for the adoption of such an instrument.

The proposal will still have to surpass the thresholds of proportionality and subsidiarity.⁷⁷ It would have to be shown that it is both a necessary and suitable response to the identified problems and that the objectives of the proposed action cannot be sufficiently achieved by Member States. Therefore, by reason of the scale and effects of the proposed action, it can be better achieved at EU level. The principles pose little problem. Not only has it been shown that harmonisation in this area is necessary, the creation of an optional instrument has also been shown to be the suitable response to the problems created for the market: it would facilitate trade by enhancing legal certainty and reducing the associated costs which currently act to deter trade. The optional nature of the harmonised instrument would also be the least restrictive means by which to achieve this result. National contract systems would be unaffected and it would also be respectful of national regulatory autonomy, maintaining the social, cultural and legal diversity which is inherent in the internal market and should not be lost through harmonisation.⁷⁸ In this way, the principle of proportionality is satisfied but the proposal also respects the idea underlying the principle of subsidiarity.⁷⁹ It is clear that, to the extent that obstacles to the functioning of the internal market arise from divergent national law, the objective of action cannot be sufficiently achieved by Member States individually. The multifarious development of national laws demonstrates that action is necessary at the EU level.⁸⁰

instrument, and the problems that can arise from categorical protection to SMEs by analogy with consumers, which is discussed in 6.4.1.

⁷⁷ Article 5 TEU (ex Article 5 EC)

⁷⁸ The maintenance of such diversity being an important consideration in articulating the future approach to the harmonisation of European contract law, see Chapter 3.2.2.

⁷⁹ Hesselink, *The Values Underlying the Draft Common Frame of Reference: What role for fairness and social justice*, A Short study note prepared for the European Parliament (2008), available at, <http://www.jur.uva.nl/csecl/news.cfm/5F7839CD-1321-B0BE-A41B920971C302EC#p6>, 67.

⁸⁰ See for example, C-491/01 *British American Tobacco and Imperial Tobacco* [2002] I-11453, para 181.

6.3 The Applicability of the Optional Instrument

With the legal parameters of the proposal established, it is necessary to consider how effect is to be given to possible optional instrument(s). This requires, first, that the legal nature of such instruments, whether opt-in or opt-out in nature, is determined.

The principal argument in favour of an opt-in instrument is that it would optimise the parties' freedom of contract if they could choose to apply the rules as the governing law of their contract where it is suited to their economic or legal needs better than the alternative national contractual regime.⁸¹ Such an approach would be wholly in accordance with the optional nature of the instrument which, by remaining distinct from the national contract systems, would respect the need to maintain the existing legal and cultural plurality inherent in the internal market, as well as being the more respectful approach to the principles of proportionality and subsidiarity. It would thus be more likely than the alternative to receive political approval. The prospect of an opt-out instrument does, however, have merits and could be particularly useful for SMEs, as freedom of contract within the choice of law system does not always assist this group in cross-border trade. The principle presumes the existence of equality of bargaining power, which is commonly not the case for SMEs contracting with larger enterprises, and an opt-out regime would be more appropriate. It would allow the parties to maintain their freedom of contract, to the extent that they could opt out, but would provide the SME, commonly the weaker party, with a suitable default regime.⁸² In light of the arguments advanced in favour of an opt-in regime, however, it is clear that such an approach would be too intrusive and too close to the codification of national contractual systems to be likely to gain political support. The likely outcome is, therefore, opt-in instrument(s) of European contract law and the issue arises as to how the parties are to 'opt' for such rules.

⁸¹ 2003 Communication, para 92.

⁸² Hesselink, *SME's in European Contract Law* (2007), 26.

6.3.1. The Optional Instrument and Rome I

The applicability of an optional instrument as the 28th contractual system, and governing law of a contract, is foremost an issue of choice of law. An important part of the regulatory proposal to assist contracting in the internal market will, therefore, be the relationship between the Rome I Regulation on the law applicable to contractual obligations and the optional instrument. This will determine the extent to which the optional instrument can form the simplified regulatory framework that is required by contracting parties in this context. In particular, the inclusion of harmonised mandatory rules within the instrument would make the optional regime a valuable tool for trade, particularly in the B2C context. This, however, will be dependant upon the ability of the optional instrument to affect the application of national mandatory rules, which otherwise apply under the scheme of Rome I.

Coherence between the two systems is thus paramount to the realisation of the objectives in creating and giving effect to an optional instrument. Indeed, the harmonisation of choice of law rules and of substantive contractual provisions, share similar objectives.⁸³ They are both a means by which to organise legal diversity and in doing so they are intended to provide contracting parties with legal certainty and greater confidence in the stability of legal relationships.⁸⁴ Within the European context, the harmonisation of both types of rules has been joined by a shared concern for the proper functioning of the internal market, and ensuring the right conditions for free movement among the Member States.⁸⁵ The Commission has thus reinforced the importance of coherence between the optional instrument and the European choice of law system,⁸⁶ so that effect can be given to the optional instrument within the scheme of the latter.

⁸³ See Speech of Vogelaar, DG for the Internal Market and Approximation of Legislation in, Giuliano and Lagarde, Report on the Convention on the Law Applicable to Contractual Obligations, OJ C 282, 31.10.80, pp 1-50, para 2. Also, Chapter 2, 2.1.3.

⁸⁴ Ibid. para 1.

⁸⁵ Vogelaar, para 2, and Cheshire, North and Fawcett, *Private International Law*, 14th ed. Oxford: OUP, 2008, 668 -9. The Rome I Regulation was thus adopted on the basis of Article 61 (c) EC, by which reference is made to Article 65 (b) EC which seeks to promote compatibility of the rules applicable in the Member States concerning the conflict of laws in so far as necessary for the proper functioning of the internal market. See Recital 6 of Rome I to this end.

⁸⁶ 2004 Communication, Annex II, 19.

Freedom of contract would be fully realised in the internal market if contracting parties could expressly choose the optional instrument as the governing law. The choice of non-state law such as the optional instrument has, however, traditionally been precluded by the European choice of law system. Article 3 of the Rome Convention, which preceded the Rome I Regulation, permitted only the choice of law of a State,⁸⁷ and as such deprived businesses of a valuable option in being able to choose more appropriate non-national rules to govern their cross-border contracts. In this respect the Rome Convention was considered to be out of date and in dire need of reform.⁸⁸ The conversion of the Rome Convention into an EU instrument, and the debate generated by the Commission's Green Paper⁸⁹ in 2002 on the modernisation of the choice of law regime was, therefore, an opportunity to reform and extend Article 3. The proximity in timing also to the debate on European contract law, lead to an intention on the part of the Commission to coordinate the conversion with the contract law project in order to ensure coherence with the proposed optional instrument.⁹⁰

Reform of the choice of law regime in this way had, however, traditionally been ruled out owing to the absence of a full and consistent body of European contract rules which could justify the extension of the freedom of choice embodied in Article 3 of the Rome Convention.⁹¹ Those who argue against allowing the choice of non-state rules have pointed to the need to ensure that such rules are balanced: complying with the needs of individual justice and capable of providing sufficient legal certainty.⁹² Previous harmonisation attempts at this level, notably PECL, have been found to be lacking in both respects. While it was envisaged that the principles could be applied to contracts via Article 3,⁹³ they were simultaneously criticised for containing wide lacunae which would necessitate gap filling⁹⁴ and it is acknowledged that they fail to take adequate account of

⁸⁷ Lagarde, *Le nouveau droit international prive des contrats après l'entrée en vigueur de la Convention de Rome* du 19 juin 1980, RCDIP, 1980. 287, 300.

⁸⁸ Juenger, *The lex mercatoria and Private International Law*, (2000) *Uniform Law Review* 177, 183 -4.

⁸⁹ Green Paper on the Conversion of the Rome Convention of 1980 on the Law Applicable to Contractual Obligations into a Community Instrument and its Modernisation, COM (2002) 654 final.

⁹⁰ 2004 Communication, Annex II, 19.

⁹¹ Green Paper on the Conversion of the Rome Convention, 3.2.3.

⁹² Drobniig, *The UNIDROIT Principles in the Conflict of Laws*, (1998) *Uniform Law Review* 385, 387.

⁹³ PECL, Article 1:101(2).

⁹⁴ Drobniig (1998), 392.

social and welfare values.⁹⁵ Ultimately, previous harmonisation attempts have compared unfavourably with national contractual systems. The Commission's original proposal for Rome I⁹⁶ did, however, provide that the parties may choose as the applicable law, principles and rules of substantive law of contract recognised both internationally or in the EU,⁹⁷ including PECL.

In the legislative process reference to substantive principles and rules recognised in the EU was abandoned in favour of those rules recognised internationally.⁹⁸ The justification given by the European Parliament was that while the freedom of the parties to choose the applicable law comprised the right to choose rules of substantive law of contract recognised internationally, such principles and rules must comply with certain minimum standards in order to be eligible. In particular, such principles should be created by an independent and neutral body, their content should be balanced and contain mandatory rules, and they should regulate rights and duties in a reasonably comprehensive way.⁹⁹ An example of rules considered as meeting these conditions were the Unidroit Principles of International Commercial Contracts,¹⁰⁰ and by implication, and in light of earlier criticism, not PECL, obviating the need to refer to such rules and principles at the EU level. Further, at that stage, the European Parliament considered it undesirable to refer in the regulation to the CFR, as it did not politically exist at that time. As such, it was unclear what shape the contract terms would take and on what legal basis it would be adopted. It is now clear, however, that an optional instrument, originating with the EU, would necessarily satisfy those standards of the European Parliament in order to serve as a governing law. This is particularly if the instrument is to realise its objective in creating a simplified regulatory environment.¹⁰¹ However, in terms of choice of law under Rome

⁹⁵ See Chapter 3, 3.2.2.

⁹⁶ Proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I), COM (2005) 650 final 2005/0261 (COD).

⁹⁷ Article 3 (2) of the Rome I proposal.

⁹⁸ Draft European Parliament legislative resolution on the proposal for a regulation of the European Parliament and of the Council on the law applicable to contractual obligations (Rome I) (COM (2005) 0650 – c6-0441/2005/0261 (COD).

⁹⁹ Ibid. Amended recital 7.

¹⁰⁰ Ibid.

¹⁰¹ I.e. The instrument will have to be balanced, containing mandatory rules, and will necessarily regulate rights and duties in a comprehensive way.

I, while the instrument does not preclude the contracting parties from incorporating by reference into their contract non-state rules,¹⁰² they cannot make an express choice of such rules as the governing law of their contract.

The possibility that parties may opt-in to an optional instrument as the governing law of their contract has, however, still been provided for in Rome I. Recital 14 provides that should the EU adopt, in an appropriate legal instrument, rules of substantive contract law, such instrument may provide that the parties may choose to apply those rules. This opens the way for a coherent application of the two instruments, and while an express choice of the optional instrument as a non-state law under Article 3 has thus been precluded, an express choice of the instrument as the governing law need not be ruled out.

It would be possible to draw on the legal nature of the instrument as a Regulation, i.e. as a directly applicable contractual regime, which is implemented into national law in its entirety. The contractual rules would be common across all the Member States and would co-exist with the national contract provisions. It could, therefore, be characterised as a 2nd domestic system.¹⁰³ The parties' choice would, therefore, be for a system of national law, which is permitted under Article 3 of Rome I. The characterisation of the optional instrument as domestic law means that it could also apply as the governing law of domestic transactions.¹⁰⁴ The instrument would thus benefit from universality of application,¹⁰⁵ and this would optimise the benefits of harmonisation for those who opt-in¹⁰⁶ to the instrument as the applicable law.¹⁰⁷

¹⁰² Rome I, recital 13.

¹⁰³ The characterisation of the optional instrument as a 2nd domestic regime is also utilised by the Principles of European Insurance Contract Law (PEICL), in regard to an optional instrument in the area of insurance contract law. See Principles of European Insurance Contract Law, prepared by the project group on a restatement of European contract law, I 45, (Munich: Sellier, 2009).

¹⁰⁴ This can be distinguished from purely domestic contracts which, at the choice of the parties, are governed by the law of another Member State. This is governed by Article 3 (3) of Rome I, but this article would not apply in the case of the optional instrument, as this would form domestic law.

¹⁰⁵ A dual regime would not have to result where businesses and consumers could not contract under the optional instrument in domestic contracts, but only cross-border contracts.

¹⁰⁶ Although not as a choice of law under Rome I in domestic cases, but rather through a substantive choice, discussed below.

¹⁰⁷ Unlike the CISG, where an 'international element' is required in order to determine applicability, this limitation would be neither suitable nor justified in the context of the internal market. As opposed to the international context, the optional approach can be seen to be less of an intrusion on national sovereignty.

In accordance with Recital 14, it would be necessary for the optional instrument to provide the right for parties to expressly choose the 2nd domestic system as the governing law of their contract within the scheme of Rome I, in accordance with Article 3, and thus begin to articulate the relationship between the two instruments.¹⁰⁸ The availability and right of the parties' to choose the optional system could be contained in a substantive provision¹⁰⁹ within the instrument.¹¹⁰ It is then envisaged that when the parties choose the law of a Member State as the applicable law of their contract under Rome I, the substantive rule of the Regulation would allow them to opt-in to the 2nd domestic system which would then become the applicable law of their contract.¹¹¹ This, however, would be a convoluted and unnecessary means of giving effect to the parties' intention to apply the optional instrument as the applicable law. Parties should be free in the first place to expressly choose the optional instrument, or 2nd domestic system, as the governing law of their contract. This should be possible under Article 3 as the choice of the parties would, owing to the characterisation of the Regulation, be for the choice of a law of the Member States, and not a non-state law.¹¹² The formalities of the choice of law would then be governed by Article 3.¹¹³ In this way the optional regime would also retain its status as the 28th contractual regime within the EU. To expect the parties to first choose the 1st contract law of a Member States would be contrary to their intention where they wish the 2nd regime to apply as the governing law, and would undermine the intended neutrality of the optional regime.¹¹⁴ Parties will benefit from the enhanced certainty and transparency of the applicability of the optional contract regime under Rome I, where they expressly choose it. Indeed, the optional regime should only apply where expressly chosen by the

¹⁰⁸ Further issues in regard to the relationship would need to be clarified within the optional instrument, in particular, the relationship between the national mandatory rules applicable under Rome I, and those of the former instrument. Discussed further below.

¹⁰⁹ As opposed to giving effect to the instrument through a choice of law rule, which would be subject to Article 23 of Rome I.

¹¹⁰ The use of a substantive rule to this effect in the Regulation is discussed by Heiss and Downes, *Non-Optional Elements in an Optional European Contract Law. Reflections from a Private International Law Perspective*, (2005) 5 ERPL 693, 707.

¹¹¹ *Ibid.* It would still be necessary under this approach to exclude the application of national mandatory rules, see Heiss and Downes further, 708.

¹¹² Recital 13.

¹¹³ I.e. Article 3 (1) requires that the choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case.

¹¹⁴ I.e. the availability of the optional instrument would no longer overcome the shortcomings of party autonomy under the choice of law system, particularly for SMEs. See, 6.1.1.

parties. With the need for legal certainty in mind it would be undesirable for the optional system to otherwise apply by virtue of Article 4 of the Regulation in the absence of a choice. This latter Article should continue to operate to objectively refer to the law of a 1st domestic system so that parties, who have not expressly chosen the instrument, will not be subject to any unfair surprise by its application.

In order to serve as the applicable law, however, regard must be had to the expected scope of the applicable law under Rome I. Article 12 provides that the law applicable to a contract shall govern, in particular, issues of interpretation, performance, and the consequences of breach, including the assessment of damages. It shall also govern the various ways of extinguishing obligations, prescription and limitations of actions, and finally, the consequences of nullity of the contract. Failure on the part of the instrument to regulate these issues, risks the choice of the 2nd domestic system being treated as a partial choice, and that regulatory gaps in the instrument, as the governing law will arise.¹¹⁵ The need for the application of other sources of law to fill those gaps would compromise the intended autonomous nature of the instrument, and the creation of the simplified regulatory environment.

The need for the optional instrument to form a comprehensive contractual regime is reinforced, and is tenable on the existing scope of the DCFR.¹¹⁶ Even then, however, the DCFR recognises that issues may arise relating to matters within the scope of the instrument, but which are not expressly settled by it. In this case, as the DCFR provides, issues should first be settled, in so far as possible, in accordance with the general principles underlying the instrument.¹¹⁷ In this way, the optional instrument can maintain its autonomous nature, at least within its scope. Where such interpretation cannot settle matters, or for issues which arise outside of the scope of the instrument, it will be

¹¹⁵ See Heiss and Downes (2005), 701, who express these concerns in response to the envisaged scope of the optional instrument in the Commissions 2003 and 2004 Communications, and in the alternative to the PECL as an applicable law. In either case, the instrument would form an insufficient *lex causae*.

¹¹⁶ These matters are regulated by the DCFR. See discussion of the scope of coverage of the DCFR, in Chapter 4, 4.2.2. and the preceding discussion in 6.2.

¹¹⁷ DCFR Outline Edition (2009), I-1:102(4), which draws on Article 1:106(2) of PECL. This solution was also provided by the Rome I proposal, when it provided for the choice of non-state law recognised internationally or in the EU.

desirable in the interest of certainty to apply the law that would have applied to the contract under Rome I, as was advanced by the PECL.¹¹⁸ The optional instrument would contain a clause setting out its intended field of application and providing for the autonomous interpretation and development of the instrument within its scope, as the DCFR does.¹¹⁹ It has been envisaged, therefore, that the optional instrument would contain a scope clause which would also articulate the relationship between the optional instrument and Rome I,¹²⁰ i.e. that Rome I would not apply to matters regulated by the optional instrument,¹²¹ or conversely, that for matters outside of its scope the contracting parties would be directed to the applicable law under Rome I. The Commission envisaged that such a clause could take effect as a special conflict of law rule that would enjoy precedence over Rome I by virtue of Article 23 of the conflict of law system.¹²²

Further consideration must, however, be given to the relationship between the optional instrument and Rome I. The applicability of mandatory rules of other legal systems, which apply despite an effective choice of law, presents an issue for any proposal which seeks to give effect to the optional instrument within the system of Rome I. Their application would undermine the inclusion of mandatory rules within the optional instrument itself, and ultimately its value as a tool for trade in the internal market.¹²³ The optional instrument must, therefore, affect the application of the applicable mandatory rules under Rome I.

¹¹⁸ Ibid.

¹¹⁹ DCFR Outline Edition (2009), I.-1:101 and 102.

¹²⁰ Subject to further discussion in 6.3.2. on the relationship between the optional instrument and Rome I in regard to the application of national mandatory rules under Articles 6 and 9 of Rome I.

¹²¹ As this would be a matter of autonomous interpretation.

¹²² See, 2004 Communication, 18 and Colombi Ciacchi, *An Optional Instrument for Consumer Contracts in the EU*, (in) *The Politics of the Draft Common Frame of Reference*, Somma (ed.), The Netherlands: Kluwer Law International BV, 2009, 12.

¹²³ See, 6.1.1.

6.3.2. The Relationship with National Mandatory Rules

The extent to which the application of national mandatory rules can be excluded where the optional instrument is the governing law of the contract, however, raises fundamental issues which must be addressed.

In the first place, the optional instrument will need to include its own mandatory rules if the national rules are to be excluded. From an internal market perspective it has been shown that it is mandatory rules of consumer protection that have created the greatest obstacles to cross-border trade in the B2C context. The issue that arises, therefore, is whether an optional instrument could adequately represent the interests which are protected under Article 6 of Rome I? The Commission has gone further to envisage that overriding national mandatory rules could also be excluded where the optional instrument applies as the governing law of the contract.¹²⁴ Article 7 of the Rome Convention, now Article 9 of Rome I, formerly provided for the application of the overriding mandatory provisions of the forum and of a third country with which the situation had a close connection. The application of such rules thus similarly carries for contracting parties the risk of uncertainty and increased transaction costs, thus acting to deter economic activity.¹²⁵

Derogation from Article 9 therefore receives support. It is considered that this would significantly enhance the utility of the optional instrument, and its impact on the functioning of the internal market,¹²⁶ as parties would know which mandatory rules are applicable to their contractual relationships.¹²⁷ Article 9 is intended, however, to give effect to a narrower type of national mandatory rule than those under Article 6. While rules within the scope of the latter Article cannot be derogated from by contract and so operate as a limitation on the freedom to choose the applicable law, rules applicable

¹²⁴ 2004 Communication, 21.

¹²⁵ Dickinson, Third-Country Mandatory Rules in the Law Applicable to Contractual Obligations: So Long, Farewell, Auf Wiedersehen, Adieu? (2007) 3 Journal of Private International Law 53, 61.

¹²⁶ Heiss and Downes (2005), 702.

¹²⁷ 2004 Communication, 21.

under Article 9 will override the applicable law.¹²⁸ They are concerned with safeguarding the Member States public interest, such as their political, social or economic organisation.¹²⁹ Given the importance of such rules to the Member States, the issue of whether an optional instrument could adequately represent and protect such interests is even more acute. It will, therefore, be necessary to have regard to the nature of those rules given effect to under Articles 6 and 9 of Rome I, in order to ascertain whether the optional instrument can contain sufficiently protective and representative rules. Only if the instrument can will the exclusion of national mandatory rules be justified.¹³⁰

If it is found that an optional instrument cannot satisfy this requirement, then as effect will be given to the instrument within the scheme of Rome I, national mandatory rules should continue to apply.¹³¹ There may be good reason why this should be the case, and it will be pertinent to consider the object of the conflict of law provisions which support the application of the law of a Member State other than the applicable law. This in turn must be balanced against the object of the optional instrument in terms of facilitating internal market trade. It is first necessary, therefore, to ascertain what types of national rules fall to be considered as mandatory rules within the meaning of Article 6 and 9 respectively, in order to determine whether such rules can be included within an optional instrument. In this regard, the competence of the EU to enact such rules must also be borne in mind.

Article 6 of Rome I operates so that the parties choice of law cannot deprive the passive consumer of the protection afforded to them by provisions which cannot be derogated from by agreement, i.e. domestic mandatory rules of consumer protection, in the law of their habitual residence. The object of the Article is thus to protect the consumer as the weaker party to the agreement,¹³² and presumes that the law of their habitual residence will provide the best protection of their interests.¹³³ The concern that has arisen in regard to the applicability of the optional instrument is, however, that if this was joined by

¹²⁸ Cheshire, North and Fawcett (2008), 730-1.

¹²⁹ Article 9 (1) Rome I.

¹³⁰ See generally, Rutgers, *An Optional Instrument and Social Dumping*, (2006) 2 *European Review of Contract Law*, 199, 201.

¹³¹ *Ibid.*

¹³² Giuliano and Lagarde (1980), Article 5 section, para 2.

¹³³ Rutgers (2006), 203.

derogation from Article 6 then the choice of the instrument would exclude higher national levels of protection, and thus result in a situation of reduced social protection.¹³⁴ This result would not only be unsatisfactory, but would also have practical implications for the adoption of optional instruments.

Rutgers highlights,¹³⁵ that if the optional instrument does not contain sufficiently protective rules then Member States are more likely to stick to the application of their own mandatory rules and will be less willing to give up their competence in that area. Thus either the Member States will not agree on the enactment of an optional instrument which excludes conflicting national mandatory rules,¹³⁶ or they may be inclined to continue applying their own national mandatory rules where the optional instrument is the governing law, in order to apply higher levels of protection.¹³⁷ This would significantly undermine the utility and value of the optional instrument. A risk is that if it is found that Article 9 of Rome I cannot or should not be derogated from, the opportunity would exist for national courts to apply national mandatory consumer protection rules, i.e. those that should be given effect to under Article 6, as overriding mandatory rules under Article 9. Mandatory consumer protection rules could thus prevail over those of the optional instrument.¹³⁸

The foregoing concerns need not be overstated, however, and derogation from Article 6 need not result in social dumping. Significantly, such arguments overlook the CRD proposal which would precede an optional instrument in moving to a full harmonisation approach for B2C sales and services contracts across the Member States. Thus should the EU adopt an optional instrument governing sales and services contracts,¹³⁹ the CRD provisions, which are classified as mandatory rules of consumer protection by the proposal,¹⁴⁰ will be decisive in establishing the level of consumer protection within the

¹³⁴ Rutgers (2006), refers to social dumping, 200.

¹³⁵ Ibid. 207.

¹³⁶ See, Colombi Ciacchi (2009), 17.

¹³⁷ Rutgers (2006), 207.

¹³⁸ Colombi Ciacchi (2009), 15.

¹³⁹ Discussed further in 6.4.

¹⁴⁰ See Article 43 of the CRD on the imperative nature of the Directive, to the effect that consumers may not waive the rights conferred on them, where the law applicable to the contract is that of a Member State.

optional instrument. That level of protection clearly cannot be less than that provided under the CRD,¹⁴¹ and there may be good reason to emulate those provisions of the CRD, in the interest of coherence between the two instruments.¹⁴²

It is clear, therefore, that the full harmonisation approach of the CRD will make the adoption and applicability of the optional instrument less contentious within the shared scope of the provisions. The potential for conflict between national mandatory rules and those of the optional instrument, and concerns of a loss of consumer protection will, however, continue to exist outside of that shared scope. The narrow scope of the CRD proposal and its dependence upon national law has been a significant criticism of the instrument, and a significant advantage of the optional instrument as a regulatory response is, therefore, its extended scope.¹⁴³ The issue arises, therefore, of how the derogation from Article 6 may be made acceptable to Member States so that they will forego their competence in that area. It is clear that the instrument will have to provide consumers with a high level of protection, and comprehensively and adequately protect the consumer's interests which are protected at the national level. If this is achieved the incentive for Member States and their national courts to continue to apply their own mandatory rules of consumer protection within the narrowed scope where potential for conflict exists¹⁴⁴ will be much reduced.¹⁴⁵ It also means that Article 6 could be derogated from in full. Effect could be given to the derogation by a conflict of law clause within the optional instrument, which would have precedence over the rule in Article 6 by virtue of Article 23 of Rome I. It would then be desirable in terms of certainty, particularly for national courts applying the optional instrument as the applicable law, that the mandatory nature of the consumer protection rules of the instrument is made clear,¹⁴⁶ i.e. that parties

¹⁴¹ Which will become the national level.

¹⁴² Discussed in Chapter 4, 4.3, and in 6.4.2.

¹⁴³ I.e. beyond that of the CRD. Discussed in 4.1.3 and considered further in 6.4.2.

¹⁴⁴ i.e. outside the shared scope of the CRD.

¹⁴⁵ See Rutgers (2006), 212. Further safeguards to prevent the categorisation of national mandatory consumer rules as overriding mandatory rules is further discussed below in the context of the discussion on Article 9.

¹⁴⁶ This is the approach of both the CRD, in Article 43, and the DCFR, see for example, II.-3:109 (5), which specifies the mandatory nature of the rules on remedies for breach of information duties.

may not, to the detriment of consumer, exclude the application of such rules, or vary their effect.

The competence of the EU to enact an optional instrument to include mandatory rules of consumer protection is already widely evident in the consumer acquis,¹⁴⁷ which attributes mandatory status to its provisions, including the CRD in Article 43.¹⁴⁸ As regards the competence of the EU to enact consumer rules which go beyond the scope of the CRD, the limitation in scope of the latter instrument has been explained in terms of the change in regulatory approach.¹⁴⁹ While the CRD seeks full harmonisation on a non-optional basis it threatens national regulatory autonomy. This has resulted in a compromise, both in the scope of the instrument, and in the scope of the EU's competence to enact consumer protection rules. It has been advanced, however, that an optional instrument can provide a more suitable regulatory approach to the realisation of the regulatory objectives of the CRD, without undermining Member States regulatory autonomy. The optional instrument can, therefore, result in a more comprehensive instrument which is necessary in the internal market, and if Article 6 of Rome I is to be derogated from.

Overriding mandatory rules on the other hand are to be construed restrictively,¹⁵⁰ and form a more limited category of mandatory rules.¹⁵¹ Article 9 seeks to ensure the applicability of those rules to which a Member State¹⁵² attaches such importance that they should apply whatever law is otherwise applicable to the contract.¹⁵³ In the first instance, therefore, Article 9 (2) safeguards the application of the mandatory rules of the forum. In this regard the interest of the Member State in ensuring that they can continue to apply such rules in cases before them is clear from the imperative nature of the rules,¹⁵⁴ and has

¹⁴⁷ Including those Directives that will be repealed with the adoption of the CRD. See, for example, Article 12 (2) of the Distance Selling Directive (Directive 97/7/EC), and Article 6 of the Unfair Contract Terms Directive (Directive 93/13/EC).

¹⁴⁸ Also see recital 59.

¹⁴⁹ Chapter 5, 5.3.

¹⁵⁰ Rome I, recital 37.

¹⁵¹ Bonomi, *Overriding Mandatory Provisions in the Rome I Regulation on the Law Applicable to Contracts* (2008) 10 Yearbook of Private International Law, 285, 288.

¹⁵² Either the forum (Article 9 (2)) or a third state (Article 9 (3)).

¹⁵³ Green Paper (2002), 33.

¹⁵⁴ Giuliano and Lagarde (1980), Article 7 section, para 4, and Cheshire, North and Fawcett (2008), 731.

proved uncontroversial. The application of third country rules by the forum to contracts before them has, however, been more contentious. This has been principally because of the uncertainty that the provision could give rise to and for this reason the Rome Convention allowed Member States to exercise a reservation in regard to the then Article 7 (1).¹⁵⁵ As to why effect should be given to the mandatory rules of another Member State it is considered, in the first instance, that the application of a foreign law is justified when that law expresses a policy of the foreign state, and the connections of the case with that state are such as to give it a legitimate interest in having its policy applied.¹⁵⁶ It is further advanced that the forum should defer to the interests of other States for reasons of comity, and thus they should mutually regard and respect each others interests.¹⁵⁷ A number of reasons have been given for why this should be the case. Chong refers to, among others, a motivation to preserve relations with friendly foreign states, a need to foster international cooperation, and to do justice between the parties. There is also an element of self-interest, to the extent that deference to another Member States interests will invite reciprocal action that will advance the forum's policies in cases before courts in other Member States.¹⁵⁸

It is for the law of the Member State from which the rule originates to determine whether or not a rule is mandatory in the overriding sense.¹⁵⁹ The task will, however, fall upon the forum to determine this in light of its own legal system in the case of Article 9 (2), and in accordance with the law of the third State in the case of Article 9 (3). The approach to categorisation is thus highly subjective as well as discretionary, i.e. effect only may be given to overriding mandatory provisions. This adds to the criticism of the uncertainty which results from this provision for the contracting parties, and will present a difficult task for the forum. National rules will not always provide for their overriding effect, and the approach to categorisation of overriding mandatory rules may vary even within a

¹⁵⁵ See, Giuliano and Lagarde (1980) Article 7 section, para 3, and Dickinson (2007), 55.

¹⁵⁶ And when there is no conflicting interest of the forum. This is based on governmental interest analysis, advanced by Currie, *Selected Essays on the Conflict of Laws*, Durham, NC, Duke University Press, 1963, 48, discussed in Chong, *The Public Policy and Mandatory Rules of Third Countries in International Contracts* (2006) 2 *Journal of Private International law* 27, 36.

¹⁵⁷ Chong (2006), 37 – 38.

¹⁵⁸ *Ibid.* 37 – 40.

¹⁵⁹ Chong (2006), 32, and Green Paper (2002), 33.

single state.¹⁶⁰ An example of an overriding statute which does provide for its overriding mandatory nature is the Unfair Contract Terms Act 1977. Section 27 (2) provides that the Act is to have effect notwithstanding any contract term which applies the law of another country outside the UK, where it appears that the intention was to enable the party imposing the choice of law term to evade the operation of the Act.¹⁶¹ Where the mandatory nature of the provision is not provided, however, little guidance has been given as to what rules fall to be considered within this category. Rules that have been regarded as overriding mandatory rules have concerned rules on import and export prohibitions, anti-trust laws, and exchange regulations.¹⁶²

Article 9 (1) of Rome I, therefore, introduces a definition for overriding mandatory rules,¹⁶³ drawing on the Court of Justice's categorisation of Belgian public order legislation in the case of *Arblade*.¹⁶⁴ The case ultimately, however, concerned the compatibility of the national legislation, which was concerned with the protection of workers, with the Treaty fundamental freedoms. It was not, therefore, the Courts intention to formulate its own definition of this category of rules, rather it was a definition chosen by the European Commission.¹⁶⁵ The Court categorised the legislation at issue in terms of its classification under Belgian law as public order legislation. The latter term was understood as applying to national provisions, compliance with which has been deemed to be crucial for the protection of the political, social or economic order in the Member State concerned as to require its compliance by all persons present on the

¹⁶⁰ See, Cheshire, North and Fawcett (2008), 735-6, which demonstrates the difficulty of construction in the context of the British Courts when the provision does not express its overriding effect, and highlights that whilst in principle it is possible to have mandatory common law rules, examples are very rare because of the difficulty in identifying such rules.

¹⁶¹ The act applies in this sense to B2B contracts but will similarly apply in a contract where one of the parties deals as consumer, where they are habitually resident in the UK, and the essential steps necessary for the making of the contract were taken there, whether by him or by others on his behalf, s. 27 (2) (b).

¹⁶² Examples taken from Hellner, Third Country Overriding Mandatory Rules in the Rome I Regulation: Old Wine in New Bottles? 5 (3) Journal of Private International Law (2009) 447, 458, and Chong (2006), 32.

¹⁶³ This is the first conflict of law instrument to provide a definition of an overriding mandatory rule, see Bonomi (2008), 287.

¹⁶⁴ C-369/96 and 376/96, *Criminal Proceedings against Jean-Claude Arblade and Arblade & Fils SARL and against Bernard Leloup and Others* [1999] ECR I-8453.

¹⁶⁵ Green Paper (2002), 34.

national territory of that Member State, and all legal relationships within the state.¹⁶⁶ It will be sufficient, therefore, that the Member State with whom the rule originates regards it as crucial for safeguarding its public interests, such as its political, social or economic organisation. Categorisation will remain subjective to that Member State,¹⁶⁷ and to the construction in those terms of the national court hearing the case at hand.¹⁶⁸

While the new definition makes way for an EU wide approach to categorisation, the issue of how it is to be interpreted and applied, if any differently from the pre-Rome I approach of national courts, remains to be considered. At the heart of the definition, and *Arblade*, are rules concerned with the public interest. This has led some to interpret the provision as meaning that rules pursuing private interests cannot be categorised as overriding mandatory rules.¹⁶⁹ Such a narrow construction would be contrary to the view of those who see Article 9 as going beyond the public and general interests to also protect private interests, and in particular weaker parties, including, employees, franchisees, and commercial agents.¹⁷⁰ Indeed, national courts have been willing to protect private and individual interests that are not covered by the special conflict of law rules of Rome I, i.e. beyond the consumer and the employee.¹⁷¹ Bonomi gives an example of the French *Cour de cassation en banc* which, with the intention of protecting the weaker business, recognised the nature of an overriding mandatory rule in an action between a subcontractor and its employer.¹⁷² This has not, however, been the approach of all Member States. Germany, for example, has taken a narrow construction to the categorisation of overriding mandatory rules, which includes only those provisions which concern the public interest, to the exclusion of private interests.¹⁷³

¹⁶⁶ *Arblade*, para 30.

¹⁶⁷ See, Dickinson (2007), who is critical of the continued subjective approach, 67.

¹⁶⁸ Difficulties in determining the overriding mandatory nature of such rules, in these terms, will thus remain.

¹⁶⁹ Notably Hellner (2009), on the basis of the Commission's Green Paper on the Conversion of the Rome Convention, 458.

¹⁷⁰ See for example, Rutgers (2006), 204, and Chong (2006), 51.

¹⁷¹ Highlighted by Bonomi (2008), 291.

¹⁷² *Ibid.*

¹⁷³ See Hellner (2009), 458, and Bonomi (2008), 291.

It is, however, the wider construction that the Commission intended in utilising the definition in *Arblade*,¹⁷⁴ which itself concerned rules which were directed at the protection of employees. The Commission's Green Paper on the conversion of the Rome Convention categorised mandatory rules of consumer protection, falling under Article 6, as public policy provisions, i.e. those which are designed to guarantee a country's social and economic order.¹⁷⁵ This suggests that they see protection of the weaker party as 'public policy', and thus capable of constituting an overriding mandatory rule. It should also be noted that in regard to the relationship between Articles 6 and 9, the Green Paper considered that while the scope of the two articles is not identical, Article 6 does not interfere with the possible application of overriding mandatory provisions under Article 9. The latter Article can provide complementary protection where the conditions for application are satisfied.¹⁷⁶ The concern appeared to be that a contrary interpretation, i.e. one that held that when the conditions of Article 6 are not met, Article 9 could also not apply, would deprive a mobile consumer, who already does not enjoy the protection of Article 6, of what was considered to be the "safety valve" of the public order acts.¹⁷⁷ This interpretation of the relationship between the articles further suggests that the protection of the weaker party is a concern of overriding mandatory rules. It equally highlights the potential for national courts, in the application of the optional instrument as the governing law, to categorise national consumer mandatory rules¹⁷⁸ as overriding mandatory rules.

The latter construction of overriding rules, so as to include the protection of the weaker party, is clear from the decision in *Ingmar*.¹⁷⁹ The case concerned the scope of application and thus mandatory nature of Articles 17 and 18 of the Commercial Agency Directive, which guarantees a right of compensation to the commercial agent after the termination of a commercial agency contract.¹⁸⁰ The Court observed that the Directive

¹⁷⁴ Contrary to Hellner's view above.

¹⁷⁵ Green Paper (2002), 33.

¹⁷⁶ *Ibid.* 34.

¹⁷⁷ *Ibid.*

¹⁷⁸ Which would otherwise not apply owing to the derogation from Article 6.

¹⁷⁹ *Ingmar GB Ltd v Eaton Leonard Technologies Inc* [2000] ECR I-9035.

¹⁸⁰ Council Directive 86/653/EEC on the coordination of the law of the Member States relating to self-employed commercial agents. The case was heard before the English High Court, while the governing law of the contract was the law of California.

was designed to protect commercial agents and, in the case of Articles 17 and 18, to provide protection after the termination of the contract. The regime established by the Directive for the purpose of protecting the weaker party was considered mandatory.¹⁸¹ This categorisation was confirmed by Article 19 of the Directive which provides that the parties may not derogate from the rules to the detriment of the commercial agent before the contract expires.¹⁸² The Court finally drew upon the wider purpose of the Articles which was to protect for commercial agents freedom of establishment and the operation of undistorted competition in the internal market. This required that the provisions be observed throughout the EU if those Treaty objectives were to be obtained. The Court, therefore, also made a link between the purpose of the Directive and wider public interests, which will often be the case. As Hellner highlights, few rules protect only a purely private interest, and will be joined by protection of the general interest.¹⁸³ As such, together with the Commission's interpretation of the relationship between Articles 6 and 9 of Rome I, there could be said to be few rules outside the definition of overriding mandatory rules.¹⁸⁴ It is thus advanced that less attention should be paid to the definition of overriding rules, and greater attention given to the condition for their application in geographical terms, i.e. as rules that are applicable to any situation within their scope, irrespective of the law otherwise applicable to the contract.¹⁸⁵

Article 9 attempts to limit the scope of application, and thus impact of such rules in a number of ways. In the first place, although it has been advanced that a wide categorisation of overriding mandatory rules can result from the definition, the existence of the definition may have a limiting effect. It has been considered¹⁸⁶ that the reference to rules deemed to be 'crucial' for safeguarding the public interest, and for maintaining the political, social and economic organisation of the state may restrain national courts from categorising national rules as overriding rules too easily. This could act to prevent significant derogations from the optional instrument as the applicable law.

¹⁸¹ *Ingmar*, paragraphs 20 -21.

¹⁸² Para 22.

¹⁸³ Hellner (2009), 469.

¹⁸⁴ *Ibid.*

¹⁸⁵ Hellner (2009), 460.

¹⁸⁶ Bonomi (2008), 289.

The next limitation arises in Article 9 (3), which governs the application of overriding mandatory rules of third countries. It has been advanced that it is in this context that greater uncertainty has arisen for contracting parties as under Article 7 (1) of the Rome Convention effect could be given to the overriding mandatory rules of any country with which the situation had a close connection. The result was that mandatory rules of several systems might have been applicable, and thus the parties could not identify which laws, other than the governing law and that of the forum, would apply to their contract.¹⁸⁷ It was on this basis, and in light of concern for the uncertainty and transactions costs which could arise from this situation that lead Member States to opt-out of Article 7 (1), and for the Commission to propose the inclusion of overriding mandatory rules within the optional instrument. These concerns have, however, somewhat abated with the new Article 9 (3). This provides only for the application of the overriding mandatory provisions of the law of the country where the obligations arising out of the contract have to be or have been performed. Greater foreseeability is thus ensured for contracting parties, and preference is given to the law of the place of performance, which recognises that the performance obligation is central to the contract.¹⁸⁸ It is this Member State which has the necessary 'close connection' with a contract so as to have a legitimate interest in having its law applied.¹⁸⁹

In a further limitation, Article 9 (3) provides that those overriding mandatory rules of the place of performance will only apply in so far as they render the performance of the contract unlawful. This provision reflects the fact that the applicability of third country mandatory rules has traditionally been concerned with situations of illegality, and particularly where that has been concerned with the performance of the contractual obligation.¹⁹⁰ Indeed, despite the reticence shown by the UK to Article 7 (1) of the Rome Convention, it is an established common law principle that the British court will not enforce contracts which are illegal according to the place of performance.¹⁹¹ Unlawful, as

¹⁸⁷ See, Dickinson (2007), 62, and Chong (2006), 44.

¹⁸⁸ Chong (2006), 46.

¹⁸⁹ Ibid.

¹⁹⁰ Dickinson (2007), 87, and Chong (2006), 41-42.

¹⁹¹ *Ralli Bros v Compania Naviera Sota y Aznar* [1920] 2 KB 287. See, Chong (2006), 41 and 62 for a full discussion of the case law. .

termed by Article 9 (3),¹⁹² need not be interpreted so narrowly as to only include rules giving rise to criminal sanctions, and it is also understood to include any overriding mandatory rule which renders the contract, or a particular clause void or unenforceable.¹⁹³ Cases involving the application of third country overriding mandatory rules in this context have commonly concerned import and export restrictions. An example is the case of *Foster v Driscoll*,¹⁹⁴ which concerned a contract governed by English law to import alcohol into the United States at a time when it was prohibited, and which rendered the contract void.¹⁹⁵

While uncertainty will continue for contracting parties in regard to the categorisation and thus identification of overriding mandatory rules, certainty will in fact be enhanced in regard to the application of third country rules with the clarified approach of Article 9 (3). To the extent that the new rule reflects the existing approach of national courts, however, the changes may not lead to a substantial reduction in the potential scope of application of such rules.¹⁹⁶ The presence of a definition and the jurisdiction of the Court of Justice¹⁹⁷ to interpret that may, however, mean that national courts will be less inclined to categorise rules as being overriding in any case. This is particularly with the guidance of Rome I that such rules shall only apply in exceptional circumstances.¹⁹⁸ On balance, therefore, the need to derogate from Article 9, where the optional instrument forms the governing law of the contract, may not be as great as assumed by the Commission in the 2004 Communication.¹⁹⁹

¹⁹² The terms unlawful and illegal are used interchangeably in literature, and some language versions of Article 9 (3) also refer to illegal, rather than unlawful. They both, however, appear to denote the same meaning, see Hellner (2009), 461-2.

¹⁹³ *Ibid*, 461.

¹⁹⁴ *Foster v Driscoll* [1929] 1 KB 470.

¹⁹⁵ A non- UK example, is the German case of *Kulturgüterfall* (BGH, 22 June 1972; BGHZ 59), which concerned the illegal exportation of Nigerian cultural goods, discussed by Chong (2006), 41.

¹⁹⁶ See, Bonomi (2008), 297.

¹⁹⁷ The Court did not previously enjoy jurisdiction over the Rome Convention as this was not an EU instrument.

¹⁹⁸ Recital 37.

¹⁹⁹ Without explicit evidence that the application of Article 9 rules result in significant obstacles to trade in the internal market.

It is also clear that difficulties may arise for the inclusion of such rules within the optional instrument in terms of their identification. A review of relevant literature refers only in the abstract to the type of rules and interests which fall to be considered under this category of rules,²⁰⁰ and the difficulty lies in the subjective and discretionary approach to categorisation. Rules considered to fulfil the definition in Article 9 (1), owing to the nature of such rules, i.e. those regarded as crucial by a country for safeguarding its public interests, will not be static or homogeneous across the Member States. It is, therefore, also unlikely that consensus could be reached among the Member States as to the content of such rules, and thus for the optional instrument to comprehensively identify and regulate those interests and rules so that the Member States will give up their competence in this area.²⁰¹ This is evident from the way in which Member States have construed the scope of the provision in regard to public/private rules.

The task of identifying overriding mandatory rules may, however, be easier in regard to those of EU origin, as it will be possible to draw upon the approach to categorisation in the case of *Ingmar*. In the first place, the rules of the *acquis* may in fact provide for their overriding nature, as was the case in *Ingmar*.²⁰² Overriding status may, however, also be attributed though consideration of the purpose served by the rule at issue.²⁰³ The rule in *Ingmar*, while concerned in the first instance with the protection of the commercial agent as a weaker party, also sought to protect the freedom of establishment and the operation of undistorted competition in the internal market. The purpose of the rules at issue were thus inextricably linked to ensuring the proper functioning of the internal market, and thus served a clear public interest which is distinct of the EU legal system. The purpose of such rules, therefore, also clearly corresponds with the EU's competence to harmonise private law rules, which is not a general competence but one to ensure the establishment

²⁰⁰ I.e. rules concerning import and export prohibitions, anti-trust laws and exchange regulations.

²⁰¹ A concern already expressed by Rutgers and Colombi Ciacchi in regard to consumer protection rules under Article 6, discussed below.

²⁰² The Commercial Agency Directive, at issue in the case, provides that a number of Articles cannot be derogated from, including an obligation on the principal to act in good faith, Article 5. It has already been discussed that the CRD provides for its mandatory nature in Article 43. Recital 59 extends the imperative nature of the Directive to where the law applicable to the contract is that of a third country, where all other elements relevant to the situation are at the time of the choice located in one or more Member States.

²⁰³ Necessarily if the provision does not provide for its overriding status.

and functioning of the internal market.²⁰⁴ It could thus be envisaged that if a sector-specific optional instrument were created to govern commercial agency agreements, then it could contain, and categorise as mandatory, those mandatory rules of the Commercial Agency Directive.

It is not clear, however, that the EU would have competence to harmonise those overriding mandatory rules at the national level,²⁰⁵ where they can be identified, and where the examples given go beyond the contractual and internal market scope and legal basis of the instrument.²⁰⁶ For example, while import and export restrictions will constitute overriding mandatory rules in Member States and pose restrictions to the free movement of goods within the internal market, they have been regulated negatively by the EU and thus examined for their compatibility with the fundamental freedoms, rather than being harmonised.²⁰⁷ Articles 34 and 35 TFEU thus prohibit restrictions of imports and exports, unless they can be justified on grounds provided in Article 36 TFEU, including public morality, public policy or public security. Where the restrictions are not directly discriminatory,²⁰⁸ they can also be justified by reference to wider, non-exhaustive, objective justifications which can be invoked by the Member States.²⁰⁹ Resulting restrictions must also comply with the principle of proportionality, and thus be suitable and not go beyond what is necessary in order to achieve the Member State's objective in proposing the rule, i.e. not disproportionately restrict the fundamental freedom.

The wider inference is thus that restrictions to the application of overriding mandatory rules already exist, as they can be examined by the Court of Justice for their compatibility with the EU fundamental freedoms.²¹⁰ This was the case in *Arblade*.²¹¹ Here the Court

²⁰⁴ See, 6.2.

²⁰⁵ I.e. beyond those implementing EU mandatory rules.

²⁰⁶ For discussion of Article 352 TFEU as the legal basis, see 6.2.

²⁰⁷ A positive form of integration.

²⁰⁸ I.e. protectionist in their intent.

²⁰⁹ In the area of goods the objective justifications are referred to as mandatory requirements. See Case 120/78 *Rewe-Zentral AG v Bundesmonopolverwaltung für Branntwein (Cassis de Dijon)* [1979] ECR 649, para 8. These may relate, for example, to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions, and the defence of the consumer.

²¹⁰ See, Rutgers (2006), 204.

highlighted that national public order legislation is not exempt from compliance with the provisions of the Treaty.²¹² While accepting that the protection of workers can constitute an overriding justification relating to the public interest, the Court undertook a rigorous review of the proportionality of the application of the rule.²¹³ Unjustified or disproportionate restrictions on the fundamental freedoms by the application of overriding mandatory rules will not, therefore, be tolerated.

The approach of the Treaty and the Court in accepting justifications for such restrictions also recognises, however, the Member States interests in applying national mandatory rules which protect the national interests, and which are otherwise given effect to under Article 9 of Rome I. Given the nature of overriding mandatory rules, i.e. those seeking to protect the public interest, and the non-exhaustive approach that the Court has taken to objective justifications in regard to restrictions to the fundamental freedoms, it is clear that Member States and their national courts would have little difficulty in justifying the application of overriding national mandatory rules. Given that the object of the optional instrument is to facilitate trade in the internal market, the more significant issue will be that of proportionality. The issue will be whether the application of the national mandatory rule goes beyond what is necessary to achieve the end sought by the Member State, in terms of restricting free movement. With the application of national mandatory rules being reviewed for compatibility with the Treaty fundamental freedoms it could then be anticipated that the categorisation of Article 9 rules by national courts will take on an objective element.²¹⁴ The national court would thus have to ask whether the application of the rule would pose a disproportionate interference with the fundamental freedoms. This would be particularly so now that the Court of Justice has jurisdiction over both the definition of Article 9(1), and can thus review national categorisation of rules in terms of that definition, and also over the review of restrictions to the fundamental freedoms. The Court can thus draw on the relationship between the two in

²¹¹ See, Bonomi (2008), 291.

²¹² *Arblade*, para 31.

²¹³ Although the application of the principle of proportionality will ultimately be a question for the national court.

²¹⁴ See, Dickinson (20087), 67, who is in favour of the adoption of an objective approach to categorisation of overriding mandatory rules reflecting the approach of the Court concerning restrictions to the fundamental freedoms.

terms of any potential disruption to the optional instrument as the applicable law from overriding mandatory rules.

From the foregoing it is clear that it may be neither possible to comprehensively include overriding mandatory rules within an optional instrument, nor necessary, as their application can be reviewed. Indeed, neither PECL nor the DCFR seek to preclude the application of national overriding mandatory rules. Significantly, Article 1:103 (2) of PECL allows for effect to be given to those mandatory rules of national, supranational and international law which, according to the relevant rules of private international law, are applicable irrespective of the law governing the contract.²¹⁵ This provision is considered to apply to those overriding national mandatory rules which apply under Article 9 of Rome I.²¹⁶ As such, PECL, which like the optional instrument sought to create an independent legal order,²¹⁷ would take effect subject to overriding mandatory rules of both national and EU origin. This is confirmed by Article 15:102, which provides for the effects on a contract of an infringement of a mandatory rule applicable under Article 1:103. In the first instance, it provides that the effects will be those prescribed by the mandatory rule, in order to respect the provisions of the applicable law.²¹⁸ This provision can also be found in the DCFR II.-7:302. However, unlike PECL, the DCFR does not contain a provision akin to Article 1:103, and thus we are not to know the origin of mandatory rules which are infringed. If it is to be inferred from the scope of PECL, however, it would provide for the effects of infringement of mandatory rules of both EU and national origin.²¹⁹ It is thus implicit that the DCFR also takes effect subject to overriding mandatory rules, and that scope exists for the application of other sources of law within that system.

²¹⁵ These are to be distinguished from those rules which may be rendered inapplicable by the parties choice of the principles as the governing law, i.e. domestic mandatory rules (Article 1:103(1)).

²¹⁶ At the time, Article 7 of the Rome Convention. See, MacQueen, *Illegality and Immorality in Contracts: Towards European Principles* (in) *Towards a European Civil Code*, Hartkamp et al. (eds.), 3rd ed. Nijmegen: Kluwer Law International, 2004, 416.

²¹⁷ *Ibid.* 415.

²¹⁸ MacQueen (2004), 420.

²¹⁹ As Rutgers does infer. Rutgers, *The DCFR, Public Policy, Mandatory Rules, and the Welfare State*, (in) *The Politics of the Draft Common Frame of Reference*, Somma (ed.), The Netherlands: Kluwer Law International, 2009, 121.

It can be submitted that the optional instrument, like any governing law under the Rome I system, must similarly recognise the interest of other contractual systems in having their mandatory rules applied where Article 9 so prescribes. Indeed, the optional instrument will rely on the willingness of the Member States, and their national courts, to apply the instrument without undermining the objectives of the optional regime by applying their own mandatory rules. This is particularly so as not to undermine the derogation from Article 6. Allowing for the application of overriding mandatory rules where the optional instrument applies as the governing law will thus invoke considerations of comity, and encourage cooperation by national courts, including in the interpretation of Article 9 (1), so as not to undermine the objectives of the optional instrument.²²⁰

Mandatory rules, such as those in Ingmar,²²¹ which can be identified, particularly from within the EU acquis, must however be included within the optional instrument. Although, such rules can be categorised as being of an overriding nature, this designation within the optional instrument would not be necessary. It is not the intention that mandatory rules of the instrument would apply other than when it applies as the governing law of the contract, and therefore apply by virtue of Article 9.²²² The intention is the creation of an independent and autonomous contractual regime, and thus such rules should be included and categorised as mandatory so that parties will know with greater certainty²²³ the mandatory rules that will apply to their contract, and reduce the need for the application of mandatory rules of other systems. The inclusion of mandatory rules, beyond those of consumer protection will, therefore, increase the utility of the instrument for those operating in the internal market.

While the optional instrument remains subject to Article 9, there will be scope for the application of overriding mandatory rules of other Member States. Their application will, however, be subject to scrutiny for compatibility with the fundamental freedoms, and

²²⁰ I.e. keeping disruption by the applicability of national mandatory rules to a minimum.

²²¹ I.e. those which may seek to protect a weaker party, but which are inextricably linked to market integration and the proper functioning of the internal market.

²²² See discussion on Article 4 of Rome I, above.

²²³ Although some uncertainty will remain, as Article 9 will still apply. Certainty will be significantly enhanced in B2C contracts with the derogation from Article 6.

thus subject to justification and proportionality. Where the interests that the mandatory rule seeks to protect are already sufficiently protected by the optional instrument, the application of such rules would be disproportionate. This is clear from the judgement in *Arblade*, where the Court held that the application of the national public order rules at issue would not be justified nor proportionate where the public interest is already safeguarded by the law of the applicable Member State.²²⁴ This could be formalised in the scope clause,²²⁵ which governs the relationship between the two instruments,²²⁶ so that Article 9 will only apply to matters which are not regulated by the optional instrument. This would explain the continued application of national overriding mandatory rules where the optional instrument applies as the governing law, subject to scrutiny in terms of compatibility with the fundamental freedoms, and with the definition in Article 9(1). It would also ensure the application of the mandatory rules of the optional instrument, which would provide certainty for contracting parties.

The former scrutiny of the categorisation and application of overriding mandatory rules also presents a safeguard for the application of the mandatory consumer protection rules of the optional instrument. Attempts by national courts to apply national mandatory consumer rules would not be justified or proportionate, as the interests which they seek to protect will be adequately represented in the optional instrument. Indeed, while the optional instrument ensures a high level of consumer protection, and comprehensively includes rules of consumer protection present at the national level,²²⁷ the need and incentive for Member States to categorise their consumer mandatory rules as Article 9 type rules will be reduced in any case. The autonomous nature of the optional instrument can thus be ensured in this respect.

²²⁴ The case concerned the freedom to provide services. To the extent that the interests at issue were already protected by rules of the Member State of establishment, and the defendants had already complied with these, it would be disproportionate to also require compliance with the rules of the state in which the service was being provided, para 80 (3).

²²⁵ In addition to the full derogation from Article 6 of Rome I.

²²⁶ Discussed in 6.3.1.

²²⁷ Drawing in the first place on the common core of rules provided in the CRD, which means that the risk of conflict between the mandatory consumer rules of the Member States, and those of the optional instrument is significantly reduced.

It has, therefore, been maintained that the applicability of the optional instrument can be ensured within the Rome I system as a directly applicable contractual regime, which will co-exist alongside national contract law as a 2nd domestic system. It has further been shown that it would be possible for the optional instrument to exist to a great degree autonomously from the national systems, and thus to create the simplified regulatory environment required by contracting parties in the internal market. In order to ensure the applicability of the optional instrument, however, it would also be necessary to exclude the application of the CISG. This applies as part of the wider regulatory framework in the B2B context, and in light of potential overlap in subject matter between the two instruments potential for conflict exists. It would be possible to exclude the application of the instrument as while that is opt-out in nature,²²⁸ the optional instrument should be opt-in. It will be for the parties, therefore, to tacitly exclude the application of the CISG through the choice of the optional instrument as the governing law. This is provided for in Article 6 of the CISG.²²⁹

6.4. The Optional Instrument as a Tool for SMEs

From the foregoing, it is clear that an optional instrument provides a suitable and desirable response to the obstacles for cross-border trade arising from the existing state of European contract law. It would create the simplified regulatory environment required in the internal market for the benefit of both B(SME)2B(SME) and B(SME)2C transactions. As an optional regime it would provide the parties with a neutral, non-national system of law, adapted to cross-border trade and, therefore, overcome the inadequacies of trade regulation in the internal market. These attributes mean that optional instruments could be particularly useful for SMEs because of their capped capabilities to trade currently in the internal market. Support thus exists for the creation of such instrument(s) which are particularly attuned to the needs of this group.

²²⁸ As a result of which parties who fail to make a choice of law become unwittingly subject to the (unknown) provisions of the CISG. This is particularly SMEs.

²²⁹ 2004 Communication, 21.

To this end, the creation of an optional instrument which would create the regulatory framework for the most common commercial and consumer transactions, those of sales and services, would be beneficial.²³⁰ This would be the first of a number of vertical instruments governing specific contracts which, drawing on the existing scope of the DCFR, could include distribution, lease, franchise etc. In terms of the content of this instrument it could draw on Book IV of the DCFR which provides specific rules for contracts of sale and for the provision of services.²³¹ The instrument would then include, and comprehensively regulate, general contract law throughout the life cycle of the contract, drawing on the content of the DCFR.²³² Such an extensive instrument in these terms is necessary if the optional instrument is to provide a sufficient *lex causae* under Rome I where chosen as the applicable law²³³ and if it is not to result in regulatory gaps. The need to refer to national law would undermine the intended autonomous nature and utility of the optional instrument, which would then be subject to similar limitations of the CISG. For example, while the latter instrument governs the contract of sale and the rights and obligations of the seller and buyer arising from such a contract,²³⁴ it does not concern itself with the validity of the contract.

With the motivation to create an autonomous contractual framework it would also be desirable to include related, but non-contractual, issues which commonly arise. For example, it would not be sufficient to provide harmonised rules on sale and not on the effect of those rules on the transfer of property. The existing divergence between national property law on this matter would remain and be exacerbated in light of the harmonisation of the contractual rules. This would justify their inclusion within the optional instrument. Another issue that would commonly arise is the effects in restitution of withdrawing from a contract and this should also be regulated within the instrument.²³⁵

²³⁰ As sales and services are often the subject of mixed contracts, it is suggested in order to enhance certainty and avoid the risk of regulatory lacunae, that they should form one instrument. As is the intended approach of the CRD.

²³¹ Parts A and C respectively.

²³² Books II and III, see discussion in Chapter 4, 4.2.2. It being intended in any case that the political CFR will comprehensively include rules of general contract law alongside the consumer provisions, 4.2.3.

²³³ This being a parameter of the content of the instrument, discussed in 6.3.1.

²³⁴ Article 4 CISG.

²³⁵ As in the case of both the proposed CRD (Articles 16 and 17), and the DCFR Outline Edition (2009), III.-3:510.

It has been highlighted that competence would exist under Article 352 TFEU to enact a comprehensive contractual instrument. This could support sector-specific instruments, at least those of importance to the internal market, which would be accompanied by provisions outside of the contractual scope of the optional instrument where their inclusion would facilitate the functioning of the internal market. Indeed, as the proposal for an optional instrument is narrowed to govern several specific contracts, the need to include within the instruments related rules from outside of the contractual scope will increase, along with the competence to harmonise such rules on this basis.²³⁶

The foregoing will form the minimum content of the optional instrument for both B2B and B2C contracts. A significant addition will then be harmonised rules of consumer contract law²³⁷ and in this regard consistency must be ensured between the fully harmonised provisions of the CRD and those of the optional instrument within the shared scope.²³⁸ The instrument should reflect a structural division in this respect between the rules applicable to B2B contracts and those which will apply only to B2C contracts. The division should be clear to the instruments' intended users, i.e. lawyers, but also significantly businesses, consumer advisors, and consumers themselves.²³⁹ It is clear that in creating an instrument attuned to the needs of SMEs in particular, who will have limited resources to receive legal advice, that a clearly structured and comprehensible instrument must result. The DCFR thus presently provides for distinct consumer rules within the general structure of the instrument²⁴⁰ so that, for example, the pre-contractual duty of disclosure in B2C contracts is clearly distinguished from and follows the duty owed in B2B contracts.²⁴¹ Concerns in regard to the utility of the DCFR to otherwise serve as the basis of the optional instrument have, however, been discussed in chapter 4. In particular, it is clear in regard to the placing of contract rules within the wider

²³⁶ I.e. If the intention is to create autonomous instruments governing the whole relationship.

²³⁷ Containing all consumer protection required by EU law (discussed below), along with general rules of contract law, the optional instrument would solve 99% of the cases likely to arise, Beale (2008), 15.

²³⁸ The need for consistency has been highlighted in 6.3, and consideration is given to how this is to be achieved in 6.4.2.

²³⁹ Beale (2009), highlights, however, the difficulty in drafting provisions that will be understandable to even the majority of consumers, 299.

²⁴⁰ I.e. we do not see the enactment of such provisions in their own code or section, but rather they form qualifications of the general law, see Whittaker (2009), 628-9.

²⁴¹ With distinct provisions and approaches, see discussion in Chapter 4, 4.2.2.

categories of juridical acts and of obligations,²⁴² that such distinctions will not prove necessary, nor user friendly in a contractual instrument. This structural division of the DCFR should not therefore appear in the optional instrument.²⁴³

The inclusion within the optional instrument of consumer protection rules considered as mandatory in the Member States, together with the derogation from Article 6 of Rome I, overcomes a significant obstacle to cross-border trade in the B2C context. It thus forms a significant incentive for all businesses wishing to engage in cross-border contracting, but in particular SMEs who are not well placed to deal with differences between such rules,²⁴⁴ to opt-in to the optional regime. The incentive for consumers to opt-in to the instrument is less clear. This is particularly as they will lose the protection of the mandatory rules of their habitual residence and further concerns will arise for consumer protection as the optional instrument will harmonise such rules on a full harmonisation basis. While SMEs have much to gain therefore from the creation of a simplified regulatory environment, the risk is that, like the CRD proposal, the result may well be a business driven instrument.²⁴⁵ Concerns in regard to consumer protection can, however, be overcome if a high level of consumer protection is sought. Consumers will then stand to benefit under the optional instrument from welfare gains. That is to say, the availability of the optional regime should lead to greater willingness by businesses to engage in cross-border trade, and thus result in greater competition between suppliers, in more choice, and better prices. Further consideration must however be given to the optional instrument in the B(SME)2C context to assess the extent to which the intended benefits of the regime will be realised.²⁴⁶

If an optional instrument is to facilitate trade by SMEs, however, it must also address potential imbalances that arise with their contracting partners. It will be necessary for the instrument to also introduce protective provisions in favour of the (weaker) SME. The instrument could, for example, in line with the approach of the DCFR, protect this group

²⁴² See further, Whittaker (2009), 628.

²⁴³ Discussed in 4.2.2.

²⁴⁴ Unlike large businesses.

²⁴⁵ See discussion in regard to the CRD in Chapter 4, 4.1.3, and further discussion in 6.4.2.

²⁴⁶ Considered further in 6.4.2.

by extending marketing and pre-contractual duties to B2B relations, and by controlling the substantive fairness of standard terms which can often be imposed on the weaker party as a result of the imbalance.²⁴⁷

The result may, however, be that large businesses will be reluctant to subject their dealings to what may pose an unfamiliar²⁴⁸ and uncertain law,²⁴⁹ which seeks to limit their contractual freedom even in the B2B context. The implication is that SMEs will not benefit from the rebalance in contractual position that the instrument seeks to achieve, or the wider benefits that it intends to bestow.²⁵⁰ This concern should not, however, be overstated. There is a clear incentive for SMEs to opt-in to the instrument while contracting with each other,²⁵¹ and while this group accounts for 99% of businesses in Europe there is still considerable scope for the optional instrument to govern a significant number of transactions in this context. However, given that the definition of SMEs is wide,²⁵² imbalance in respective contractual bargaining positions will exist even within this category. It must also be accepted, therefore, that even within the SME group not all will need or wish to be subject to the protective regime.²⁵³ The issue arises, therefore, of how businesses can be persuaded to use the optional instruments between themselves even if one of them is a large(r) business.

In cases of unequal bargaining power businesses can often offer their standard contract terms, including their choice of law, on a take-it-or-leave-it basis, as it will often be more cost efficient to do so.²⁵⁴ In this situation it may be open to the weaker party to shop

²⁴⁷ How protection is to be afforded to SMEs is considered further in 6.4.1.

²⁴⁸ Although concerns with regard to unfamiliarity should not be seen as a good reason for not going forward with the adoption of such instruments. With use businesses will become familiar, and there are clear incentives for businesses to utilise such instruments, discussed further below.

²⁴⁹ See, Heiss and Downes (2005), 697.

²⁵⁰ For example, enabling the use of EU-wide standard contract terms.

²⁵¹ I.e. parties of the same bargaining position who can benefit from the neutrality of the instrument.

²⁵² Discussed below in 6.4.1.

²⁵³ As either the weaker or stronger party respectively.

²⁵⁴ This forms the premise for the use of such contracts. See generally, Beale, Bishop and Furmston, *Contract: Cases and Materials* (4th ed.), London: Butterworths, 2001, Chapter 38, Standard form contracts, and Chapter 5, 5.2.1.1.

around for more favourable terms,²⁵⁵ but they may still find themselves bound to accept the governing law of the standard contract for a variety of reasons.²⁵⁶ For example, the choice of the optional instrument as the governing law may not exist in the particular market as competitors use the same standard contract terms, there may not be another supplier of the goods or services, or the weaker party not wish to loose what would be a lucrative contract and thus they are left with little choice but to accept the choice of law. The alternative is, however, that they pay for the protection of the optional instrument.²⁵⁷ Schwartz contends that most buyers will be able to avoid any one term if they concentrate their entire resources on doing so.²⁵⁸ However, the stronger party may still be unwilling to negotiate the contract as the cost of doing so and any new risk undertaken by them as a result of the change in governing law, including that arising from the limitation of contractual freedom, may exceed the gains of the entering into the contract.²⁵⁹ The effect of a change in the governing law for that party would be significantly different to the removal of a single, self-contained disclaimer for non-conformity, for example.²⁶⁰ Opting into the optional instrument may well have an effect on the standard contract terms as they stand, however, such effects will be unknown at an early stage. The weaker party may also be left unable or unwilling to pay as the cost of avoiding a term will often be more than the value of the risk it represents. It will reflect the cost to the business of having to make two types of contracts, for example, one governed by the optional instrument and one governed by the stronger party's preferred choice of law.²⁶¹

Enjoying the protection and benefits of the optional instrument should not however come at an excessive price. It may only take a margin of buyers to shop around for more

²⁵⁵ This possibility is highlighted by Posner, *Economic Analysis of Law* (2nd ed), 85, in Beale et al. (2001), 952.

²⁵⁶ See further, Trebilcock, *An economic approach to unconscionability* (in) *Studies in Contract law* (Reiter and Swan eds.), in Beale et al. (2001), 954.

²⁵⁷ As the supplier, the SME may have to accept a reduction in the contract price that the other (stronger) party is willing to pay to reflect the risk that they undertake where the contract is governed by the optional instrument.

²⁵⁸ Schwartz, *Seller Unequal Bargaining Power and the Judicial Process* (1974) 49 (3) *Indiana Law Journal* 367, 371.

²⁵⁹ *Ibid*, 372-3.

²⁶⁰ The example used by Schwartz. The calculation of the cost of removal would be more straightforward in that example.

²⁶¹ Schwartz (1974), 373.

favourable terms in a workably competitive market to put pressure on suppliers to adjust their terms or else risk losing customers to their competitors.²⁶² Thus if enough SMEs were to ask for the optional instrument to act as the governing law of the contract, and were willing to pay for greater protection initially,²⁶³ then this may bring about a greater willingness by large businesses to contract on this basis.²⁶⁴ Indeed, incentive may soon exist for larger businesses to have all contracts governed by the optional instrument in order to save the cost of offering a number of different contracts on this basis and thus to enjoy the economies of the standard form contract. This will depend, however, on there being a sufficient amount of demand and therefore on SMEs being aware of the availability and benefits of the optional regime as the governing law of their contracts.²⁶⁵

It is clear from the outset, therefore, and as intended, that it is SMEs who stand to benefit the most from the availability of the optional instrument in both the B2C and B2B context. Large businesses have little need for such an instrument, and while it may be possible to persuade such businesses²⁶⁶ to opt-in to the optional instrument in the B2B context, this may come at a price. It is also clear that while the optional regime will limit the contractual freedom of such parties, they will seek certainty and predictability in the approach that the instrument takes to protecting the SME, and thus to any new risks that they undertake towards the weaker party where they opt-in to the instrument. Further consideration must therefore be given to how protection is to be extended to SMEs under the optional regime, and thus to how a balance is to be achieved between these competing interests.²⁶⁷

²⁶² Trebilcock, in Beale et al. (2001), 954-5.

²⁶³ Although not an excessive amount.

²⁶⁴ In these terms also see Schwartz (1974), 373.

²⁶⁵ In this regard see further the related discussion on the need for consumers to also be aware of the availability and benefits of the optional regime, 6.4.2.

²⁶⁶ Including those SMEs who do not need or desire such protection.

²⁶⁷ Already touched upon in the context of the discussion of the DCFR in Chapter 4, 4.2.2.

6.4.1. B(SME)2B(SME)

The most straightforward approach to the protection of SMEs would see the extension of EU consumer protection provisions to all SMEs in B2B contracts. This approach gains support to the extent that it treats like situations alike, on the basis that the SME is in an analogous position to the consumer, and would benefit from the same protection.²⁶⁸ The need to extend protective measures to SMEs, by analogy with consumers, has been considered by the Commission²⁶⁹ as a regulatory response to the existing imbalance. However, as SMEs account for 99% of all businesses in Europe, this would amount to a fundamental policy change in this area²⁷⁰ and it is unlikely that such a categorical approach to protection is justified. It would result in the overprotection of those who although within the definition of ‘SME’ do not need or may not want such protection. The SME will not always be as vulnerable as the consumer.

A slightly more restrictive approach would be to extend protection only where the SME is contracting with a larger business and not to SME2SME contracts. Alternatively, it could be extended only when dealing with a small business within the definition of ‘SME’, and thus would include SME2SME contracts, but only where a presumed imbalance in bargaining positions is present. This approach was proposed by the Law Commissions of England and Scotland in seeking to extend the consumer controls over unfair terms to contracts between businesses and small SMEs.²⁷¹ The latter group was defined as being of 9 or fewer employees, in accordance with the Commission’s definition of micro-enterprises.²⁷² In doing so the proposal sought to protect the least sophisticated businesses, which are so small that they are unlikely to have expertise in

²⁶⁸ Hesselink, *SMEs in European Contract Law*, (2007), 14.

²⁶⁹ See discussion in 6.2.

²⁷⁰ Protective SME rules would become the norm with there being a separate non-protective regime as the exception for contracts between large businesses.

²⁷¹ Law Commissions’ Final Report on Unfair Terms in Contracts (Law Com no 292, Scot Law Com no 1999), 2005.

²⁷² As it existed at the time. The new definition defines micro-enterprises as those which employ fewer than 10 employees, see Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, *OJ* 2003, L 124/36, Annex, Article 2, Para 3.

contracting or the resources to seek legal advice. They were thus presumed to be in a very similar position to consumers.²⁷³

While this approach is intended to provide businesses with certainty and predictability as to when protective provisions will apply,²⁷⁴ and would appear to offer a narrower approach than extending protection to all SMEs, it would in fact have a more uncertain and wide impact than that. In the first place, it was conceded that it would not always be straightforward to determine the size of a business, and that some businesses would approach contracts uncertain of whether they were dealing with a small business.²⁷⁵ It is then the case that 92% of businesses within the EU²⁷⁶ are classified as micro-enterprises.²⁷⁷ The extension of protection to this group would thus amount to a significant limitation on contractual freedom which is not apparent from the rule, and which again would not be justified.

The problem for such an approach lies in the arbitrary fashion in which SMEs are distinguished from other businesses. Currently, the European Commission defines SMEs as ‘enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.’²⁷⁸ As has been seen, however, this definition can be further broken down into micro (less than 10 employees), small (between 10 and 50 employees), and medium-sized (between 50 and 250 employees) businesses, and can cover many different types of businesses, i.e. from self-employed persons and family businesses to companies financed by venture capital, and from craft to high-tech companies.²⁷⁹ In extending protection to SMEs, and particularly in deciphering which ones, it is again clear that categorical

²⁷³ Law Commission Report (2005), para 5.35. The report confirmed the limited capabilities of small SMEs to trade effectively and safely even in a domestic setting.

²⁷⁴ Ibid. para 5.37.

²⁷⁵ Law Commission Report (2005), para 5.47.

²⁷⁶ 94% within the UK. Ibid. para 5.14.

²⁷⁷ European SMEs under Pressure, Annual Report on European Small and Medium-Sized Enterprises 2009, http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/performance-review/pdf/dgentr_annual_report2010_100511.pdf, 15.

²⁷⁸ Commission Recommendation (2003), Annex, Article 2, Para 1.

²⁷⁹ Hesslink, SME's in European Contract Law, (2007), 4.

protection, based on the number of employees or annual turnover,²⁸⁰ will lead to arbitrary results. While a business with 9 employees would attract protection, a business with 11 employees would not.²⁸¹ It may be the case that a business with more employees will be in greater need of protection than a smaller one and, as already highlighted, businesses falling with the category of protection may not in fact need or desire the protection of such a regime. The Law Commissions' proposal acknowledged this fact with a number of exceptions. The proposal sought to exclude those businesses from protection which, although satisfying the size criterion, were felt to operate in such a sophisticated environment that it would not be appropriate for them to be treated as small businesses, or the contract was one which fell into a field which was already sufficiently regulated in order to prevent overregulation.²⁸² While such exceptions would become necessary with a categorical approach, it is clear that certainty and predictability would be further undermined.²⁸³ Ultimately, while a categorical approach to protection would not reflect the realities of the current situation, nor greatly ensure certainty or predictability in the protection regime, it does not pose an appropriate approach for the optional instrument.

A better approach would, therefore, not seek to limit the protective provisions of the optional instrument to particular categories of SMEs. In this respect, it has already been highlighted²⁸⁴ that the DCFR provides an appropriate solution, through its combined use of general principles and objective standards,²⁸⁵ and the generalisation of the acquis provisions to B2B contracts. The intention behind doing so was seemingly to protect SMEs in cases of inequality of information and bargaining power²⁸⁶ and the result is a

²⁸⁰ The Law Commissions' report rejected the possibility of using the turnover criterion as the determinative issue as this was not considered to be an accurate guide to the size of the business. Neither would it achieve the necessary certainty nor predictability for those operating in the market, as turnover was considered to be rarely accurately accessible on the 'face' of the business, paras 5.36-37.

²⁸¹ Criticism highlighted by Hesselink, *ibid*, 18, or similarly, if only small/micro businesses were to be protected and not medium sized.

²⁸² The exceptions were directed at the financial services industry but were not limited to this. The exceptions concerned small businesses that formed part of a larger group, contracts with a value higher than £500,000 and contracts for regulated financial business, see para 5.24, and from para 5.45.

²⁸³ The Law Commissions' report, for example, accepted that imposing a transaction limit of £500,000 would likely present the parties with problems of ascertainability and predictability similar to those presented by the employee number test, para 5.62.

²⁸⁴ Discussed in Chapter 4, 4.2.2.

²⁸⁵ Hesselink (2007), supports such as, he terms, a 'nuanced' approach, 18.

²⁸⁶ DCFR Outline Edition (2009), paragraphs 9-11.

more balanced approach which is attuned to the needs of this group.²⁸⁷ An example of the DCFR's approach, already encountered,²⁸⁸ is the creation of a pre-contractual duty of disclosure on businesses, to provide such information concerning goods and services as the other party can reasonably expect.²⁸⁹ In assessing what information the other party can reasonably expect to be disclosed in B2B contracts, what is deemed to be reasonable is judged against an objective standard of good commercial practice.²⁹⁰ In this way the test of 'reasonableness' is narrowed, so some direction is given as to what should be considered in the assessment and application of this open norm. At the same time, the decision on whether this standard has been met should entail subjective consideration of factors such as the parties' relative experience, the available information and their respective bargaining positions. In this way, the term 'reasonableness' provides a flexible means by which to achieve a fair and just balance between the parties' interests according to the circumstances.²⁹¹

Similar concerns however arise for the use of such an approach, as those in regard to the proposals for categorical protection.²⁹² In the first place, while the duty of disclosure is extended to all B2B transactions, this implies a significant limitation on contractual freedom in the commercial context, and thus a significant extension of protection. The advantage of this approach is, however, that it should reflect the reality of the situation between the parties. Thus unlike the categorical approaches, the result should be that only those SMEs requiring protection will receive it.²⁹³ It is also clear that the intention behind the use of such an approach is not to limit contractual freedom.²⁹⁴ The DCFR clearly

²⁸⁷ Evidence of Vogenauer to the House of Lords EU Committee (2009), Q. 43, as well as being more attuned to the needs of social justice, see discussion in Chapter 3, 3.2.

²⁸⁸ Chapter 4, 4.2.2.

²⁸⁹ Book II, Article 3:101.

²⁹⁰ Whether failure to provide information would deviate from good commercial practice, Article 3:101 (2).

²⁹¹ On the role and function of 'reasonableness' in European contract law, see generally, Troiano, *To What Extent Can the Notion of 'Reasonableness' Help to Harmonize European Contract Law? Problems and Prospects from a Civil Law Perspective* (2009) 5 *European Review of Private Law* 749. The author highlights that the attractiveness of the standard of 'reasonableness' is its flexibility and proximity to concrete circumstances, 759.

²⁹² Highlighted in Chapter 4, 4.2.2.

²⁹³ The threshold applying for the finding that the duty has been breached will vary depending on the facts, and the parties.

²⁹⁴ The difficulties faced by the Network in regard to the extent to which freedom of contract can be restricted to address inequality in bargaining power is discussed in Chapter 4, 4.2.2.

distinguishes in the application of the standards of protection which it applies to B2B and B2C contracts, with a higher threshold put in place for a breach to be found in commercial transactions.²⁹⁵

This distinction can be seen, for example, in the way in which the DCFR regulates unfair terms, which is another area that warrants greater protection of the weaker party where inequality in their bargaining position exists with their contracting partner.²⁹⁶ In the case of B2C contracts a term is to be regarded as unfair if it is supplied by the business and it significantly disadvantages the consumer, contrary to good faith and fair dealing.²⁹⁷ A higher threshold for intervention with the substance of the contract is, however, put in place for the regulation of standard terms in commercial contracts. In this context, a term is deemed to be unfair if it forms part of the standard terms supplied by one party and its use is such as to grossly deviate from good commercial practice, contrary to good faith and fair dealing.²⁹⁸ Thus once again we see the use of the objective standard of good commercial practice, but the need for the use of the standard term to ‘grossly’ deviate from this standard further narrows the opportunity for intervention in the parties contract vis-à-vis the B2C context. In this way the DCFR takes a more cautious approach to protecting the weaker party in cases of inequality of bargaining power than we would see in the B2C context²⁹⁹ as this is balanced with the need to preserve freedom of contract.³⁰⁰

The second concern that arises, however, is that this balance is achieved at the expense of certainty and predictability, which would be undermined by the DCFR’s approach.³⁰¹ In the first place, therefore, the protective provisions would apply in principle to all B2B

²⁹⁵ In regard to the duty of disclosure, 4.2.2. contrasts B2C contracts, in which a lower threshold for disclosure is imposed, and the incursion on contractual freedom is more intrusive.

²⁹⁶ See, DCFR Outline Edition (2009), Principles, para 10.

²⁹⁷ Book II.-9:403.

²⁹⁸ Book II.-9:405.

²⁹⁹ And is criticised as such. Hesselink, for example, is critical of the ‘sharp contrast’ in the treatment of consumers and SMEs, and highlights that the approach will lead to a loss of protection for SMEs in those Member States where consumer protection is extended to this group. Hesselink, *The CFR and Social Justice*, (in) *The Politics of the Draft Common Frame of Reference*, Somma (ed.) The Netherlands: Kluwer Law International BV, 2009, 109.

³⁰⁰ DCFR Outline Edition (2009), para 10.

³⁰¹ This concern was raised in Chapter 4, 4.4.2.

contracts, and uncertainty would also arise from the use of objective standards.³⁰² Both features are, however, also advantages of the approach. It has been demonstrated that approaches which seek to categorise and thus limit those SMEs who would fall within the protective scope of such measures provide little more certainty or transparency for businesses as to when protection will be extended. It is also clear that while they extend consumer protection to large groups of SMEs it amounts to a significant and often unjustified limitation on contractual freedom in the B2B context.

It is clear that on balance, therefore, the current approach of the DCFR presents the most appropriate way forward for extending protection to SMEs, and it does so within acceptable parameters for those larger businesses which will become subject to the protective regime. While the inclusion of general principles and objective standards can provide the necessary flexibility to achieve a fair contractual balance in the specific circumstances of the case, the potential uncertainty that may arise should not be overstated nor justify not pursuing this approach. Experience in Member States, including Germany and France, has in fact shown that the lack of formal legal certainty in the approach is largely compensated for by substantive foreseeability.³⁰³ Ultimately, larger parties will know that protection will be provided to the weaker party in unbalanced contractual situations but that, in cases of more or less equal bargaining positions, their contractual relationships will be unaffected.³⁰⁴

6.4.2. B(SME)2C: The ‘Blue Button’

In the B2C context, one manifestation of the optional instrument that is proposed is the ‘blue button’, in the context of internet shopping.³⁰⁵ Here, as an alternative to contracting under the law of the consumer’s habitual residence, the business can highlight the availability on their website of contracting under the optional contractual regime. This would be symbolized by a ‘blue button’ which is envisaged as a European flag. By

³⁰² Ibid.

³⁰³ Hesselink, *SME’s in European Contract law* (2007), 18.

³⁰⁴ Ibid.

³⁰⁵ Hans Schulte-Nölke, *EC Law on the Formation of Contract – from the Common Frame of Reference to the ‘Blue Button’* (2007) 3 *European Review of Contract Law* 322.

clicking on it, the consumer would agree that their contract will be governed by European sales law and this would lead to the retailer's EU-wide standard terms and conditions,³⁰⁶ including a choice of law clause for the optional instrument. It should be highlighted that the 'blue button' is not distinct from the optional instrument in the B2B context, it is merely one manifestation and a means by which to make the availability and benefits of the optional system visible to the consumer.³⁰⁷

E-Commerce is the principal form of distance sales³⁰⁸ within the internal market with 51% of EU traders engaged in internet-based sales.³⁰⁹ It is relatively uncommon, however, for consumers to purchase good or services in another Member States via the internet and, while in 2008 the number of consumers buying at least one item over the internet was 33%, the number of cross-border sales via this medium accounted for only 7%.³¹⁰ At the same time, only 21% of those retailers selling via the internet are currently conducting cross-border transactions.³¹¹ A tangible gap between domestic and cross-border internet-based sales therefore exists.³¹² The problem for e-commerce as a cross-border retail channel, and thus the reluctance of both groups, is the model example of the established internal market hypothesis. It can thus be explained in terms of a lack of consumer confidence in cross-border transactions and unwillingness on the part of businesses to provide goods and services to consumer in other Member States. Since consumers are not taking full advantage of the opportunity to shop online in other Member States³¹³ and businesses are not fully exploiting this retail channel in the cross-

³⁰⁶ The adoption of an optional instrument would facilitate the elaboration of EU-wide standards terms and conditions, which has regained favour as a means by which to facilitate trade in the internal market, see Chapter 5, 5.3.

³⁰⁷ Beale (2007), 12. The 'visibility' playing an important function in the promotion of B2C cross-border transactions, see discussion below.

³⁰⁸ Meaning the business will have to comply with the consumer law of the Member State in which the consumer has their habitual residence.

³⁰⁹ Commission Staff Working Document, Report on cross-border e-commerce in the EU, SEC (2009) 283 final. 6

³¹⁰ Ibid.

³¹¹ E- Commerce report (2009), 8.

³¹² Ibid. 6 and 18.

³¹³ As a retail channel it provides distinct benefits for consumers. It allows them to compare prices across a wider range of goods, increases the availability of offers and provides the choice of alternative suppliers. E-commerce report (2009), 11.

border context,³¹⁴ some form of action is needed to improve the regulatory environment and make it more conducive to such trade.³¹⁵ The area of internet sales is, therefore, an apt context for trialling the utility of an optional instrument in this context.

Presently, the CRD is presented as the response to such problems.³¹⁶ It intends to decrease the existing fragmentation, simplify the regulatory framework, and increase consumer confidence through a high common level of consumer protection.³¹⁷ It has been seen, however, that the CRD proposal fails to fully satisfy these objectives³¹⁸ and that in regulatory terms they may be better realised by the adoption of optional instruments of European Contract law. More specifically, in the context of B(SME)2C transactions, and as the first instrument, one in the form of a ‘blue button’ applicable in the e-commerce context.³¹⁹ Unlike the CRD, the optional instrument can provide the single, directly applicable and complete regulatory framework that is required for trade in the internal market. This framework would not be dependant on other sources of law and thus subject to the same problems of multi-level governance that have plagued EU regulation of such issues to date³²⁰ and which would persist under the CRD proposal.³²¹

A particular limitation of the CRD as the regulatory response is its limited scope and targeted nature. This has already been discussed in terms of the relationship that exists between the CRD and the sector-specific *acquis*, in Chapter 4. It also, however, leaves many important issues outside of its scope, which also fall outside of the scope of the *acquis*.³²² Such issues will be regulated totally or partially by national law, upon which

³¹⁴ Distance sales methods (especially e-commerce) seem to be the key driver for opening up the retail Internal Market, Flash Eurobarometer 224 (2008), 6.

³¹⁵ E- Commerce report (2009), 14.

³¹⁶ E- Commerce Report (2009), 13.

³¹⁷ CRD Proposal (2008), 2.

³¹⁸ Discussed in Chapters 4 and 5, 5.3.

³¹⁹ Although it is possible to envisage the use of the instrument in other contexts, for example, mail order catalogues, as 30% of retailers currently make use of this sales channel, E- commerce report (2009), 6.

³²⁰ Discussed in Chapter 5, 5.1.

³²¹ In general, the Commission’s intention to develop additional legislation, i.e. a Consumer Rights Directive, which might overlap with existing national and EU regulations was criticised and it was felt that it would have been more suitable, and thus in the alternative, to first improve the enforcement of the existing legislative measures, Detailed analysis of the response to the Green Paper on the Review of the Consumer *Acquis*, 8.

³²² Highlighted by Beale (2009), 294, and Colombi-Ciacchi (2009), 10. Discussed further below.

the CRD is dependant in its application. A clear shortcoming of the proposal in this respect is that it fails to spell out adequately the consumer's remedies. For example, while the proposal lays down specific and detailed information duties, the consequences of breach of these duties is to be determined in accordance with the applicable national law, and Member States are to provide for effective contract law remedies.³²³ The proposal is, therefore, dependant upon the applicability of another source of law, which remains fragmented between Member States. In this respect, it has also been discussed that the remedies of the CRD for lack of conformity³²⁴ will co-exist with national remedies in the creation of a dual regime, for example, with the immediate right to reject in UK law.³²⁵

This approach serves to undermine the move to full harmonisation that the proposal seeks to make.³²⁶ The relationship that exists between the CRD and national law will, in the first place, cause great uncertainty for Member States.³²⁷ For example, what remedy must the Member State provide to be considered an effective response in the case of breach of the information duties?³²⁸ While the desire to limit interference³²⁹ with the general contract law of the national systems may be welcomed from the perspective of preserving the national legal systems and regulatory autonomy, this is a further compromise made by the proposal.³³⁰ The result is that it fails to provide the necessary certainty and simplification that is needed and thus fails to meet its objectives in this respect. It is advanced, therefore, that it would be better to remove the reference to national law and for the proposal to spell out what is required in detail.³³¹

³²³ Articles 5 and 6 CRD Proposal.

³²⁴ Article 26 CRD Proposal.

³²⁵ Chapter 4, 4.1.3.

³²⁶ De Booy, Mak and Hesselink (2009), 16.

³²⁷ Uncertainty for Member States as to what falls within the scope of the proposed Directive and thus subject to full harmonisation, and what rules Member States are free to maintain, i.e. higher levels of protection, has been discussed in Chapter 4, 4.1.3.

³²⁸ Discussed by Beale (2009), 296.

³²⁹ Suggested rationale, De Booy, Mak and Hesselink (2009), 4.

³³⁰ See discussion, Chapter 5, 5.3.

³³¹ Beale (2009), 296.

While businesses are intended to benefit from the move to full harmonisation under the CRD, it is clear that this will not be the case.³³² Many of those rules outside of the scope of the CRD, owing to the B2C context, will be regarded as mandatory consumer protection rules within the meaning of Article 6 of Rome I, which the parties will not be free to derogate from.³³³ The business directing their goods and services at consumers in other Member States will, therefore, continue to comply with the divergent mandatory laws of the Member State. The maintenance of the current situation in this respect means that the incentive to engage in cross-border B2C contracts will still not exist. In order to benefit from a full harmonisation regime, businesses will be better off opting into the comprehensive optional instrument, which will fully harmonise those mandatory rules of consumer protection which fall outside of the scope of the CRD. It is clear that for the consumer also, a good degree of uncertainty will remain under the CRD framework, where consumer remedies are part of that dual regime and will continue to be regulated at both the EU and national levels. This, together with the decision to implement the CRD in the form of a directive, which will allow Member States to give effect to its provisions in a piecemeal fashion across national law, means that the proposal will not result in a single and transparent statement of consumers' rights. This will serve to undermine the confidence in European consumer law which the review of the *acquis* sought to create in consumers. An optional instrument, in the form of a regulation, and thus as a comprehensive, directly applicable statement of such rights, would clearly be a more appropriate way forward in these terms for both consumers and businesses.

Where chosen as the applicable law of the contract, the parties can also overcome the fragmentation found at the EU level. Businesses will no longer be subject to diverging levels of consumer protection, because of the full harmonisation approach of the instrument. The optional instrument can also incorporate the inconsistent and fragmented *acquis* to be found currently in the sector-specific instruments within its horizontal framework. In this regard it has been shown that the (D)CFR, which could provide the basis of the optional instrument, offers a more suitable basis upon which to simplify and

³³² It should enable them to use the same standard contract terms, irrespective of the home state of the consumer, and thus benefit from a reduction in transaction costs.

³³³ Highlighted by Beale (2009), 295.

rationalise the *acquis* than that which has been achieved under the CRD proposal.³³⁴ It is questionable, therefore, whether it is desirable and necessary to advance with the much criticised CRD proposal while the objectives of action can be realised by optional instrument(s). In response, however, there are good reasons why both instruments must feature as part of the regulatory response.

In the first place, those objectives can only be realised by the optional instrument where it is chosen as the applicable law. While clear incentives exist for the parties to opt-in to the instrument, where this is not the case, fragmentation both at the EU and national levels will persist. It will, therefore, still be necessary to advance harmonisation on a horizontal and full basis to address the causes of fragmentation that exist within the *acquis*, and at the EU level. The need for the CRD thus remains, and the proposal now proceeds to this end.³³⁵ If both proposals are to advance, however, and co-exist as two, fully harmonised instruments, drawing on the same sources, governing the same transaction, and originating with the same Directorate-General then coherence between the two regimes must be achieved. Inconsistencies within their shared scope would cause a new source of fragmentation at the EU level which would not assist businesses or consumers.³³⁶

As to how coherence is to be achieved, as the adoption of the CRD will likely precede that of the optional instrument, the provisions of the CRD must be incorporated into the latter. This will be the case if the (D)CFR is to form the basis of the optional regime as the political CFR will itself now reflect the provisions of the CRD.³³⁷ The result will be a common core of fully harmonised, mandatory³³⁸ rules of consumer protection.

Outside of the common core of rules, and in light of the limited scope of the CRD, there is still significant scope for the optional instrument to regulate, and as a source of that, for the (D)CFR to make an impact on the contractual framework, as the starting point for

³³⁴ Chapter 4, 4.3.

³³⁵ The current status of the proposal is discussed in Chapter 7.

³³⁶ The benefits of coherence between the two instruments has already been touched upon in terms of the relationship between the optional instrument and Rome I, and the resulting level of protection in the optional instrument, discussed further below.

³³⁷ The future relationship between the CRD and CFR is discussed in Chapter 4, 4.3.

³³⁸ As designated under Article 43 of the CRD proposal. Discussed in 6.3.2.

rules and for political consideration. It has already been highlighted that the CRD leaves many important issues to be regulated by national law. As many of these rules will be considered mandatory in their Member States, in order to ensure the applicability of the mandatory rules of the optional instrument over national rules, in accordance with the derogation from Article 6 of Rome I, the optional instrument must regulate such rules comprehensively in order to adequately protect the consumer interests which are protected at the national level.³³⁹ Such matters include³⁴⁰ the position with negotiated terms, controls over price, general rules on validity, and many rules concerning remedies.³⁴¹ It is the ability of the optional instrument to, for example, spell out the consumer's remedies fully, and thus to regulate contract law issues comprehensively beyond the scope of the CRD, that presents a real advantage of the optional instrument. This will allow the optional regime to exist independently of the national systems.

The relationship with the CRD within the shared scope of the instruments, and for reasons of coherence already advanced, means that the CRD will be decisive in determining the level of consumer protection within the optional instrument.³⁴² This gives rise to concern, however, in light of earlier criticism made of the level of protection achieved under the CRD proposal, which sees the reduction and removal of important consumer rights within the regime. It has even been questioned whether the proposal meets the Treaty requirement of ensuring a high level of consumer protection to which it, and the optional instrument is bound.³⁴³ The effect is that, at least within the shared scope of the instruments, and if action is not taken to address the level of protection in the CRD as a precursor also to that of an optional instrument, which would be desirable,³⁴⁴ then consumers may well loose out under the optional instrument in terms of protection. This

³³⁹ See further, 6.3.2.

³⁴⁰ Discussed by Beale (2009), 294.

³⁴¹ Both those remedies within the scope of the measure but which are left for national law, i.e. information duties, and those traditional contract law remedies that co-exist with consumer remedies in the Member States, and thus fall outside of the scope of the CRD.

³⁴² Discussed in part in 6.3.2.

³⁴³ Article 169 TFEU (ex. Article 153 EC). The European Consumers Association (BEUC), for example, advance that the level of protection established in the proposal has to be increased in order to comply with the Treaty, and to promote consumer confidence in the internal market, Synopsis of BEUC's opinion on the Proposal for a Directive on Consumers Rights, ref. X/073/2009, 22.10.2009, 4.

³⁴⁴ See discussion in Chapter 7.

has already been pointed out in regard to the CRD, which is considered to be a business driven instrument.³⁴⁵ Such criticism will, however, often accompany a move to full harmonisation which removes Member States regulatory autonomy to maintain higher levels of protection, and thus risks current levels of protection enjoyed in the Member States. Howells & Schulze³⁴⁶ thus question at a fundamental level, how a maximal harmonisation approach can enhance consumer confidence rather than minimum harmonisation set at a high level, as the latter may well be needed to give consumers confidence when buying in other Member States.³⁴⁷

Benefits, however, can arise for the optional instrument as a regulatory response because of its close relationship with the CRD. As the latter proposal would also represent consumer protection provisions at the national level, both businesses and consumers will be familiar with the core rights within the optional instrument. As such, unfamiliarity with the new contractual framework created under the optional instrument need not prove a significant reason for parties choosing not to opt into the instrument as the applicable law in this context. The relationship also means that the risk posed to the consumer of opting into the instrument is reduced. The concern that arose was that by opting into the optional regime, businesses could opt out of national consumer protection rules, which would potentially provide more consumer friendly rules on a minimum harmonisation basis than those under the optional instrument. As already explained,³⁴⁸ however, this concern need not be overstated as national consumer law will already be fully harmonised within the scope of the CRD, and this will be reflected in the optional instrument. Acceptance and use of the optional instrument as the governing law is thus made easier with the adoption of the CRD, although opposition to the level of protection will remain in regard to the latter.

It is outside of the shared scope of the instruments that the level of protection achieved by the optional instrument becomes more contentious, and where fresh concerns may arise in

³⁴⁵ Discussed in Chapter 4, 4.1.3.

³⁴⁶ Howells and Schulze (2009), 8.

³⁴⁷ They are thus critical of how, where the CRD sets the existing minimum level as the maximum, this can enhance consumer rights, Ibid. Discussed in greater detail in Chapter 4, 4.1.3.

³⁴⁸ 6.3.2.

regard to a loss of consumer protection or social dumping by the optional instrument.³⁴⁹ It is clear therefore, and as already discussed,³⁵⁰ that a high level of consumer protection must be achieved, alongside the comprehensive regulation of consumer issues commensurate with the national level. The initial source of the optional instruments' rules outside of the scope of the CRD will be the DCFR. The level of protection achieved by these rules should, however, be assessed in light of corresponding national provisions of consumer protection. This will be necessary in order to ensure that a high level of protection is achieved and to avoid the criticism that arises in regard to the reduction and loss of protection caused by the CRD vis-à-vis the experience and level of protection currently afforded by Member States under a minimum harmonisation approach.³⁵¹

It has, however, been advanced that businesses may not wish to opt-in to an optional instrument if the level of protection is too high, i.e. a higher level than would otherwise be applicable under national law,³⁵² and which thus protects their interests less. It is clear, however, that this view overlooks the fact that businesses, who are more likely (than consumers) to be repeat players, will have much to gain from the possibility of having to deal with only one legal system in relation to all their contracts throughout Europe.³⁵³ Such benefits,³⁵⁴ and significantly the reduction in transaction costs, may result in a willingness by business stakeholders to accept a high level of protection. This will be necessary if consumers too are to agree to the use of the optional instrument, as if they, and their representatives, i.e. consumer associations, are not convinced by the adequacy of the level achieved by the instrument, it will fail to obtain their support. Ultimately, the consumer is free not to opt-in to the optional instrument, and would continue to benefit from the level of protection that they enjoy in their Member States³⁵⁵

³⁴⁹ See discussion Ibid. In particular, reference to those concerns of Rutgers (2006).

³⁵⁰ 6.3.2.

³⁵¹ See, Howells and Schulze (2009), 25.

³⁵² See, for example, Lurger, 'The Common Frame of Reference/Optional Code and the various understandings of social justice in Europe', in: T. Wilhelmsson, E. Paunio, A. Pohjolainen (eds.), *Private Law and the Many Cultures of Europe* (Alphen a/d Rijn: Kluwer Law International 2007), 177 – 199.

³⁵³ One standard contract, one legal department, etc. Hesselink (2008) *Common Frame of Reference and Social Justice*, Centre for the Study of European Contract Law Working Paper Series No. 2008/04, 3.

³⁵⁴ Which would not be equally realised under the CRD.

³⁵⁵ Although this will not be significantly different given the relationship between the optional instrument and the CRD, and thus national law.

under private international law. The repercussion is, however, that they may lose the opportunity to buy a particular product at a more competitive price because businesses may refuse to contract under the law of their habitual residence which, even with the CRD, remains fragmented. The choice nevertheless exists for the consumer, and it is important, therefore, that they should be able to make an informed choice. They must be aware of both the benefits and the risks. This includes that by opting into the optional regime they are opting out of the mandatory rules of consumer protection which apply outside the scope of the CRD. This may, therefore, mean differences in terms of their protection, and this would need to be detailed locally. To this end, Beale has envisaged, for example, that local consumer organisations could arrange for automatic on-line advice to pop up as to the risks, if any, that the consumer will take by clicking on the 'blue button'.³⁵⁶ This could also make clear that the core of consumer protection in the optional instrument is that found in their national systems, and thus that they would be contracting under a contractual system that would be largely familiar. Then, that outside of that core, a high level of protection is sought, and as such there is little risk posed to the consumer by clicking on the 'blue button'.

Returning then to the 'blue button' proposal, a distinct feature of this is the visual availability of contracting under the optional instrument. With the optional regime maintaining a high level of consumer protection, this visibility could be central to enhancing consumer confidence and trust in cross-border E-transactions, which is presently undermined.³⁵⁷ It could be envisaged that the use of the 'blue button' may come to influence consumers' choices and encourage them to purchase goods or services from businesses in other Member States. Brand recognition and the presence of national certification schemes have been demonstrated to influence consumer choice.³⁵⁸ In particular, trust marks at the national level have been used successfully in order to assure

³⁵⁶ Beale (2009), 295.

³⁵⁷ Similar effect could be achieved in other contexts of distance selling, such as catalogues and mail, where the extended use of trustmarks is also prevalent, see for example the Dutch Home-Shopping Association, *Thuiswinkel.org*, Gateway to Holland (2009), 29, on file with author.

³⁵⁸ E- Commerce Report (2009), 12.

the consumer not only of the security of the transaction,³⁵⁹ but also of the reliability of the trader.³⁶⁰ However, although it has not been possible to achieve a sustainable trust mark at EU level,³⁶¹ it may be that the optional instrument could perform an analogous role to such schemes.

The visual ‘blue button’ would identify to the consumer that the business, in offering to contract under the law of the optional instrument, will respect the rules and standards contained therein. Thus, similar to the codes of practice to which businesses sign up to with trustmarks and with similar effect, the consumer would be confident of the rules and the high level of protection that would apply.³⁶² Indeed, it has been highlighted that a lack of a well known trust mark or e-commerce label at EU level has worked against cross-border selling.³⁶³ The creation of an optional instrument in the form of a ‘blue button’ could, therefore, go some way to meeting an identified need in this context, increasing both consumer confidence and cross-border transactions, and thus further realising the objectives of action. Attainment of this outcome will, however, depend upon consumer recognition and awareness of the ‘blue button’: of what it represents, and the benefits that it provides. This could be aided by awareness campaigns and will require endorsement, both at the EU and national levels. Indeed, while the existing fragmentary state of the *acquis* has rendered it difficult to conduct consumer education campaigns at the European level, this would be possible with the fully harmonised optional instrument and its unambiguous statement of consumer rights.³⁶⁴ Indeed, the need to publicise and promote the availability of the optional instrument applies equally to businesses and, in particular,

³⁵⁹ Ibid. The risk of fraud and thus unwilling to disclose card details on the internet is also a real concern in this context. When asked about the main reason for not wanting to buy via the internet product or service that is cheaper or better in another Member State, 31% gave the latter reason.

³⁶⁰ For example, the Dutch Home- shopping Association (Thuiswinkel.org).

³⁶¹ E- Commerce Report (2009), 18.

³⁶² The ‘blue button’ will of course not be a ‘trustmark’. It will not involve features such as accreditation and monitoring in the traditional sense.

³⁶³ Summary of Response of the European Consumer Centres (ECC’s), E- commerce report (2009), 54.

³⁶⁴ The use of consumer awareness campaigns was considered as a policy option to overcome the negative effects of the fragmentary state of the *acquis* in the impact assessment accompanying the CRD proposal ((PO2), 21), which identifies the need to provide consumers with adequate information about their rights and how to exercise them as an objective. CRD proposal (2008), 2.

to SMEs if they are to benefit, and Member States could be required to take appropriate measures to promote awareness of this option among both groups.³⁶⁵

6.5. Conclusion

The optional instrument can provide the single, comprehensive, and directly applicable contractual framework that is required for trade in the internal market. Where chosen by the parties as the applicable law of their contract it can overcome the existing fragmentation at both the national and EU levels. It is clear in regard to the latter level that the proposal is capable of overcoming much of the criticism that is directed at the proposed CRD owing to its limited scope and targeted nature which sees the move to full harmonisation being undermined. The objectives of the CRD in this respect, and in the B2C context, can be better achieved by the optional instrument. This is due to its extended scope which can result in the comprehensive regulation of consumer rights on a full harmonisation basis, and it is this inclusion of mandatory rules which forms the principal benefit of the optional regime for businesses, and in particular SMEs, in this context. While the incentive for consumers to opt-in to such a regime is less clear, it is clear that, like businesses, they will be better off under the optional regime than under the CRD proposal. While businesses will benefit more significantly from the full harmonisation approach of the optional instrument, this will benefit consumers in terms of welfare gains. The optional instrument can also result in the single and transparent statement of consumer rights³⁶⁶ which is needed by both groups, and while it should provide for a high level of consumer protection, it may act as a platform for enhancing consumer confidence in cross-border transactions.

It has been maintained, however, that the CRD still has an essential role to play as part of the regulatory response. While it precedes the optional instrument on a full harmonisation basis, it is also an important precursor to that and facilitates the acceptance and use of the

³⁶⁵ Directive 2009/136/EC of the European Parliament and the Council of 25 November 2009, the “Citizen’s Rights” Directive, part of the telecoms reform package, discussed in 6.2. While it allows SMEs to request consumer contracts for a telecoms contract, it requires that Member States should take appropriate measures to promote awareness amongst SMEs of this possibility, recital 21.

³⁶⁶ Including all EU consumer rights.

optional regime. For coherence, therefore, the CRD will inform the development of the optional instrument. While the optional instrument derives benefits from its relationship with the CRD, it will also be subject to the limitations and criticisms of the latter proposal. Those limitations have been discussed in this chapter in regard to the level of consumer protection secured under the CRD, and as part of a wider discussion of the proposal in Chapter 4. The relationship with the CRD may, therefore, also impact negatively upon the optional instrument within the shared scope, and on the extent to which the intended benefits of the optional regime can be realised. This is unless the limitations of the CRD are not first addressed.³⁶⁷

Beyond that, and in the B2B context, the optional instrument continues to offer an attractive regulatory option. With the need to create an optional instrument particularly attuned to the needs of SMEs it has been maintained that the instrument must address the imbalance that can exist when small and inexperienced market actors seek to contract with larger businesses. The inclusion of protective measures to this end will thus make the instrument particularly useful for this group, who stand to gain most from the optional regime. While larger businesses are not in need of the envisaged instrument in either the B2B or B2C context, it is clear that the availability of the optional instrument can still be to the significant benefit of the wider business group³⁶⁸ and to consumers as part of an all round response to the obstacles faced by both groups at the national and EU levels. It has further been shown to be a desirable regulatory solution which, owing to its optional nature, allows for the wider issues and objectives that impact upon the harmonisation debate, and the suitability of the way forward in those terms to be satisfied, within a contractual framework which first and foremost seeks to overcome obstacles to cross-border trade arising from the current state of European contract law. It is understandable, therefore, that the adoption of such instruments is regaining significance on the political agenda. Moving forward, there is a very strong case for pursuing this regulatory proposal.

³⁶⁷ Necessary future action is discussed in Chapter 7.

³⁶⁸ With SMEs forming the vast majority of that.

Chapter 7

This Way Forward

In order to overcome obstacles to cross-border trade arising from the present divergent and fragmentary state of European contract law, the European Commission advanced three proposals for future action. As a response to obstacles at the European level, the Commission proposed the review of the *acquis communautaire*, which has resulted in a proposal for a Consumer Rights Directive, and the creation of a Common Frame of Reference. At the national level, the Commission has continued to pursue the idea of a harmonised instrument of European contract law in order to overcome the divergence in national contract systems, through the proposal to adopt optional instrument(s) of European contract law. The most appropriate way forward for European contract law, on the basis of these proposals, has been determined by an assessment of the suitability and desirability of the respective proposals and progress to date.

The optional instrument has been shown to be the most suitable and desirable regulatory response. An optional instrument can provide the single, comprehensive and directly applicable legal framework necessary for cross-border¹ transactions in the internal market. Drawing on the content of the (D)CFR, an extensive contractual instrument can be envisaged which would comprehensively regulate rules of general contract law in order to support the creation of sector-specific instruments. It would then be necessary for the instrument to govern related issues which arise outside of the contractual scope of the instrument.² The inclusion of such rules will be necessary in order to create an autonomous regulatory framework to govern entire contractual relationships, without the need to refer to divergent national rules.

It has been demonstrated that the relationship that will exist between the optional instrument and European private international law will be integral to the achievement of

¹ Although also capable of applying to domestic transactions or else fragmentation will continue in this respect, Chapter 6, 6.2.

² For example, rules on the passing of property, or the restitutionary effects of a party's withdrawal from a contract.

that independent framework. It has been maintained that effect should be given to the instrument within the system of Rome I as an express choice of a ‘2nd’ domestic system under Article 3 Rome I. In order to maintain the autonomous nature of the instrument, however, the choice of the optional instrument must be accompanied by a derogation from Article 6 of Rome I, and from the application of the mandatory rules of the consumer’s habitual residence in B2C contracts. Such rules must be regulated comprehensively and adequately within the optional instrument to ensure their application over those of national law. While the inclusion of overriding mandatory rules within the optional instrument and derogation from Article 9 Rome I would further minimise disruption to the application of the instrument, it has been maintained that this may be neither possible nor necessary. Controls already exist to ensure that the application of the optional instrument, as the governing law, is not unduly undermined by the application of such rules.³ The autonomous nature of the instrument can thus be realised.

It is also clear that while the optional instrument can comprehensively and horizontally⁴ regulate B2C contracts on a full harmonisation basis, including harmonised mandatory rules of consumer protection,⁵ it can overcome fragmentation at the EU level.⁶ The proposal, therefore, provides two levels of regulatory response within one instrument, and ensures coherence between those levels of regulation. It would then be possible to treat a contract of sale, for example, between parties in different Member States as if they were contracting within a single state.

While this aim was sought by the review of the *acquis*,⁷ the resulting proposal for a CRD fails to achieve it. The proposal was presented as a compromise, because of what it sought to achieve, namely, full and binding harmonised rules on the consumer sale of

³ However, to the extent that rules of overriding mandatory nature, particularly those of EU origin, are included in the optional instrument, Article 9 will only apply to the extent that the national interest at issue is not already protected by the optional instrument, Chapter 6, 6.3.2.

⁴ In comparison to the sector-specific approach of the existing *acquis*, which is continued in the CRD

⁵ Including those of EU origin.

⁶ Chapter 6, 6.4.2.

⁷ Chapter 4, 4.1.1.

goods to replace national law on these issues.⁸ Not only does this objective threaten Member State regulatory autonomy within the scope of the proposal, but contentiously, also the level and nature of consumer protection currently enjoyed in Member States. The result is an instrument of limited scope, which necessarily co-exists with the sector-specific *acquis* and is dependant on the application of national contract law. The proposal, even with the continued vertical revision of the *acquis* and enhanced coherence at this level, does not adequately achieve its intended horizontal application, and cannot provide the certainty and simplification of the regulatory environment necessary to be presented as the regulatory solution and tool intended to facilitate trade in the internal market.

This objective can be better achieved through the adoption of optional instruments, and it is clear that both businesses and consumers will be better off under the optional regime than under the proposed CRD. It is however SMEs, as intended, who have the most to gain from the availability of optional instruments. In the B2C context, therefore, it has been maintained that it is SMEs who will principally benefit from the harmonisation of consumer protection measures on a full harmonisation basis, and thus have the greatest incentive to opt-in. For consumers, however, while the move to full harmonisation and the derogation from the safeguard of Article 6 Rome I may serve to undermine confidence, a high level of protection must be sought by the optional instrument, and consumer rights must be regulated comprehensively. Then consumers stand to gain from the creation of a single and transparent statement of consumer rights. It is clear that both groups will benefit from the distinct ‘visibility’ of the proposal. First, they will benefit from the transparency and certainty created by the optional regime as a directly applicable, and thus single and complete contractual framework. As a result, businesses, in particular SMEs, will be more willing to supply goods and services to consumers in other Member States, and consumers, with enhanced confidence in cross-border transactions, will be more willing to buy goods from traders in other Member States. The visual ‘blue button’ will then highlight the ease and accessibility of cross-border contracting under the optional instrument for both groups.⁹ It will no longer be the case

⁸ Chapter 5, 5.3.

⁹ Chapter 6, 6.4.2.

that transactions are perceived as more difficult simply because they are occurring across borders. Through the optional instrument, citizens will participate with greater ease and lower costs in cross-border transactions, and will then positively “see” the tangible benefits that the internal market has to offer.¹⁰

In the B2B context, it has been advanced that the utility of the optional instrument, one that is particularly attuned to the needs of the SME, will be greatly enhanced by the inclusion of protective provisions in order to readdress the contractual imbalance that can arise in this context. While this will result in limitations on contractual freedom in commercial dealings however, it is clear that there will be little incentive for larger parties in similar bargaining positions to opt-in to the instrument, and a reluctance on their part to become subject to the protective regime vis-à-vis the weaker party. The need to protect SMEs must, therefore, be balanced against the need to preserve freedom of contract, and thus the approach taken must ensure that only those parties in need of protection receive it. The approach of the DCFR to protection in this respect presents the most appropriate way forward. The protection of the weaker party, and the realisation of other advantages in this context for SMEs may however, at least initially, come at a price before those benefits can be enjoyed in the longer term.

In the wider debate too, the optional instrument has been shown to be a suitable and desirable regulatory form for the harmonisation of European contract law. From an economic perspective,¹¹ the proposed instrument utilises both centralised and decentralised regulation. Optional instruments thus have the distinct advantage of enhancing regulatory competition within the internal market, providing a valuable alternative governing law for businesses wishing to contract. At the same time, the addition of a 28th contractual regime may also result in greater convergence between the national contractual systems: decreasing, incidentally, the divergence that currently acts as an obstacle to cross-border trade. A significant strength of the proposal is, therefore, that an influential contractual regime, attuned to the needs of cross-border trade in the

¹⁰ i.e. larger markets, with a more competitive supply of goods and services to the benefit of both businesses and consumers

¹¹ Chapter 3, 3.1.

internal market, can be created without jeopardising the existing national contract systems and their socio-cultural and political backgrounds.

It is clear that the (D)CFR is capable of forming the foundation for the future regulatory approach to European contract law. The strength of the draft instrument lies in its ability to bring together the two debates that have been presented. It thus serves as a basis by which to overcome the identified obstacles to cross-border contracting at both the national and European levels, while ensuring that the issues and objectives involved in the wider debate as to the way forward come to the foreground.¹² In the first place therefore, and as highlighted, the comprehensive contractual framework created by the draft text, which successfully represents the political choices and balance between freedom of contract and social justice that need to be made in the creation of a harmonised European contractual system, means that the (D)CFR will serve as a suitable basis for optional instruments. The approach of the DCFR to the simplification and rationalisation of the consumer acquis, in order to offer a more horizontal and coherent approach, also means that it would serve as a good basis for the review of the acquis which would culminate in a horizontal instrument of European consumer contract law. In this way, and functioning in both intended roles, a coherent regulatory response can be achieved at the European level through the CFR.

Developments mean, however, that the relationship between the proposals will not be entirely as originally envisaged. As the Commission now proceeds with the CRD as the result of the acquis review, before the adoption of a political CFR, coherence and consistency in the regulatory response is rather to be achieved through the CRD, which will form the basis of the future regulatory approach, at least in the B2C context.

In terms of what this means for the future relationship between the instruments, beginning with the CRD and CFR, it has been shown that the DCFR, at least informally, fed into the CRD proposal and the influence of the DCFR can be found within the

¹² Despite early concern in regard to the Commission's narrow technocratic agenda, which have impacted upon the way in which it has led the European contract law debate.

instrument. Differences however remain between the instruments and in the interest of consistency and coherence, and while the CRD can serve as a framework for the future development of the contract law acquis in this area, it is clear that the CRD provisions will now feed into those of the DCFR. As regards to the relationship between the CRD and optional instrument, it is clear that while both instruments seek similar objectives, to govern the same transactions,¹³ and both originate from within the same DG, coherence and consistency in terms of the regulatory approach at this level will be necessary. Within the shared scope of the instruments, therefore, provisions of the CRD will be incorporated into the optional instrument. This is consistent with the CFR continuing to serve as the basis of the optional instrument, as the CFR itself will incorporate the provisions of the CRD. It is outside of the common core of consumer mandatory rules that will result from the relationship between the CRD and optional instrument, however, that greater scope exists for the (D)CFR to impact upon the contractual framework of the optional instrument. Outside of this shared scope¹⁴ and in the B2B context, and thus in regard to provisions of general contract law, the CFR can act as the starting point for the rules of the optional instrument.¹⁵ The rules of general contract law contained within the CFR will also provide the wider contractual framework within which the CRD will exist, and the EU will legislate.¹⁶ There is still very much a role for the CFR to play in the final regulatory response.

The benefits arising from the relationship between the CRD and optional instrument have been outlined in terms of facilitating the acceptance and use of the optional instrument within the B2C context.¹⁷ Moving forward in terms of the regulatory response, however, greater issues arise in regard to the relationship because of the limitations of the CRD. These deficiencies, discussed below, must be overcome if the CRD is to form the basis of the optional instrument in the B2C context, or else they will be incorporated into and thus undermine the optional contractual framework. They must also be overcome if the CRD is to address the existing fragmentation at the EU level where the optional instrument is

¹³ I.e. consumer sales and services.

¹⁴ While still in the B2C context.

¹⁵ Also providing a source of rules for specific contracts, and protective provisions in the B2B context.

¹⁶ Chapter 4, 4.3.

¹⁷ Chapter 6, 6.4.2.

not chosen as the governing law of cross-border contracts,¹⁸ and thus if it is to serve as a suitable framework for consumer contract legislation in the Member States on a full harmonisation basis.

In terms of necessary action, therefore, it has already been noted that the CRD fails to meet its simplification aims. It has sought consolidation of the review directives, while maintaining sector-specific distinctions, and fails to address existing regulatory gaps which arise as a result. As such, provisions of the CRD require greater coherence and clarity and thus as the proposal stands it does not form a sound basis for a horizontal instrument of European consumer contract law, nor for the ongoing review of the *acquis*. In this respect, it has been maintained that the (D)CFR would form a more suitable basis and legislative toolbox and that while the CFR will draw upon the CRD, it is desirable that the CFR also include recommendations for improvements to the *acquis* derived rules. It could then be hoped that the CFR can serve in the future as a basis for the continuing review of the *acquis* and also, while the opportunity exists, provide the CRD itself with greater certainty and horizontal application. A more coherent European contract law could result at this level, and this would benefit the coherence of the common core of consumer mandatory rules in the optional instrument.

In light of significant concerns in regard to the reduction and removal of important consumer rights within the CRD, action must also be taken to address the level of protection achieved by the proposal. In the first respect, concerns have arisen where the proposal adopts as a maximum, the existing minimum level of protection. Such a development would not enhance consumer confidence and action must be taken to address the level of protection in this respect to ensure, in line with Treaty expectations, that a high level of protection is achieved. These concerns arise not only in regard to the fully harmonised regime of the CRD, which will detrimentally impact on national consumer protection, but also within the common core of consumer rights within the optional instrument. The CRD in this respect acts as a limitation on the extent to which the optional instrument itself can provide a high level of protection and thus serve to

¹⁸ The need for the CRD remains in that situation.

increase consumer confidence in cross-border contracting. It had been advanced that a higher level could be achieved under the optional instrument because of its optional nature.¹⁹ The relationship with the CRD, however, undermines this.²⁰ In this regard, the CRD proposal could give greater consideration to the adequacy of the level of protection created therein vis-à-vis national standards and take action on this basis. Indeed, in light of calls for clarification of the impact of the proposal on existing levels of consumer protection in the Member States,²¹ the Commission created a comparative table to this end.

Concerns in regard to the level of protection have, therefore, been acknowledged by the Commission, negotiations on the proposal are ongoing, and new options for improvement are being presented in order to create a more acceptable proposal.²² Rather than directly addressing the level of protection that is achieved,²³ however, the Commission is advancing more “practical solutions”,²⁴ and is currently reviewing whether the proposal is sufficiently targeted towards those issues that have the most benefit from a single market point of view.²⁵ The result of this review would be a more limited and targeted application of the full harmonisation approach in order to alleviate existing concerns. One way in which this is envisaged is, in the short-term, only to fully harmonise those rules on distance contracts, and thus those of the Distance Selling Directive – e.g. that apply for e-commerce, where it is maintained consumer confidence and legal certainty for businesses is crucial. Direct selling²⁶ would, however, continue to be subject to minimum

¹⁹ As opposed to the binding nature of the CRD.

²⁰ Although a high level can still be achieved outside of the shared scope.

²¹ In light of concerns outlined here.

²² See the speech of Commissioner Reding, Vice-President of the European Commission responsible for Justice, Fundamental Rights and Citizenship An ambitious Consumer Rights Directive: boosting consumers' protection and helping businesses, Madrid, 15 March 2010, <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/10/91&format=HTML&aged=0&language=EN&guiLanguage=en>.

²³ Which would have been to the advantage of the level of protection in the optional instrument.

²⁴ Commissioner Reding, 15th March 2010.

²⁵ Ibid.

²⁶ I.e. Doorstep Selling Directive.

harmonisation, where it is maintained that greater differences exist between national laws at this stage.²⁷

This regulatory proposal is, however, not to be welcomed. Not only does it avoid addressing the issue of the level of protection in the CRD directly, it would further undermine the need for certainty and coherence in that regime. The effect is that the move to full harmonisation would be further undermined, and a further source of fragmentation would arise. A dual regime would be created for businesses and consumers, depending on whether the sale contract occurred, for example, on-line, or face-to-face. If the intention is, therefore, to limit the detrimental impact of full harmonisation on domestic transactions, and thus on those consumers that do not wish to engage in cross border transactions, this will not be the case. Direct transactions may well be between parties from different Member States, for example, the tourist purchasing goods while on holiday in another Member State. While distance transactions may be between parties in the same Member State via an internet sale. The distinction would also have the effect of further undermining the horizontal nature of the instrument, which already distinguishes in its provisions between distance and off-premise contracts.²⁸ Such an approach would then exacerbate the related and unaddressed regulatory gaps in the *acquis* in regard to, for example, the use of mixed off-premise and distance marketing strategies.²⁹ Not only would it be unclear to parties which rules apply, i.e. those for distance, or off-premise contracts, but also what level of harmonisation will apply, and thus whether it is sufficient for the business to comply with the exhaustive requirements of the CRD, or whether it must also look to the law of the consumer's habitual residence. While a differentiated approach to harmonisation may, therefore, produce a more politically acceptable result in regard to the impact of the full harmonisation approach of

²⁷ Press Release, Consumer rights: Full harmonisation no longer an option, on a meeting of Commissioner Reding and the European Parliament Internal Market and Consumer Protection Committee, 17th March 2010, http://www.europarl.europa.eu/news/expert/infopress_page/063-70800-076-03-12-911-20100317IPR70798-17-03-2010-2010-false/default_en.htm.

²⁸ Discussed in Chapter 4, 4.3.

²⁹ Discussed *Ibid*, and 4.1.3.

the CRD, it would clearly fail to achieve the certainty and simplification of the regulatory environment that is sought by the Commission.³⁰

The removal of important consumer rights within the CRD proposal, which results in the creation of a dual regime, and the CRD being dependant upon the application of national law,³¹ must also be addressed. A number of options have been discussed, for example, in order to achieve greater clarity in the relationship between consumer remedies under the CRD and national contract law.³² One proposal sees national provisions on remedies, such as the UK's right to reject, being integrated into the proposal.³³ Progress to date on the proposal, however, evident in the UK's opposition to the loss of the national right to reject, suggests that achieving agreement on the full harmonisation of these issues is highly unlikely. This is, therefore, another area where differentiated harmonisation is envisaged for on-line sales and direct contracts, in an attempt to address those areas most beneficial to the functioning of the internal market, and thus to advance ongoing negotiations on the proposal.³⁴ The result will, however, once again be compromise on the part of the proposal and, thus, fragmentation of the regulatory environment. It is clear that the objectives of the review cannot be fully realised while the proposal continues to seek some degree of full harmonisation in a binding form to replace provisions of national contract law, as opposed to an optional regime.

In terms of the way forward for the CRD proposal in this respect, therefore, limitations in its scope and relationship with national law may have to be accepted. In this regard, the CRD must be transparent as to its scope so that it is understood by both businesses and consumers who seek to benefit from the instrument.³⁵ Indeed, benefits can still arise from the proposal where these limits are properly understood. Certainty will be increased, for

³⁰ The Commission had discounted this approach in regard to the scope of the review proposal as it would result in fragmentation, undermining consumer confidence and would not provide the necessary simplification of the regulatory environment, Chapter 4, 4.1.2. and CRD proposal, 7.

³¹ Discussed in Chapter 4, 4.1.3.

³² The resulting uncertainty in regard to this relationship was criticised in Chapter 6, 6.4.2.

³³ Commissioner Kuneva, Speaking in the European Parliament, 4 May 2009, Oral question with debate O-0076/09; Debate: CRE 04/05/2009.

³⁴ Commissioner Reding (2010).

³⁵ Chapter 5, 5.2.2.

example, as a result of the fully harmonised 14 day withdrawal period, replacing the diverging periods which currently exist. The proposal for differentiated harmonisation, however, should not be pursued. The narrowing of the full harmonisation scope of the CRD in this way would in fact make the need for an optional instrument greater, if parties are to benefit from a full harmonisation regime in the near future. Then, however, the optional instrument would no longer benefit from the full core of fully harmonised rules of consumer protection within the existing CRD proposal, which would have aided its use and acceptance. The limitation of full harmonisation to distance contracts would, however, have little effect on the ‘blue button’ proposal in the e-commerce context. Yet it would mean that the optional instrument,³⁶ like the CRD, would still contain rights within the shared full harmonisation scope that are not considered to offer a sufficiently high level of protection.³⁷ Outside of that, where minimum harmonisation at the EU level would remain, it is clear from the experience of the CRD and reaction to that, that the existing minimum can only serve as the starting point for the full harmonisation approach of the optional instrument, and that a higher level can and must be ensured. The adoption of an optional instrument in this context may thus prove more contentious,³⁸ however, to the extent that it can achieve the fully harmonised, comprehensive and directly applicable framework for trade in the internal market, which will leave national systems intact, it must be pursued.

Progress towards achieving the objectives of the European contract law project is imperative at a time when the EU is looking to strengthen the internal market in order to facilitate cross-border trade as a means of assisting Europe out of economic crisis. The need for, and desirability of, optional instruments to support trade in the internal market is therefore clear. It is through such instruments that citizens will realise the benefits of the internal market. A caveat must, however, be made. This is that optional instruments and the broader regulatory response can only address one factor which serves to render cross-border trade more difficult and costly, namely the present state of European

³⁶ And thus the ‘blue button’.

³⁷ Moving forward it is clear that addressing the level of protection within the CRD would have been a better approach than narrowing the full harmonisation scope of the proposal

³⁸ Although not as significantly as it does not affect existing national levels of protection, as the CRD does.

contract law. Other factors capable of impeding cross-border trade will remain, and this will prevent the creation of a wholly level playing field within the internal market.³⁹ While some issues can be addressed through further action at the EU level, such as through promoting and strengthening cross-border redress mechanisms, which will be necessary in particular to assist consumer participation in cross-border trade,⁴⁰ other factors which affect the behaviour of market participants such as language, cultural differences and distance cannot. As a regulatory solution, however, the optional instrument is nonetheless a significant means by which to make it easier and less costly for businesses and consumers to conclude cross-border contracts in the internal market. With political will and momentum now mounting behind the development of optional instruments, therefore, the EU's resources are properly placed with the development of the final CFR, which can still serve as the basis of the optional instruments, and for the continuing review of the consumer acquis.

³⁹ Highlighted in Chapter 3, 3.2.

⁴⁰ Chapter 6, 6.4.2. Action is needed, in particular, to address the practical issues which influence consumer willingness to engage in cross-border transactions, such as after-sales issues and the accessibility of redress.

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