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European Contract Law: the politics of law

The European Commission wants a European Contract Law for the European Union. Not to replace national laws, but to be available to contracting parties to choose instead of national laws, should the parties so wish. The Commission's overt reason for this is that it hopes that the option of a European Contract Law will remove an obstacle to the proper functioning of the internal market within the European Union. The covert reason may have more to do with the vision of Europe. Whatever the reason, if the Commission gets its way, will its new law be of real value to the financial services industry? Or, should as one committee of the European Parliament has suggested, financial services be excluded from its scope? Is the ability to sell across Europe on the same contract sufficiently advantageous to outweigh the costs and uncertainties of a new law?

Laws are usually passed in order to achieve a wider purpose such as protecting consumers and curbing drug user. Seldom is the aim simply to pass a law regardless of its content. Yet that is where the European Commission is heading with its proposals for a European Contract Law. It wants a European Contract Law as soon as it can get one, but it is happy to leave the content to others. The act of passing the law is what counts, not the law itself.

Coded messages

This is the politics of codes. Napoleon did not create his great code out of an enduring fascination with the intricacies of offer and acceptance or the effects of a pre-contractual misrepresentation. His aim was to abolish local customs, exemptions and privileges, unifying under a single law a population only some half of whom even spoke French. So it is with the Commission. We already have a large bulk of EU law, but it remains a fragmentary superimposition on national laws. The symbolic effect of an EU contract law, even one sitting alongside national laws, could be immense, perhaps going some way towards undoing the damage to the European vision caused by the failed EU constitution.



The title of the Commission's Green Paper leaves no doubt as to where the Commission is headed. The Green Paper

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is about "policy options for progress towards a European Contract Law for consumers and businesses". The issue for the Commission is not about whether there should be European Contract Law; it is how to get one.

Delving deeper into the Green Paper, the Commission offers seven options, from doing nothing at one end of the scale to a European civil code replacing all national laws at the other. However, as with a certain kind of multiple choice test, most of the options can immediately be rejected; after eliminating the absurd, what remains must be the right answer. That right answer in this case is an optional instrument of European contract law – sorry, European Contract Law – that parties could choose as the governing law of their contracts instead of, say, English, French or German law. Whether there should be an optional European Contract Law is the real question, though the Commission's favoured answer is equally clear.

The implications of a European Contract Law are potentially very wide-ranging since so much in the financial world hinges on contract law – bank accounts, loans, custody arrangements, acquisitions, capital, derivatives and so on. Everyone connected to the financial markets should be interested in the Commission's plans, whether to cheer it on or to oppose it trenchantly.

The common frame of reference

Since it is heading towards a European Contract Law, it is fortunate that the Commission already has available a document that looks remarkably like a European Contract Law. In 2003, the Commission embarked on the creation of a "common frame of reference" for contract law. This enigmatic title meant different things to different people. However, as the academic group contracted to produce the common frame of reference was called the Study Group on a European Civil Code (SGECC), it was no surprise that its work, published in 2009, turned out to be a draft code. Indeed, it turned out to be a code that stretched beyond the bounds of contract law into, for example, property and insolvency law.

The Commission has now employed an "Expert Group" to cut down the common frame of reference to contract law alone. The group's initial instructions are to produce a "user-friendly and legally certain set of approximately 150 rules", focusing (though not exclusively) on consumer transactions.

Politics and legality prevent the Commission from saying overtly that it wants a European Contract Law in order to drive the European vision onwards (though EU Justice Commissioner Viviane Reding has come close to saying this). Instead, the expressed argument for a European Contract Law turns on the proper functioning of the internal market. Different contract laws may, the Commission says, make businesses reluctant to sell across the EU's internal borders and similarly may make consumers reluctant to risk buying over the internet from suppliers in other countries. The functioning of the internal market is therefore obstructed, particularly for consumers in the smaller member states, by the existence of different contract laws. A route around this obstacle is required, and that route is a European Contract Law.

In the financial markets, the Eurocrats are not concerned about the choice of law to govern cross-border transactions between large institutions. In business to business dealings, the parties can employ lawyers and make their own informed and negotiated decisions as to the law they want to govern their transactions. In addition, business thrives on certainty, commonly built on the precedents of many decades, even centuries. A new European Contract Law will not be able to compete with national laws in this field. For example, the drafts so far prepared all include an overriding obligation of good faith. But what does 'good faith' mean? Will it follow the German model, the French model, or will the courts create a new, European meaning? How will an obligation of good faith affect the ability to close out a derivatives transaction or call an event of default under a facility agreement?

European Contract Law may eventually be available, but it is hard to see why a multinational financial services business would opt to write its commercial derivatives contracts, its facility agreements or anything else by reference to a law whose uncertainties could only be resolved through the offices of the Court of Justice of the European Union which is a court that is not renowned for its speed, its commerciality or its predictability. Even if European Contract Law were to be chosen, it would not necessarily avoid the need to consider other laws. In, for example, cross-border acquisition financings or securitisations, the laws relating to the location and treatment of assets, intellectual property, or the insolvency of the parties, are all as relevant as contract law, and will remain so notwithstanding any European Contract Law.

So the argument for a European Contract Law turns on the benefit to consumers. Is it appropriate in this context? Not even consumer organisations think that concerns over contract law seriously inhibit consumers from making cross-border purchases. How many consumers are familiar with their home consumer protection and other laws, let alone bothering about anyone else's? Does the lack of knowledge of French or German law really deter an English domiciled party

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from buying insurance from AXA or Allianz? The point is regularly made that of greater importance to consumers is the ability to secure practical redress should something go wrong – for example, is there someone who speaks the same language at the other end of the phone to chase up delivery? For financial institutions, this issue is typically solved by having an international retail network with local native speakers on the ground to deal with queries or customer complaints.

But the Commission's argument does not turn on the fears and expectations of consumers. Rather, it turns on the effect of Europe's many contract laws on businesses, particularly SMEs, which supply goods and services to consumers. In this regard, the greatest contractual deterrent to a business that wants, say, to use the internet to sell to consumers across the EU's internal borders is the EU's own legislation. Article 6(2) of the Rome I Regulation on the choice of law gives consumers the protection of their home laws whatever law governs the contract. A diligent business must, therefore, take legal advice on the consumer protection laws of each country into which it wishes to sell – ultimately on the laws of all 27 EU member states. This is not a small or cheap task. How much cheaper for a business, including one in the financial sector, which wants to trade cross-border to be able to write its consumer contracts just once under a single, European law, rather than having to take legal advice from lawyers in each member state.

A European Contract Law could achieve this if it allowed the choice of a European Contract Law that incorporated consumer protection provisions and which was not overridden by national laws (ie article 6(2) of the Rome I Regulation ceased to apply). But the ECON Committee of the European Parliament has adopted a report which supports the optional instrument in general terms but which also proposes a specific exclusion for financial services on the basis that the Commission should consider financial services at a later stage. Financial services are already surrounded by a considerable volume of EU regulation, but should a reform available to other businesses and that might make it easier to sell across borders be side-lined as far as the financial services industry is concerned, at least for the time being?

Consumer organisations are concerned at the prospect of a single set of consumer protection laws. At present, each member state of the EU has its own consumer protection laws that have been built from a foundation of EU directives. Are those countries that have given consumers rights significantly exceeding the EU's minimum standards prepared to expose their consumers (and voters) to the potentially lower standards of protection that might be provided by a European Contract Law? Are those who have kept consumer protection to a minimum prepared to risk discouraging suppliers and business by giving more onerous, and potentially more costly, consumer rights?

The political augurs in this respect are not good. The EU has been trying to agree a consumer rights directive that would harmonise consumer protection provisions for some years, but has failed to reach consensus because of these very issues. Why should negotiations on a European Contract Law fare any better?

Legality

Nevertheless, the Commission is moving ahead with its plans for a European Contract Law. It is, however, coy about the legal basis upon which it is entitled to legislate for a European Contract Law.

Whatever the underlying economic and political arguments, the principle of legality is important in itself. The Commission should act within the EU's powers, as article 5 of the Treaty on European Union obliges it to do. The Commission should not be spending time and money on a matter while at the same time avoiding the question of whether it has the power to do so.

Legality is linked to the impact assessment that the Commission must carry out because of the focus on the internal market. To justify legislation aimed at solving a defect in the single market, the Commission must have evidence to show that the problem exists and both that it will be cured by the proposed solution and that the solution is proportionate and meets the requirement of subsidiarity. The Commission has yet to conduct a full impact assessment – a detailed analysis of the underlying problem and the potential solutions. Without the impact assessment, who can say whether different national contract laws really are an obstacle to the internal market or, if they are, whether they are significant enough when set against other obstacles or solutions to justify a whole new legal infrastructure?

Does it matter?

If the Commission can find a legal basis for its European Contract Law that passes the cardinal requirements of subsidiarity and proportionality, does it matter for the financial services industry if the EU does legislate for an optional European Contract Law? There are two views, at polar extremes.

On the one hand, what harm can an optional instrument do? If parties want to choose it as the governing law of their contract, that's a matter for them. The financial industry frequently exercises its right to choose the governing law of a

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contract. On what logical basis can it oppose more choice? Indeed, the extra choice might offer advantages. For those who sell services across Europe (bank accounts, insurance contracts, custody services, escrow accounts, other fiduciary services and so on), it might be easier to do so under a single form of contract governed by a neutral European Contract Law rather than having to be concerned with the laws of each member state. Each supplier can decide whether the European Contract Law is sufficiently certain and otherwise meets its needs. A survey in 2005 by Clifford Chance found that 83 percent of European businesses favoured an optional European Contract Law.

On the other hand, the certainties afforded by these laws are essential to underpin European financial services. Lord Kerr's comment in the House of Lords that "the optional turns into the obligatory over time in the European Union" is often quoted in this regard. What would happen to financial services if Lord Kerr's prediction comes to pass, and national laws were replaced by the European Contract Law? Would international business move to New York, Geneva and other locations outside the EU rather than adopt the sole new law? But, against this, is it a sound basis on which to object to an extra law that, in future, someone might suggest that pre-existing laws be removed, a suggestion that no one is seriously making now? Why cannot that suggestion be repelled if and when it is made?

There are also practical objections. Lawyers, including judges, across Europe would need to learn about the new law, at considerable cost. Appeals as to the meaning of the new law would ultimately have to go to the Court of Justice of the European Union, which is already overstretched. Would it be able to cope with a flood of cases requiring its decision as to the meaning of a European Contract Law? Might the Court need to develop a commercial division at further cost?

Where's the beef?

So far we have been discussing the politics of a European Contract Law, the need for it and its legal base within the European Union. But what about its content? Will the common frame of reference, and any European Contract Law built on its foundations, be any good as a contract law? A yawning gap in the Commission's long march is the absence of any serious discussion on the content of its European Contract Law. The Commission treats the content as if it were purely a technical matter that can be left to experts to resolve without any open debate. But contract law isn't like that. Each problem in contract law is susceptible to numerous possible solutions. Value judgements must be made as to whether, for example, there should be an overriding obligation of good faith, whether contracts should be interpreted objectively or subjectively, when terms added in a written confirmation of an oral contract should be binding, and so on. There is no single right answer. If there were a single right answer, choice of law would not be an issue.

The Commission first left the content of its common frame of reference to the SGECC, and has now passed that content to its Expert Group with instructions to build a European Contract Law. Where in this process are the politicians and the practitioners, the businessmen and the consumers? Unless there is wide involvement in the process, few will have confidence that the product meets their needs, that it is practically grounded and that it is sufficiently certain in its meaning.

The Commission's reluctance to open out the discussion of the content, as well as the recent imposition on its Expert Group of an arbitrary cap of 150 rules, is probably to do with speed, which comes back, full circle, to politics. Discussion, negotiation and compromise tend to be slow processes, and European Commissioners want results now (well, by the second half of 2011, in time for the Polish Presidency of the EU, which is reputedly enthusiastic about the project). That very desire for speed could undermine the Commission's work. If businesses and others lack confidence that European Contract Law meets their needs, they won't use it. And where will the vision of Europe be then?

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