

# TOWARDS A EUROPEAN CONTRACT LAW: FOR A PROSPEROUS FUTURE OF INTERNATIONAL TRADE

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*This article strongly supports the drafting and adoption of a uniform European contract code. The article discusses the ways in which the current legal diversity hampers international trade. This will take many years to implement, so in the interim, the author suggests that existing European Communities (EC) legislation should be reviewed, improved and clarified to remedy inconsistencies in European contract law. The author also argues that international private law in Europe should be further harmonised and European jurisdiction expanded.*

*Soulignant dans quelle mesure les modèles légaux européens sont concurrents et partant, entravent le commerce international, l'auteur se fait le défenseur de l'adoption d'un code européen des contrats. Conscient de l'inévitable difficulté et des longueurs qui accompagnent toute entreprise de codification, il suggère que l'on utilise dans un premier temps, la législation déjà existante de la Communauté Européenne, laquelle serait simplement revue et améliorée notamment pour unifier ce qui formera le droit du contrat européen. En marge de cette entreprise, l'auteur préconise également une harmonisation des règles de conflits de lois et de juridictions en droit international privé en vigueur en Europe.*

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## **I INTRODUCTION**

Although the European Communities ("the Communities")<sup>1</sup> are increasingly going beyond the boundaries of just being an economic project, their central objective has long been and still is to

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1 The term "European Communities" or "European Community" will be used rather than referring to the term "European Union". Though the Community has, under the 1993 Treaty on European Union, consolidated version (24 December 2002) <[http://europa.eu.int/eur-lex/en/treaties/dat/EC\\_consol.html](http://europa.eu.int/eur-lex/en/treaties/dat/EC_consol.html)> (last accessed 21 June 2004) ["EU Treaty"] come to form part of the European Union, the reference to the Community seems more appropriate, as contract law implications stem exclusively from the Community.

establish a common market (the so-called internal market).<sup>2</sup> Today, this has largely been achieved through European legislation implementing the Fundamental Freedoms. The Fundamental Freedoms are included in the European Communities Treaty ("EC Treaty"); they guarantee the free circulation of goods, persons, services, capital and monetary transactions. By implementing the Fundamental Freedoms through legislative means, national markets have been integrated in order to enhance the production and distribution of goods.

As part of this integration, the Communities at first felt no need to harmonise or unify core fields of private law such as contract law. National contract laws were similar enough to enable the realisation of most market transactions without major obstacles. Consequently, the Communities first focused on other more urgent areas.

Nevertheless, at some stage contract law became the subject of European legislation. However, contract law issues were regulated only sporadically, mostly alongside consumer legislation;<sup>3</sup> systematic and comprehensive legislation concerning contract law has not been on the agenda so far.<sup>4</sup> To a large extent, domestic contracts are still governed by the various national contract laws. Even cross-border contracts are not subject to a unified regime in all Member States, as Portugal, the United Kingdom and Ireland have not ratified the United Nations Convention on Contracts for the International Sale of Goods (CISG).<sup>5</sup>

The debate over whether to move one step ahead and generally unify contract law in Europe is sensitive and highly controversial.<sup>6</sup> This article suggests that the arguments for unification prevail. The current legislative "piecemeal" approach should be abandoned in order to comprehensively unify contract law in Europe.

## **II LEGAL DIVERSITY: AN OBSTACLE TO INTERNATIONAL TRADE**

An analysis of the current state of European contract law reveals that a range of transnational instruments already exists. Thus, some international contracts are not subject to divergent national contract laws, but to a unified regime of rules as provided by those instruments. However, not all existing instruments completely dispose of legal diversity. In fact, due to limitations as to the scope

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2 Article 14 of the Treaty establishing the European Communities, consolidated version (24 December 2002) <[http://europa.eu.int/eur-lex/en/treaties/dat/EC\\_consol.html](http://europa.eu.int/eur-lex/en/treaties/dat/EC_consol.html)> (last accessed 21 June 2004) ["EC Treaty"].

3 Thomas Wilhelmsson (ed) *Perspectives of Critical Contract Law* (Dartmouth, Aldershot, 1993) 78 ["*Perspectives of Critical Contract Law*"].

4 Ulrich Drobnig "Creating International Legislation for the Twenty-First Century: Unified Private Law for the European Internal Market" (2001) 106 *Dick L Rev* 101, 105.

5 United Nations Convention on Contracts for the International Sale of Goods (1980) <<http://www.cisg.law.pace.edu/cisg/text/cisg-toc.html>> (last accessed 21 June 2004).

6 For up to date-information on unification efforts in Europe see the European Commissions' website <[http://europa.eu.int/comm/internal\\_market/contractlaw/index\\_en.htm](http://europa.eu.int/comm/internal_market/contractlaw/index_en.htm)> (last accessed 21 June 2004).

of applicability, most cross-border contracts are still subject to the divergent national contract laws. Consequently, legal diversity remains. As legal diversity itself is not necessarily a problem, there is a need to establish whether it actually hampers international trade. This article argues that different contract laws are indeed a relevant obstacle to cross-border trade in the European Communities.

#### A *Different Contract Laws – Different Rules*

At the outset, legal diversity can only be a problem if the different contract laws actually provide different rules. If different contract laws apply, but all of them feature (nearly) the same substantive provisions, legal diversity is a purely formal diversity, probably not presenting a relevant obstacle to cross-border trade. As a matter of fact, the contract laws throughout Europe differ, presenting diversity not only as a formal but also as a substantive issue.<sup>7</sup> Differences are so numerous that it is hardly possible to provide more than an appropriate selection. Nevertheless, even such a selection highlights that – besides some common elements – national contract laws feature a broad range of differences.

The binding character of contracts is a basic principle existing in all European national contract laws (*pacta sunt servanda*).<sup>8</sup> For a valid and binding contract, all jurisdictions require that the parties intend to be legally bound and that they agree upon sufficiently definite terms.<sup>9</sup>

However, remarkable differences relating to various formation issues come to mind.<sup>10</sup> For example, Romanist legal systems require writing as a general condition for the enforceability of contracts. Other states such as Germany, the United Kingdom and the Nordic countries do not set up such requirements for most kinds of contracts.<sup>11</sup> With regard to specific contracts, the differences are even more obvious. For instance, the guarantee of a surety is not valid in France unless the maximum amount of the guarantee is mentioned in the written instrument. This requirement is not part of most other contract laws.<sup>12</sup>

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7 Ole Lando *The Private Law Systems in the EU: Discrimination on Grounds of Nationality and the Need for a European Civil Code* (2000) Legal Affairs Series JURI 103 EN, 4 ["Lando *The Private Law Systems in the EU*"]; Maurice Sheridan and James Cameron *EC Legal Systems An Introductory Guide* (Butterworths, London, 1992); Peter Marsh *Comparative Contract Law: England, France, Germany* (Gower, London, 1994).

8 Lando *The Private Law Systems in the EU*, above n 7.

9 Marsh, above n 7, 42.

10 For a general overview see Marsh, above n 7, 41 and following.

11 Ole Lando "Some Features of the Law of Contract in the Third Millennium" <[http://www.cbs.dk/departments/law/staff/ol/commission\\_on\\_ecl/literature/lando01.htm](http://www.cbs.dk/departments/law/staff/ol/commission_on_ecl/literature/lando01.htm)> (last accessed 21 June 2004).

12 Joint Response of the Commission on European Contract Law and the Study Group on a European Civil Code (2001) ["Joint Response"] 14.

Furthermore, consideration is regarded by the United Kingdom and Ireland as a condition for a binding agreement. The civil law countries do not have the requirement of consideration and even acknowledge a "gratuitous promise" as binding.<sup>13</sup> Besides the aspect of consideration, differences become apparent with regard to the question whether the lack of good faith can render an agreement unenforceable. General good faith plays a major role in Germany. It cannot only be used to modify an existing agreement, but may also be used to deny the formation of a contract or lead to the later termination of it.<sup>14</sup> In contrast, the United Kingdom is very reluctant to resort to or even to acknowledge a principle of good faith.<sup>15</sup>

Still regarding formation, the question arises whether an offer can be revoked by the offeror prior to acceptance. Under German law, an offer is generally binding for a reasonable time and generally cannot be revoked. In contrast, United Kingdom contract law allows the offeror to revoke the offer until the offeree accepts it.<sup>16</sup>

Besides formation issues, there are differences in the rules determining the existence and content of a contract. First, Germany and the Nordic countries have a rule relating to a professional's written confirmation. If an (oral) contract has been concluded between professionals, or if one of them has reason to believe that a contract has been concluded, and he sends the other party something in writing that purports to be a confirmation of the contract and provides the terms of the contract, a contract is generally regarded as having been concluded on the terms of the confirmation. Such a rule does not exist in most of the other Member States.<sup>17</sup>

Related to this issue is the "battle of the forms" problem, which is approached differently in the various States. If the parties have reached an agreement but offer and acceptance refer to conflicting standard terms, according to German case law a contract is formed. The standard terms form part of the contract to the extent that they are common in substance. Where they are not, default rules of law govern (the knock out rule). Under Dutch law, the terms of the offeror prevail (the first shot rule). Under English law, the terms of the final document succeed (the last shot rule).<sup>18</sup>

Furthermore, differences regarding the validity of the contract occur. Under English law, a party is not obliged to disclose information of fundamental importance to the other party, even if they know that the other party is ignorant of it. For instance, imagine a person buying a painting for a

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13 Joint Response, above n 12, 14.

14 *Perspectives of Critical Contract Law*, above n 3, 70.

15 For a detailed analysis see Reinhard Zimmermann and Simon Whittaker (ed) *Good Faith in European Contract Law* (Cambridge University Press, Cambridge, 2000).

16 See Part II C A Case Study.

17 Joint Response, above n 12, 14.

18 Joint Response, above n 12, 14.

modest amount of money. Unbeknownst to the seller, the buyer knows that the painting has been drawn by a famous artist and is worth many times the purchase price. In the United Kingdom, such a contract is valid and generally cannot be set aside. In contrast, German law usually allows for the ignorant party to set aside the contract.<sup>19</sup>

For years, the issue of stipulation in favour of a third party constituted a further important difference. In civil law countries, such stipulations have always been valid and enforceable.<sup>20</sup> In England, the doctrines of privity of contract and of consideration have long prevented such stipulations. However, today, common law countries such as England also acknowledge stipulation in favour of a third party.<sup>21</sup> Consequently, differences in this area of contract law have ceased to exist.

Differences still appear relating to the interpretation of a contract. In the continental systems, the common intention of the parties is a generally accepted principle for the interpretation of a contract. The common intention prevails even if it differs from the literal meaning of the words used in the contractual terms. In the United Kingdom and Ireland, the literal meaning of the words prevails. The meaning is determined by looking at a reasonable person having the background knowledge which would have been available to the parties.<sup>22</sup>

In addition, the aspect of performance must be taken into consideration. Whereas there are similar approaches to monetary obligations, non-monetary obligations are treated quite differently. Common law jurisdictions grant specific performance as an exceptional, discretionary remedy. Specific performance is only granted if damages are inadequate. In contrast, civil law countries generally acknowledge the aggrieved party's right to specific performance.<sup>23</sup> Therefore common law and civil law systems are characterised by a completely different performance structure. A few years ago, not only the aspect of performance but also the issue of non-performance would have served as a good example of differences. However, these differences have diminished, especially since Germany drastically reformed its system of non-performance, largely in line with the CISG.<sup>24</sup>

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19 Joint Response, above n 12, 15. However, damages may be awarded to the other party, BGB, s 122. BGB means *Bürgerliches Gesetzbuch*, the German Civil Code: see <<http://www.bundesregierung.de/-418/Gesetze.htm>> (last accessed 21 June 2004).

20 See for example, BGB, s 328 and following.

21 See English Contracts (Right of Third Parties) Act 1999.

22 Joint Response, above n 12, 15.

23 Lando *The Private Law Systems in the EU*, above n 7, 6.

24 Hans Schulte-Noelke "The New German Law of Obligations: an Introduction" <<http://www.iuscomp.org/gla/literature/schulte-noelke>> (last accessed 21 June 2004).

Differences also surround the ending of an obligation. Under French law, two obligations capable of being set-off against each other are extinguished from the moment they conflict. Under German law, a declaration of one party is required; this declaration then has a retroactive effect to the time when the two claims conflicted. In most Nordic countries, a declaration of one party is required as well, but this declaration only has a prospective effect.<sup>25</sup>

Finally, the matter of unfair contractual conditions in standard contracts has to be mentioned. Here, the rules governing the judicial control of such conditions differ remarkably.<sup>26</sup> This might not be true in regard to consumer contracts as the national laws have been harmonised by a European directive.<sup>27</sup> However, as far as other contracts are concerned, particularly commercial contracts, some jurisdictions have their courts exert a strict control, while others set up "no challenging" restrictions.<sup>28</sup>

This selective reference to the Member States' contract laws has shown some similarities, but predominantly striking differences. Overall, the current legal diversity goes beyond being purely formal. Besides similarities in some of the very basic features, the substantive rules actually differ a lot. Consequently, the outcome of a contract law case is often dependant on the relevant national contract law to be applied. It is true that some of the differences that have been identified are less important in business transactions. For instance, differences as to the doctrine of consideration may be disregarded as there will always be consideration in commercial transactions. However, the above analysis has also identified relevant differences, for example regarding formal requirements or specific performance. In addition, the existence of different contract laws on its own might discourage businesses from entering into cross-border trade. In conclusion, the outcome of this analysis underlines the importance of further unification, namely the establishment of a European contract code.

### ***B Perception in the Business Community***

So far, the prevailing legal diversity has been analysed from a theoretical perspective only. Nevertheless, an analysis from a practical perspective might further support the idea of a unified contract law in Europe. In general, it is common knowledge that business people tend to favour the abolition of market barriers and, in particular, regulatory measures. Therefore, it appears that business people would support the establishment of uniform rules.

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25 Joint Response, above n 12, 16.

26 Lando *The Private Law Systems in the EU*, above n 7, 14.

27 Directive 1993/13/EEC OJ L (5 April 1993).

28 For a comparison, see Marsh, above n 7, 49 and following; 290 and following.

It might be helpful to look at the statements by businesses responding to the 2001 Communication of the European Commission.<sup>29</sup> When analysing those statements, it first comes as a surprise that quite a number of businesses and employers' associations seem to experience no problems at all.<sup>30</sup> However, implications resulting from legal diversity are not only a theoretical problem generated by academics and European authorities. When looking closely at the statements, it turns out that these only have limited explanatory value.

First, it has to be taken into account that only large businesses have responded to the Communication. These businesses experience no problems, as they are able to make use of choice-of-law and arbitration clauses. For small and medium-sized businesses, this solution is often not available. They lack competent legal advice and also bargaining power to impose such clauses.

Secondly, most of the large businesses that responded are based in the United Kingdom. As English contract law is a popular choice-of-law, the responses are certainly appropriate for them. Nevertheless, it must be remembered that businesses situated elsewhere must bear higher transaction costs.

Thirdly, many of the statements mix up the analysis of the current situation and the evaluation of possible solutions to existing problems. Most businesses see the current problems as a petty evil. They are strongly opposed to new European legislation, as they presume from previous actions that this new legislation might be too consumer-friendly. Consequently, the denial of existing problems can be interpreted as the wish to avoid new European legislation.

In conclusion, the business statements cannot be used as an argument against further unification.

### *C A Case Study*

Since academic and business statements are not conclusive in this area, it is necessary to go further. This may require extensive empirical studies, which naturally exceed the scope of this article. However, a case study might exemplify some of the existing problems and thereby show that the divergent contract laws indeed are hindering cross-border trade. The following example shows how the rules of offer and acceptance in conjunction with a cross-border commercial contract can affect international trade.

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29 In July 2001, the European Commission published a Communication seeking views from governments, organisations and academics on contract law unification in Europe, COM 398 Final OJ C 255 (13 September 2001); for responses to the Commission's Communication on European contract law, see <[http://europa.eu.int/comm/consumers/cons\\_int/safe\\_shop/fair\\_bus\\_pract/cont\\_law/comments/index\\_en.htm](http://europa.eu.int/comm/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/index_en.htm)> (last accessed 21 June 2004).

30 A summary of the business responses is given in the Action Plan published by the European Commission, COM (2003) 68 Final (12 February 2003) 31 and following.

Imagine that an English company intends to purchase goods for its business. It receives two offers, one from an English company, the other from a German company. As far as the English offeror is concerned, English law governs the (domestic) contract. According to English contract law, an offer is not binding at all. The English offeror can withdraw it at any time until it is accepted;<sup>31</sup> this is the time when the offeree has mailed the acceptance (the mailbox or postal acceptance rule).<sup>32</sup>

As far as the German offeror is concerned, the question arises whether English or German law governs this international contract. That needs to be determined by international private law. Generally, it must be clarified whether an English or German court has jurisdiction over the matter in question. If an English court is involved, English international private law is crucial and likewise German international private law if a German court is to adjudicate. In this case, the forum aspect is irrelevant, as the Rome Convention supersedes the autonomous international private law of both countries.<sup>33</sup> The Rome Convention applies to this case even though a contractual agreement has not yet been reached. According to article 8(I) of the Rome Convention, the law applied is that which applies when the contract is concluded. If there is no express choice of law, article 4 declares the law of the jurisdiction that has the closest link to the (potential) contract to be applicable. In general, this is the jurisdiction of the party performing the characteristic part of the contract. The characteristic performance is not the payment by the English buyer, but the delivery and assignment of the goods by the German seller. Consequently, German law applies to the offer. According to BGB section 145, an offer is generally binding unless specific circumstances occur.

It can be seen that the international transaction is disadvantaged, which presents an obstacle to cross-border trade in the Communities. First of all, as the English offeror is not bound by the offer, the offeror has the opportunity to dispose otherwise until the offer is accepted. Secondly, the situation of the English offeree has to be considered. It receives two offers. The English offer is not binding at all. The German offer is generally binding for a reasonable period of time. Consequently, the English offeree will probably first examine the English offer, holding back the answer to the German offeror. As a result, the English offeror is more likely to succeed in concluding the contract; it will also receive an answer to its offer more quickly. Thirdly, the English offeree might be reluctant to incur the application of German contract law and, therefore, tend to accept the English offer. On balance, the German offeror is more likely to fail in reaching a contractual agreement. Therefore, the German business must respond to the higher risk of failure and is likely to increase

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31 Marsh, above n 7, 58.

32 Marsh, above n 7, 69.

33 See <[http://www.rome-convention.org/instruments/i\\_conv\\_orig\\_en.htm](http://www.rome-convention.org/instruments/i_conv_orig_en.htm)> (last accessed 21 June 2004). The Rome Convention was opened for signature on 19 June 1980. The last states signed in 1991. All EC Member States are signatories to that Convention.



prices. All in all, the English offeror is in a much better position than the German offeror.<sup>34</sup> This leads to a distortion of competition in the European market. As the objective of the European Communities is to avoid such distortions, the current situation is unacceptable. Therefore, the case study underlines the argument that a uniform set of contract law principles – a European contract code – needs to be established.

### III POSSIBLE SOLUTIONS

It has already been pointed out that legal diversity goes beyond a purely formal diversity, with many substantive issues being regulated differently. Legal diversity creates problems and thus hinders cross-border trade. In the following section, this article will suggest that only a European contract code can overcome these obstacles. Although discussing a range of options, arguments for the implementation of a uniform code prevail; this is the most appropriate solution to ensure economic prosperity for the years to come.

In its 2001 Communication, the European Commission suggested four different options to approach the current problems without itself indicating the option that it favours. Option I entails leaving further development to market forces.<sup>35</sup> Option II points to the potential for the development of non-binding principles of European contract law.<sup>36</sup> Option III is concerned with the improvement and consolidation of the existing (secondary) Community private law.<sup>37</sup> Finally, option IV discusses wide-ranging legislative actions.<sup>38</sup> It is here that a European contract code would have its place.

These four options are neither exhaustive nor do they relate to each other in an exclusive manner, as different options can be combined. That is what this article argues. In the end, a European contract code is needed; however, other options – for example, review and improvement of existing legislation – should be realised prior to that and other supplementary measures considered. This article also argues that international private law should be further harmonised and European jurisdiction expanded.

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34 This case study can be supported by an actual incident: the construction of the Euro-Tunnel. Involved in this project were not only the French and English Governments, but also English and French construction workers and hundreds of sub-contractors from all over Europe. The parties could not agree on the applicable contract law. In the end, the contract included the clause that those principles, which are part of both English and French law should be applied. The contract then referred to general principles of international trade law. It is obvious that such a clause leads to legal uncertainty. See Claude Reymond "The Channel Tunnel Case and the Law of International Arbitration" (1993) 109 LQR 337; Klaus P Berger "Einheitliche Rechtsstrukturen durch außergesetzliche Rechtsvereinheitlichung" (1999) JZ 369; *Channel Tunnel Group v Balfour Beatty Ltd* [1993] AC 334 (HL).

35 COM (2001) 398 Final, OJ C 255 (13 September 2001) 49-51 ["COM 01/398"].

36 COM 01/398, above n 35, 52-56.

37 COM 01/398, above n 35, 57-60.

38 COM 01/398, above n 35, 61-69.

## A *The Preferable Option(s)*

### 1 *A system of self-regulation*

The first option presented by the Communication is to undertake no further action at a European level, but to let the market develop its own solutions.<sup>39</sup> The competitive behaviour of market participants brought about by pressure from interest groups and public authorities results in a process of self-regulation.<sup>40</sup>

Proponents of pure self-regulation claim it to be beneficial, in particular for business. They refer to the principle of freedom of contract and place emphasis on the fact that a solution, which is voluntarily agreed upon, is preferable to measures being imposed by an external authority.<sup>41</sup> Secondly, it is claimed that self-regulation is the most flexible solution. At a European level, the amendment or alteration of existing legislation is a cumbersome and time-consuming process. Consequently, self-regulatory measures might be able to respond to fast changing technological developments more easily. Those supporting the option of self-regulation emphasise that flexibility is even more important in a jurisdiction as large and culturally diverse as the European Communities. According to them, each Member State of the Communities has its own peculiarities, which have to be addressed by regulative measures in a flexible manner.

Leaving the solution to the market forces alone, however, is not appropriate for the current situation.<sup>42</sup> Undoubtedly, self-regulation has its justification in a modern legal system, but only to a certain extent. Incentives – in particular by trade associations – might be able to channel the market in a specific direction, but those incentives can only supplement, not replace, legislation. When urging the necessity for some kind of legislative action, the focus is mainly put on consumer law. However, the principle of freedom of contract must also be restricted in order to protect small and medium-sized businesses with less bargaining power. Only if all businesses have a fair chance to participate in cross-border trade can competition be guaranteed and international trade thrive.

Secondly, the European market is just too large and complex for a system of self-regulation to work. Although there is a lot of political lobbying taking place in Brussels, pressure groups still

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39 COM 01/398, above n 35, 49-51.

40 For instance, the Communication refers to Orgalime, the European group of the mechanical, electrical, electronic and metalworking industries. Orgalime issued a model consortium agreement to boost cross-border trade cooperation. See COM 01/398, above n 35, 13.

41 Klaus Berger "Auf dem Wege zu einem europäischen Gemeinrecht der Methode" (2001) ZEuP 4 and following.

42 Walter van Gerven "Codifying European Private Law? Yes, if" (2002) 27 E L Rev 156, 158; Thomas Wilhelmsson "Private Law in the EU: Harmonised or Fragmented Europeanisation?" (2002) 10 ERPL 77-94 ["Private Law in the EU"]; Ugo Mattei "Hard Code Now!" (2002) 2 Global Jurist Frontiers 1 and following ["Hard Code Now"].

mainly operate at a state and not at a European level.<sup>43</sup> Finally, self-regulation may be flexible, but flexibility also leads to a further fragmentation of contract law. A system of self-regulation without rules lacks transparency and clarity.<sup>44</sup>

To sum up, these problems cannot be left to the market alone to solve. Self-regulative measures are always welcome to supplement legislative measures. However, the European market certainly needs some kind of regulative action.

## 2 *Non-binding contract law principles*

The second option suggested by the European Commission is to conduct comparative research in order to establish the common core of European contract law. In this way, a widely accepted set of principles could be developed. In addition to that, the Communication introduces the idea of establishing standard contracts to facilitate economic transactions.<sup>45</sup>

Opponents of this idea often claim such a set of principles would be ineffective.<sup>46</sup> First, such principles could not encompass every aspect of a commercial contract. Lacking detailed solutions, these principles might bring with them legal uncertainty. This legal uncertainty would be an obstacle to parties incorporating the principles into their contract. To underpin this phenomenon, reference is made to the CISG. Although the CISG is a very successful international project, most commercial contracts contain a standard clause excluding the application of the CISG. Furthermore, authorities and courts might be reluctant to apply the principles, instead referring to the respective national law.

When looking at scholarly statements, the development of non-binding contract law principles is predominantly supported.<sup>47</sup> Most proponents of the first option also support the idea of developing "soft" law. However, their support is mainly based on the desire to avoid comprehensive legislation. Nevertheless, a good point is made when referring to the principle of freedom of contract. Elective rules naturally better correspond to that principle than does an imperative regime of rules.

Secondly, the main argument against Option II, that a set of principles is ineffective in solving the problems, is not overly convincing. It is obvious that soft law lacks legislative authority. However, one should not underestimate its persuasive authority. If the principles are well-drafted and present an attractive set of rules, contracting parties will increasingly make use of them. This

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43 "Private Law in the EU", above n 42, 85.

44 "Private Law in the EU", above n 42, 85.

45 COM 01/398, above n 35, 52-56.

46 Carol Harlow "Voices of Difference in a Plural Community" (2002) 50 Am J Comp L 339 and following.

47 See Drobnig, above n 4, 101.

becomes apparent when looking at the UNIDROIT Principles.<sup>48</sup> This process may be a long one but it features the advantage that European citizens gradually get familiar with the new contract law.

### 3 *Review and improvement of existing European Communities legislation*

Obviously a large body of Community legislation regarding contract law is already in place. It is commonly accepted that this legislation is fragmented and partly inconsistent. The third option of the Communication addresses this problem and suggests reviewing and improving existing EC legislation.<sup>49</sup>

Naturally, all statements support this option.<sup>50</sup> It is self-evident that existing legislation should be subject to permanent review in order to improve or adjust it to suit changing needs and circumstances. Definitions have to be revised and contents of various directives harmonised. Cancellation periods for contracts and consequences of cancellation must be uniform. Gaps might be filled; some directives could even be turned into regulations.

However, this approach can only remove inconsistencies among different legislative acts. The existing legislation is not only inconsistent but also fragmented. This fragmentary character results in national contract laws applying, and – as shown above – this legal diversity hampers cross-border trade. In conclusion, reviewing and improving existing EC legislation should be a self-evident but not sufficient option.

### 4 *A European contract code*

This discussion of the first three options as presented by the Communication is not particularly controversial. It is hardly denied that solving the current problems cannot be left to the market alone. The development of non-binding contract law principles is seen as mostly ineffective, but because such principles would not be mandatory, such development is rarely opposed. The need to review and improve existing EC legislation is commonly accepted. However, the question whether to supplement these three options by comprehensive legislation at a European level is highly contentious.<sup>51</sup>

In the following section, arguments in favour of and against a European contract code will be presented. This outline indicates the difficulties that might arise when enacting a European contract code. However, the following analysis also exposes the genuine truth that there is no alternative to comprehensive European legislation, at least from an economic perspective. This article focuses on

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48 The UNIDROIT Principles are a set of uniform contract law rules for international commercial contracts <<http://www.unidroit.org/english/principles/contracts/main.htm>> (last accessed 21 June 2004).

49 COM 01/398, above n 35, 57-60.

50 Van Gerven, above n 42, 158.

51 COM 01/398, above n 35, 61-69.

a trade perspective, and the following remarks unmistakably demonstrate that European businesses would be much better off with a uniform contract law.

(a) Transaction cost approach<sup>52</sup>

It is often argued that the desirability of European legislation should be resolved by a transaction cost approach.<sup>53</sup> This approach compares the input of resources to be applied to bring about unity and the output in terms of results.<sup>54</sup> At the outset, transaction costs need to be defined. Transaction costs are all those costs that preclude or reduce the possibility of smooth market transactions. Resources that could be invested in productive activities are absorbed by transaction costs and, therefore, diverted from their actual purpose. To give a general example, if there is no reliable and effective legal system, parties will need to spend resources on monitoring their transactions. The parties themselves must then supply the protection normally provided by the legal system.

As regards contract issues, contract law supplies default rules that reduce transaction costs by avoiding time-consuming negotiations; it also provides mandatory enforcement rules introducing incentives to perform and avoiding the need to establish procedures of self-enforcement.<sup>55</sup> As every legal system should work to avoid or at least reduce those transaction costs, this economic factor could justify the introduction of a European contract code.

Proponents of such a code claim that transaction costs could be reduced by legislative measures at a European level.<sup>56</sup> Three kinds of costs connected with the status quo are often mentioned. First, it is claimed that parties are burdened with information costs; for example, costs for additional legal advice. Being confronted with unfamiliar law, parties may have to reach beyond the expertise of domestic lawyers, seeking the advice of foreign practitioners.

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52 The transaction cost approach is part of a legal theory that favours an economic approach to legal issues: see Eric Posner "Economic Analysis of Contract Law After Three Decades: Success or Failure?" (2003) 112 *Yale LJ* 829; Richard Craswell "Offer, Acceptance, and Efficient Reliance" (1996) 48 *Stanford L Rev*; Richard Craswell "Passing the Cost of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships" (1991) 43 *Stanford L Rev* 361; Avery Katz "The Economics of Promissory Estoppel in Preliminary Negotiations" (1996) 105 *Yale LJ* 1249-1309; Jason Scott Johnston "Cheap Talk, Sunk Cost, and Contractual Liability in Preliminary Negotiating" (1999) 85 *Virginia L Rev* 385.

53 Ole Lando "Why Codify the European Law of Contract?" (1997) *ERPL* 525, 525; Udo Mattei "A Transaction Costs Approach to the European Code" (1997) *ERPL* 537, 539; van Gerven, above n 42, 163.

54 Van Gerven above n 42, 163.

55 Udo Mattei "Efficiency and Equal Protection in the New European Contract Law: Mandatory, Default and Enforcement Rules" (1999) 39 *Va J Int'l L* 537, 538 ["Efficiency and Equal Protection in the New European Contract Law"].

56 Hanni Honka "Harmonization of Contract Law Through International Law: A Nordic Perspective" (1996) 11 *TLNECLF* 111, 117.

Secondly, additional transaction costs might be generated as products and services have to be adapted to different legal systems. For instance, standard term contracts have to be drafted in various versions in order to satisfy the requirements of every legal system. This is true because the level of control as to the admissibility of standard contract terms differs greatly. Germany and the Nordic countries exert very strict control over the fairness of contractual terms, even as part of commercial contracts. In contrast, other Member States only provide for limited control in business relations.<sup>57</sup> For example, national rules regarding the limitation or exclusion of contractual liability in standard terms differ a lot. Whereas some States widely allow for such clauses, under French case law the responsibility of the supplier for hidden defects cannot be limited at all. Neither can a contracting party exclude its liability for future damages under Czech law. Furthermore, limitation periods are partly harmonised but still feature striking differences.<sup>58</sup> In conclusion, businesses have to use different standard term contracts in different Member States to satisfy all legal requirements. Finally, the third cost increasing factor is supposed to be the impossibility to streamline operations for the whole internal market.

Opponents of a European contract code predominantly do not negate the existence of the costs outlined above. However, it is claimed that these costs are not reduced after unification or are compensated by other costs caused by the unification process. First, it is asserted that a uniform law would not reduce information costs. As the law might be interpreted differently in the various EC Member States, parties in cross-border cases could still prefer to consult a foreign lawyer. Secondly, it might be worth considering that unification abolishes competition among different legal systems. It is argued that the current institutional competition improves each of the legal systems, thereby increasing efficiency. Consequently, unification of the law would result in a decrease of efficiency leading to further costs.<sup>59</sup> Thirdly, it is argued that unification not only distorts competition but also reduces the choice-of-law possibilities. This could increase costs as parties that have previously been able to opt for an appropriate national law find it necessary to include specific contractual provisions derived from European law. Finally, opponents refer to direct costs caused by a new codification. Businesses and their lawyers would have to learn and get familiar with the new European contract law, resulting in information costs.

In conclusion, contract law is an essential institution for an efficient market.<sup>60</sup> Therefore economic efficiency aspects should always be considered when discussing contract law issues. The

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57 Lando *The Private Law System in the EU*, above n 7, 14.

58 Lando *The Private Law System in the EU*, above n 7, 15.

59 Jürgen Basedow "A Common Contract Law for the Common Market" (1996) 33 CMLR 1169, 1185 ["A Common Contract Law for the Common Market"].

60 "A Common Contract Law for the Common Market", above n 58, 1181. The Council of the European Union even regards contract law as the "backbone of economic activity": see Council of the European Union (18 October 2001) 12735/01 JUSTCIV 124, 2.

transaction cost approach is of paramount importance in order to estimate the value of a European contract code. Such an approach must not be one-sided; the input of resources to reach unity and the output in terms of results should always be compared. This comparison needs an extensive analysis of empirical data in order to obtain reliable results. But even without analysis of empirical data, which is needed to make a final judgment, some basic evaluations are possible. First, nobody contests that the current status of European contract law creates high transaction costs. Secondly, many of those costs could be avoided if contract law was uniform. Thirdly, most counter-arguments are not deeply rooted. For instance, the reference to transaction costs caused by the introduction of a European contract code is not overly convincing. These costs are initial costs borne only once. In contrast, information costs resulting from legal diversity are permanent costs. Furthermore, loss of competition among European jurisdictions seems to be a fear that is mainly unfounded. This is true, as a vast range of contract laws would still exist throughout the world. And most states do not appear to constantly search for a better contract law.

To sum up, the implementation of a European contract code leads, inevitably, to a reduction of transaction costs. Such a reduction ensures the smooth functioning of market transactions and thereby reinforces Europe's competitive position in world trade.

(b) Legal diversity as a psychological barrier

It is claimed that the status quo not only creates the burden of high transaction costs but that legal diversity might also set up psychological barriers. If parties in an intraregional business transaction come from different states and are accustomed to different legal systems, the governing law is going to be unfamiliar to one of the parties. Absence of uniform commercial rules makes the outcome of litigation unpredictable and to some extent dependent on the court and place of hearing of the case.<sup>61</sup> This, in turn, may discourage parties from entering into intraregional trade, in particular small and medium-sized businesses.<sup>62</sup> So, legal diversity might not only be disadvantageous under a transaction cost approach, but may also put up a non-tariff barrier to cross-border trade.

Opponents of a European contract code claim that legal diversity is just one of many factors responsible for a psychological barrier to cross-border trade.<sup>63</sup> It cannot be denied that foreign languages and unfamiliar customs hinder international trade to a certain extent. However, these differences make up the cultural variety of Europe and are impossible to overcome by the European Communities; besides, it is not only impossible but also not desirable to establish uniformity in this

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61 Honka, above n 56, 118.

62 "A Common Contract Law for the Common Market", above n 59, 1181.

63 Pierre Legrand "Against a European Civil Code" (1997) 60 MLR 44, 46 ["Against a European Civil Code"].

regard. Legal diversity in contract law, on the other hand, is an obstacle that it is possible to overcome with new Community legislation.<sup>64</sup>

Theoretical remarks regarding transaction costs and a psychological barrier may be underlined by reference to statistical data. According to Eurostat, the statistical office of the European Communities, most insurance companies from Member States either prefer not to operate in other Member States at all or to operate through subsidiary companies, rather than conducting cross-border business from their home base. German non-life insurance companies, for example, obtain only 0.13 per cent of their total sales volume through direct cross-border transactions.<sup>65</sup>

(c) International private law and international arbitration

The traditional approach to solving international contractual disputes is formal and procedural. A well-functioning set of conflict-of-law rules or a reliable system of international arbitration may be all that is needed for a private party to engage in smooth trans-border transactions.<sup>66</sup> With regard to the conflict-of-law approach, parties may either insert a choice-of-law clause into their contracts, or allow conflict-of-law rules to ascertain the applicable law. A choice-of-law clause may also be supplemented by an arbitration clause establishing the jurisdiction of an arbitration tribunal. An arbitration award is nearly as effective as a judicial decision, as arbitral awards can be internationally enforced as a result of the New York Convention.<sup>67</sup> By making use of these measures, it is argued, the diversity of contract law diminishes as a problem for cross-border trade.<sup>68</sup>

Opponents of this argument assume that international private law is not a convincing tool of legal integration.<sup>69</sup> And indeed, it is not. *A priori* knowledge of the law applicable to a possible dispute, and in particular the opportunity for parties to choose the applicable law, certainly facilitates cross-border transactions. However, there are some downsides to international private law. Its first weakness is that it involves the application of a foreign law, which has to be ascertained

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64 However, some scholars also claim the contract law to be part of a country's cultural heritage and regard it as undesirable to achieve uniformity: "Against a European Civil Code", above n 63, 44 and following.

65 Jürgen Basedow *The Private Law Systems in the EU: Discrimination on Grounds of Nationality and the Need for a European Civil Code* (2000) Legal Affairs Series JURI 103 EN, 98 ["Basedow *The Private Law Systems in the EU*"].

66 Daniela Caruso "The Missing View of the Cathedral: The Private Law Paradigm of European Legal Integration" (1997) 3 Eur LJ 3, 19.

67 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (10 June 1958) 21 UST 2517; 330 UNTS 38.

68 Caruso, above n 66, 20.

69 Mark Van Hoecke and Francois Ost (ed) *The Harmonisation of European Private Law* (Hart Publishing, Oxford, 2000) 64.



and adjusted. Ole Lando reports an investigation undertaken by Max Rheinstein.<sup>70</sup> Rheinstein looked at 40 conflict-of-law cases where the United States courts have applied foreign law. He found that in 32 of these cases it was applied wrongly. In four cases the result had been very doubtful, and in four cases the result had been correct, by a mere coincidence. So on balance, the reliance on international private law leads to legal uncertainty.<sup>71</sup>

Secondly, not all parties are able to make use of choice-of-law and arbitration clauses. In some cases, the reason might be lack of bargaining power to impose the respective clause in the negotiations. In other cases, lack of legal advice might cause the failure to include such clauses. This is particularly true for small and medium-sized businesses, for which the costs relating to competent legal advice are proportionally higher.<sup>72</sup>

Thirdly, the international private law approach is restricted to disposable provisions. A choice-of-law clause does not affect mandatory provisions of the law. In this regard, it must be acknowledged that the existing legal diversity is not limited to disposable provisions, as it is mainly mandatory rules of the EC Member States that differ.<sup>73</sup> In conclusion, uniform private law, even supported by a viable system of arbitration, may well help to facilitate international trade. However, most problems remain unsolved, leaving the need for a European contract code.

(d) Standard contract terms

Standard contract terms may be one solution to problems arising from cross-border trade.<sup>74</sup> There is a great number of internationally standardised forms. The International Chamber of Commerce (ICC) has issued so-called INCOTERMS, the latest edition from 2000, governing certain aspects in the contract for the international sale of goods. Further on, the Baltic and International Maritime Council (BIMCO) has been drafting standard contracts concerning international shipping. Conceivably, standard contract terms sufficiently govern disputes arising out of international commercial contracts, leaving no need for European legislation. However, this approach requires the express incorporation of such terms into the contract. Many business actors, in particular small and medium-sized businesses, have no access to private governance mechanisms such as standardised

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<sup>70</sup> Ole Lando "Some Features of the Law of Contract in the Third Millenium" <[http://www.cbs.dk/departments/law/staff/ol/commission\\_on\\_ecl/literature/lando01.htm](http://www.cbs.dk/departments/law/staff/ol/commission_on_ecl/literature/lando01.htm)> (last accessed 21 June 2004).

<sup>71</sup> Christoph U Schmid "Pattern of Legislative and Adjudicative Integration of Private Law" (2002) 8 Column J Eur L 415, 438.

<sup>72</sup> Though consumer issues are disregarded in this article, it should be mentioned that the argument of less bargaining power and less access to competent legal advice is true particularly for consumers.

<sup>73</sup> See Part II A Different Contract Laws – Different Rules.

<sup>74</sup> Honka, above n 56, 148.

terms and, therefore, will not incorporate such terms.<sup>75</sup> This leaves the necessity for European legislation.

(e) Distortion of competition

As already indicated, the existing legal diversity distorts competition.<sup>76</sup> Different contract laws set up different standards, some establishing rules of a more restrictive nature, others of a more convenient character. If those rules are mandatory, the disadvantage for the business being subject to the more restrictive rules is obvious. However, the disadvantageous situation also becomes apparent with regard to elective rules. Bargaining always takes place, but always "in the shadow of the law".<sup>77</sup>

The bargaining position is therefore not the same for two competitors based in Member States with different contract laws. To give a specific example, the issue of standard term contracts may be addressed. In regard to the transaction cost approach, it has already been mentioned that the courts in different Member States have divergent powers to review such clauses, not so much for consumer contracts, but for business contracts.<sup>78</sup> Take the case where a producer includes high lump sum damages in the contracts with its franchisees, due if the contract is breached. The German producer runs the risk that this clause is held to be void by a German court, whereas a French competitor has nothing to fear.<sup>79</sup>

(f) Legal uncertainty

In a commercial contract, foreseeability is vital. When a dispute arises, the parties must be able to trust the contract.<sup>80</sup> In this context, it is claimed that a European contract code would result in legal uncertainty.<sup>81</sup> This may be true, as not only its provisions are unfamiliar, but also because it would be unknown how national and European courts would interpret these provisions.

However, legal uncertainty serves not only as an argument against but also in favour of a European contract code. Legal diversity provokes legal uncertainty as well. Not only businesses

75 Schmid, above n 71, 485; 486.

76 Dirk Staudenmayer "The Commission Communication on European Contract Law and the Future Prospects" (2002) 51 ICLQ 673, 676; Drobnič, above n 4, 105; Christian Kirchner "A European Civil Code: Potential, Conceptual and Methodological Implications" (1998) 31 UC Davis L Rev 671, 672; "A Common Contract Law for the Common Market", above n 59, 1175.

77 "A Common Contract Law for the Common Market", above n 59, 1175.

78 See Part II A Different Contract Laws – Different Rules.

79 "A Common Contract Law for the Common Market", above n 59, 1177.

80 Honka, above n 56, 125.

81 "Against a European Civil Code", above n 63, 59.

themselves but also most of the lawyers are not familiar with foreign law. As a result, a business can not be sure that the legal advice it has received on the foreign law is completely accurate, covers all necessary aspects and advises on what is economically the most favourable option.<sup>82</sup> A uniform European contract law would be easier to handle for both businesses and their legal advisors instead of having to deal with a variety of more than 20 divergent national contract laws. Thus, foreseeability and legal certainty are likely to increase due to harmonisation efforts.

(g) Interrelation with domestic laws

The presence of a European contract code would inevitably give rise to many questions regarding its interrelation with domestic laws.<sup>83</sup> First of all, the multi-level arrangement of European and national law makes it necessary to correlate both legal regimes. The question arises as to whether the supremacy of European law is unconfined or limited to cross-border contracts. Furthermore, it must be resolved whether gaps in the European law are to be filled by resorting to domestic contract law.

In addition to the relationship between European and domestic law, it has to be taken into account that the existing domestic contract law is incorporated in a consistent private law system. Often this aspect is supplemented by cultural issues. It is claimed that it would be dangerous to create a European law of contracts detached from its national roots, thus risking the loss of its entire efficacy.<sup>84</sup> However, the aspect of incorporation may also be regarded as merely a technical problem, disregarding cultural issues. For example, abstract terms are often supplemented by a range of provisions with definitions and rules elaborating on the abstract term in question. By replacing the domestic law with a European regime, connections and references between contract law and other areas of private law may be lost. Supplementing provisions might lose their sense, as the European contract code would probably use different abstract terms. Supplementing provisions at European level are missing; a "legislative background"<sup>85</sup> does not exist. Not only does the incorporation into domestic private law systems have to be analysed; the relation to public law, in particular constitutional law, needs consideration as well. For instance, the German Federal Court of Justice continuously adjudicates that blanket clauses – for example, the good faith provision – have to be interpreted with regard to constitutional provisions and principles. So far, the European level lacks a sophisticated system of general principles.

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82 Staudenmayer, above n 76, 676.

83 Christian Joerges "Interactive Adjudication in the Europeanisation Process? A Demanding Perspective and a Modest Example" (2000) ERPL 1 and following; Oliver Remien "*Einheit, Mehrstufigkeit und Flexibilität im Europäischen Privat- und Wirtschaftsrecht*" (1998) 62 RabelsZ 627 and following.

84 Christian Joerges "The Europeanisation of Private Law as a Rationalisation Process and as a Contest of Legal Discipline" (1995) 3 ERPL 175.

85 Staudenmayer, above n 76, 678.

Indeed, the questions posed have to be answered. However, the two aspects mentioned above are not insuperable. They emphasise the fact that the enactment of a uniform European contract code needs to be thoroughly prepared. In addition, one has to contrast the possible future problems as a result of the status quo. European and domestic provisions are not associated with each other conceptually or systematically.<sup>86</sup> Consequently, the relationship between European and domestic law is already a problem of the present situation and cannot serve as an argument against the unification of contract law. On the contrary, a European contract code offers the ultimate opportunity to solve these problems. Hence, this monumental project should be regarded as an opportunity rather than a peril.

(h) A global approach

It is claimed that a European solution is outdated.<sup>87</sup> First of all, a European codification would give rise to the question of the relationship of such a code to international conventions. Secondly, the phenomenon of globalisation urges the necessity of global, not European, solutions. However, a global solution is even harder to achieve.<sup>88</sup> The resistance to a European contract code indicates that a uniform contract code at European level is the maximum achievement possible today. Regardless of the fact that a global code might be realised one day, a start should be made at the European level now.

(i) A comparative look at other jurisdictions

The European discussion might benefit from developments in other jurisdictions. Opponents of further Europeanisation frequently refer to countries consisting of several judicial territories such as the United States or the United Kingdom.<sup>89</sup> Both are characterised by legal diversity; this did not prevent them from becoming important players in worldwide trade.

However, substantive rules in these states do not differ as it may appear from when first looking at the jurisdictional variety. With regard to the United States, the different states have actually strived to harmonise their laws on many occasions. The American Restatements of the Law<sup>90</sup> often

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86 Schmid, above n 71, 426.

87 Michael Joachim Bonell "Creating International Legislation for the Twenty-First Century: Do We Need a Global Commercial Code?" (2001) 106 Dick L Rev 87, 100.

88 Opinion of the Economic and Social Committee on the Communication to the Council and the European Parliament on European Contract Law (7 October 2002) ECOSOC INT/117 European Contract Law OJ C 241, 1.

89 See the response of the UK Government taking a rather critical position towards further harmonisation <[http://europa.eu.int/comm/consumers/cons\\_int/safe\\_shop/fair\\_bus\\_pract/cont\\_law/comments/1.4.pdf](http://europa.eu.int/comm/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/1.4.pdf)> (last accessed 21 June 2004).

90 Consider in particular, American Law Institute (ed) *Second Restatement of the Law of Contracts* (2ed, American Law Institute Publishers, St Paul (Minn), 1981).

serve as model law; so do the uniform laws drafted by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. The most successful uniform law is probably the Uniform Commercial Code (UCC). The UCC has been implemented by all states except Louisiana, which applies only part of it.<sup>91</sup> Consequently, the UCC may serve as an example for successful harmonisation.<sup>92</sup> In addition, it must be kept in mind that most commercial transactions are subject to the UCC and not the different state contract laws. Furthermore, although Louisiana is still regarded as a civil law jurisdiction, it has always been and still is heavily influenced by the common law system. The same applies to the British Isles, where the Scottish legal system cannot be regarded as a strictly civil law system, but has also been strongly influenced by the common law.

On balance, the different judicial territories existing in these countries can hardly be characterised by material discrepancies in their legal rules. The (formal) legislative competence may be distributed among many people, but there is always a tendency to reach similar substantive rules.

(j) An impossible task?

It is often claimed that comprehensive codification at a European level is impossible to achieve and, therefore, should not be tackled at all. To support this statement, cultural peculiarities and differences in legal mentalities or internal moralities are pointed out. The gap between civil law and common law systems is often mentioned.<sup>93</sup> Here, reference is also made to the fact that even the CISG has not been ratified by all EC Member States with Portugal, the United Kingdom and Ireland still missing.

In response to this argument, it must be admitted that differences between the legal systems certainly do exist. However, it should be taken into account that in fact the civil law and common law systems have come closer together. The civil law systems have developed a huge body of case law, whereas the common law systems are characterised by a broad range of legislation. Therefore it would be too restrictive to limit the argument to supposedly irremovable traditions.<sup>94</sup> Secondly, the European Principles in particular show that a compromise can be reached, thus bridging the gap between the different legal systems.<sup>95</sup> Furthermore, international lawyers operating in a European

91 Honka, above n 56, 159.

92 Schmid, above n 71, 485.

93 Pierre Legrand "Codification and the Politics of Exclusion: A Challenge for Comparativists" (1998) 31 UC Davis L Rev 799; Pierre Legrand "Structuring European Community Law: How Tacit Knowledge Matters" 21 Hastings Int'l & Comp L Rev 871; "Against a European Civil Code", above n 63; Pierre Legrand "European Legal Systems are not Converging" (1996) ICLQ 52; Pierre Legrand "Comparative Legal Studies and Commitment to Theory" (1995) MLR 262.

94 Van Hoecke and Ost, above n 69, 70.

95 European Principles <[http://www.cbs.dk/departments/law/staff/ol/commission\\_on\\_ecl/pecl\\_full\\_text.htm](http://www.cbs.dk/departments/law/staff/ol/commission_on_ecl/pecl_full_text.htm)> (last accessed 21 June 2004). The European Principles are a non-binding set of contract law principles.

context experience no difficulties in overcoming differences with their foreign colleagues.<sup>96</sup> In conclusion, the differences are not insuperable. One should keep in mind a quotation of Ole Lando:<sup>97</sup>

So, if an observer from another planet came to Earth to see how *homines judicantes* behaved in different parts of the world, he would find that they spoke different languages, wore different garments, observed different rules of the game, and were governed by different laws in deciding the merits of disputes. But if he came to study their minds, their behaviour and their actual decisions, he would discover striking similarities.

(k) Problems of interpretation

Proponents of Europeanisation further claim that uniform rules would not lead to uniform law, as the rules are most likely to be interpreted differently throughout Europe, with courts being influenced by their national legal traditions.<sup>98</sup> Consequently, unification could be senseless if its objectives were foiled by inconsistent interpretation.

As to this argument, two aspects have to be considered. First of all, the fear of inconsistent interpretation is nothing but a wild guess. When looking at the drafting process of the UNIDROIT Principles and the European Principles, it becomes apparent that despite all differences between the national contract laws, jurists from all over Europe can agree upon a compromise. Consequently, it is not unlikely that courts in different states will interpret European provisions in a similar manner. Secondly, non-uniform interpretation can be avoided by establishing a European jurisdiction. The European Court of Justice (ECJ) in its present state may be unable to fulfil this task; this is obvious when considering that a proceeding pursuant to article 234 of the EC Treaty takes around two years.<sup>99</sup> However, interpretation problems could be mitigated by expanding European jurisdiction.<sup>100</sup>

(l) The legislative quality of a European contract code

Quite often a European contract code is not opposed because of doubts about having a uniform set of rules as such. Rather, it is feared that such a code would suffer from many quality defects. First, the implementation of a European contract code is a huge task. To overcome resistance,

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96 Van Gerven, above n 42, 162; Schmid, above n 71, 438.

97 Ole Lando "Homo Judicans" (1998) 1998 ULR 535, 544.

98 Jacques Delors and Stephen Weatherill "Can there be Common Interpretation of European Private Law?" (2002) 31 Ga J Int'l & Comp L 139 and following.

99 Schmid, above n 71, 432.

100 Schmid, above n 71, 432; J P Jacque and J Weiler "On the Road to European Union - A New Judicial Architecture" (1990) 27 Com Mkt L Rev 185 and following. See Part III C 3 The procedural dimension.

compromises have to be reached. Such compromises may lead to poorer legislative quality. Second-best rules might be chosen to be part of the codification because they are politically the most acceptable. Secondly, entrepreneurs may resist contract law integration because, according to previous experiences, that could mean increased consumer protection.

In the end, referring to the alleged bad quality of a European contract code is hardly convincing. It cannot be dismissed that previous European legislation has often been poorly drafted. However, a project such as a European contract code is not likely to be drafted by civil servants of the European Commission. The commitment of a highly experienced group of academic experts and legal practitioners would not only prevent poor drafting, but also ensure that political influences are minimised. Secondly, a European contract code would not inevitably be too consumer-friendly. As the European Principles show, a European contract code could be a well-balanced set of rules. The European Principles are neither neoliberal nor carry social elements to excess. It might be the case that such a code would lead to a strong emphasis on contractual solidarity, but this is the current status of all European codifications. Yet, as solidarity mechanisms have already been integrated into national private law systems, the current state of the law would not be essentially altered.<sup>101</sup> In conclusion, quality arguments cannot be used against comprehensive legislation; quite the contrary, this project should be taken as a chance to improve the quality of contract law.

### ***B The Need for a Legal Basis***

It has been shown that action at European level has to be taken. Naturally, existing legislation should be reviewed and improved. In addition, a set of non-binding principles of European contract law has to be developed, in the end leading to a European contract code. For all the aforementioned steps, a legal basis has to be provided. As the current legislation is almost completely based upon article 95 of the EC Treaty, improving measures could also be based on that article. The development of non-binding contract law principles naturally needs no legal basis at all.<sup>102</sup>

Finally, a legal basis needs to be found for the enactment of a European contract code. As a starting point, the principle of limited powers has to be considered. This principle, also known as the principle of conferral, is enshrined in article 5(1) of the EC Treaty. It commits the Communities to act within the limits conferred upon the European organs by the Treaties and to the objectives assigned to them therein. First, article 65 of the EC Treaty does not provide the legal basis needed for comprehensive legislation, as it only deals with judicial cooperation, touching areas such as cooperation in taking evidence, recognition and enforcement of judicial decisions, choice of law rules and civil proceedings. Secondly, article 95 of the EC Treaty is also not an appropriate legal

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101 Schmid, above n 71, 485.

102 Staudenmayer, above n 76, 681.

basis.<sup>103</sup> This article allows the Communities to adopt all kinds of measures, directives and regulations for the approximation of national provisions, but only in so far as such measures have as their objective as the establishment and functioning of the internal market. The European Court of Justice suggests that measures can only be based upon article 95 of the EC Treaty if these measures genuinely have the objective of eliminating impediments to the internal market, either with regard to present or future obstacles.<sup>104</sup> That is obviously not the case where unification of a whole set of provisions regulating private or contractual relations in general is envisaged. Finally, article 308 of the EC Treaty is also not an appropriate legal basis for a European contract code. According to that article, the Communities may act if action is necessary to attain one of the objectives of the Treaties but the Treaties have not provided the necessary powers. The principles of subsidiarity and proportionality prevent the European legislator from relying on article 308.

It should be acknowledged that just recently, on 18 June 2004, the draft of a European Constitution<sup>105</sup> has been adopted with some modifications by the Conference of the Representatives of the Governments of the Member States in Brussels.<sup>106</sup> Although the Constitution does not come into force before being ratified by all Member States, it must be asked whether the European Constitution, once in force, will include a legal basis for a European contract code. Conceivably, the "exclusive competence" in article I-12 (1) – common commercial policy – or the "shared competence" in article I-13 (2) – internal market or consumer protection – may apply. In the end, with regard to subsidiarity and proportionality, this has to be denied. Such a comprehensive legislative project needs a specific competence or an enactment by way of international treaty.

It has been established that there is no legal basis for the enactment of a European contract code. However, this cannot be used as an argument against such a code. The Member States have the power to amend the EC Treaty in order to create a legal basis. They could alternatively conclude an international ad hoc treaty, directly implementing a European contract code. In conclusion, the analysis has identified the need to attend to creating a legal basis but has not diluted the argument for a European contract code.

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<sup>103</sup> Some legal scholars support the view that the EC Treaty, art 95 can be used: Basedow *The Private Law Systems in the EU*, above n 65, 1186, referring to the EC Treaty, art 100A – numbers were changed in 1997 due to the Amsterdam Treaty.

<sup>104</sup> Case C-376/98 *Federal Republic of Germany v European Parliament and Council of the European Union* [2000] ECR I-08419; Case C-491/01 *The Queen v Secretary of State for Health and Others, ex parte Imperial Tobacco Ltd and Others* [2002] ECR I-11453.

<sup>105</sup> Drafted by the European Convention (headed by Mr Valéry Giscard d'Estaing as Chairman) <<http://european-convention.eu.int/docs/Treaty/cv00850.en03.pdf>> (last accessed 21 June 2004).

<sup>106</sup> <[http://ue.eu.int/ueDocs/cms\\_Data/docs/pressData/en/misc/81109.pdf](http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/misc/81109.pdf)> (last accessed 21 June 2004).



### *C Supplementing Measures*

So far it has been proven that the Communities need to engage in further unification efforts, finally leading to the enactment of a European contract code. On the verge of this monumental project, supplementing measures have to be taken into consideration. First, areas of property law have to be included in the unification process. Furthermore, international private law should be harmonised more widely. Finally, procedural issues have to be tackled.

#### *1 Inclusion of property law issues*

It has already been indicated that contract law interconnects with various other areas of the law. Most notably, economic linkages to property law have to be considered.<sup>107</sup> In order to ensure a coherent overall concept, this relationship between contract law and property law must be acknowledged by including core areas of property law in the scope of unification efforts. Two areas illustrate the argument.

First of all, rules regarding the transfer of title should be harmonised. Diverging legal requirements as to the transfer of title create a great deal of legal uncertainty. Secondly, the rules governing securities with regard to movable goods must become the subject of harmonisation efforts. For example, retention of title clauses are treated differently in the various Member States; whereas Germany acknowledges nearly all kinds of retention of title clauses, other states such as Sweden treat many retention of title clauses as void. Furthermore, some security instruments used in Member States are unknown in other states. For example, the *Sicherungsübereignung*<sup>108</sup> is common in Germany but not used in Austria.

Legal diversity in property law creates even more problems than those shown for contract law. International property law limits party autonomy; therefore, choice-of-law clauses cannot attenuate the existing problems. The applicable law is always the *lex situs*, meaning the law of the jurisdiction, in which the goods are located. Consequently, securities valid in one state may diminish as soon as the goods are transported to another state that does not acknowledge the respective security. In conclusion, it may be unrealistic to unify the area of property law as a whole. However, when harmonising contract law, core areas of property law such as transfer of title and securities regarding movables should be included. Only then can a uniform contract law fully have positive effects on the European economy.

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107 Staudenmayer, above n 76, 674.

108 *Sicherungsübereignung* means the transfer of chattels, for example cars, to secure a debt. While the creditor acquires the ownership, the debtor keeps possession of the chattels. Thereby, the debtor can continue to use the chattels, for example for the business, but still use them as security.

## 2 *Further unification of international private law*

For the European economy to prosper, a European contract code has to be enacted. However, such a monumental project will take years to be realised. Therefore, preliminary measures must be implemented to guarantee a smooth functioning of the internal market to the greatest possible extent. As mentioned above, international private law may help in reaching that aim. The Rome Convention is helpful in this respect, but still suffers from some weaknesses. In particular, the scope of application has to be widened in order to truly achieve a uniform international private law. In this context it has to be noted that the European Communities are on the right track, with the European Commission having just published a Green Paper on the reform of the Rome Convention.<sup>109</sup>

## 3 *The procedural dimension*

European contract law also has a procedural dimension. So far, mostly substantive law issues have been addressed. However, a uniform contract law will not be effective as long as striking differences regarding procedural rules exist. Contracts must not only be governed by uniform provisions, their enforcement must likewise be subject to uniform rules.<sup>110</sup>

A procedural dimension in this context relates to the question of whether one should rely on national courts to interpret and apply European contract law, or whether a European system of courts should be established. First, it has already been indicated that courts in different Member States may interpret uniform European rules differently. It has also been pointed out that this is only an assumption; however, the danger of non-uniform interpretation exists. This must not prevent Europe from enacting a European contract code, but should encourage all involved to strive for an extension of European jurisdiction.<sup>111</sup> Secondly, even if uniform interpretation can be reached, much disparity would still be maintained by the nature of judicial processes, which are in charge of the enforcement of contracts.<sup>112</sup> Harmonisation of substantive provisions is not effective if litigation costs and other institutional incentives discourage litigation in most of the cases. In conclusion, the European Communities have to put great effort into implementing uniform contract law rules, but must also ensure that procedural rights are harmonised as well.<sup>113</sup>

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109 COM (2002) 654 Final.

110 Harald Koch "Einführung in das europäische Zivilprozessrecht" (2003) JuS 105, 105.

111 In detail see Hannes Roesler "Zur Zukunft des Gerichtssystems der EU – Entwicklungstendenzen des EuGH zum Supreme Court Europas" (2000) ZRP 52.

112 "Efficiency and Equal Protection in the New European Contract Law", above n 55, 566.

113 For further details see Konstantinos Kerameus "Procedural Implications of Civil Law Unification" in Arthur Hartkamp and Martin Hessellink and others (ed) *Towards a European Civil Code* (2ed, Kluwer Law International, Amsterdam, 1998), 121 and following.

#### IV CONCLUSION

Unification of law is always a highly controversial and very emotive topic. This is the case not only in Europe, but also in the international discussion relating to unification of laws. For example, Rene J David, a strong supporter of unification, wrote:<sup>114</sup>

Let jurists continue in their routine opposition to international unification of law; nevertheless, that unification will occur without and despite them, just as the *ius gentium* developed in Rome without the pontiffs, and as equity developed in England without the common-law lawyers. Today the problem is not whether international unification of law will be achieved; it is how it can be achieved.

On the other side, Martin Boodman, strongly resisting any unification efforts, regards "harmonisation as a myth".<sup>115</sup>

The general question to be answered is whether European contract law should be unified, in particular with regard to cross-border trade implications. First, regardless of a variety of international and European instruments, legal diversity still prevails. This diversity actually hampers international trade to a remarkable extent. Consequently, the question to be answered is how to approach these problems.

This article has discussed various options. It has been shown that international trade problems will not be solved by self-regulation alone. Regulative action at a European level has to be taken. In the end, contract law in Europe must be comprehensively unified, and a European contract code enacted.

However, an incremental approach has to be taken, considering not only theoretical arguments but also practical implications. First, existing EC legislation has to be reviewed and improved. This includes looking at the general quality of drafting, remedying inconsistencies in European contract law, simplifying and where necessary clarifying existing legislation, adapting existing legislative measures to take account of new developments and filling gaps. In this respect, the European Commission has already taken action. For instance, the SLIM Initiative<sup>116</sup> or the BEST Action Plan<sup>117</sup> are supposed to improve regulatory quality and reduce the regulatory burden. These initiatives have to be continued and must be extended.

This process should be supplemented by a new information management system. Essentially, a database has to be created gathering relevant contract law information. This has not been tackled

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114 Rene J David "The Methods of Unification" (1968) 16 Am J Comp L 13, 27.

115 Martin Boodman "The Myth of Harmonization of Laws" (1991) 39 Am J Comp L 699, 708.

116 "Simpler Legislation for the Internal Market (SLIM): A Pilot Project" COM (1996) 204 Final; see also "Review of SLIM: Simpler Legislation for the Internal Market" COM (2000) 104 Final.

117 "Action Plan to Promote Entrepreneurship and Competitiveness" COM (1998) 550 Final ["Action Plan"].

yet, but was addressed by the European Commission in the 2003 Action Plan. Here, the European Commission suggested establishing a common frame of reference, which is supposed to be a publicly accessible document helping all that are involved in the harmonisation efforts.<sup>118</sup>

Secondly, a non-binding set of European contract law principles has to be established. In this regard, the European Principles may serve as a first draft. The UNIDROIT Principles and the rules of the CISG also have to be taken into consideration. Once the principles are properly drafted, they should be publicly discussed and promoted, not only in academia, but also among legal practitioners. They should be made the subject of legal education throughout Europe. To support both the development and the discussion of such principles, the debate on Europeanisation needs to be institutionalised. Following the American Law Institute, a European Law Institute or a European Law Academy should be established. This institute could not only lead the discussion, but also provide a central website to offer information; it is important to note that not only the text of the principles but also an official commentary should be available free of charge on the internet.

Thirdly, the set of principles should serve as a draft for a European contract code, so the idea of codification imposed "from below" would be realised. It has been shown that the advantages of such a code far outweigh the disadvantages. The harmonisation of contract law began decades ago. These efforts have only been helpful to a certain extent. In particular, the implementation of European Directives has destroyed much of the national laws' coherence. European integration has moved beyond a point of no return. The work started has to be finished, and a coherent European system needs to be established. Its provisions must be simple, clear, not too abstract, accessible and comprehensive. It is important that such a code must not be a pale compromise between the various legal systems. A different drafting approach has to be taken than is common for other European legislation, which has been described as "negotiated law".<sup>119</sup> Here, only the best and most convenient rules have to be selected and combined to a consistent regime.

As the enactment of a European contract code will take years to realise,<sup>120</sup> this step-by-step approach needs to be supported by preliminary measures, particularly the wider harmonisation of international private law. In addition to substantive law unification, jurisdictional aspects have to be considered, such as expanding European jurisdiction.

When Voltaire travelled in France, he is reported to have claimed that the laws changed every time he changed horses.<sup>121</sup> It will take time to overcome existing resistance, but signs are promising

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118 For information on this project see Action Plan, above n 117, point 59.

119 Staudenmayer, above n 76, 676.

120 See for example the new Dutch Civil Code. In 1947, Queen Wilhelmina commissioned Prof Meiers to prepare a new Code. It took 45 years before the essential parts of this Code took effect in 1992.

121 See Ole Lando "Is Codification Needed in Europe? Principles of European Contract Law and the Relationship to Dutch Law" (1993) ERPL 157, 159.

that in future it will be possible to cross borders in Europe without a change of contract law. Let us follow Ugo Mattei: "Hard Code Now!".<sup>122</sup> International trade is certainly looking forward to that time.

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<sup>122</sup> "Hard Code Now", above n 42.

