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LEGAL AFFAIRS

# An Optional Instrument on EU Contract Law: Can it Increase Legal Certainty And Foster Cross Border Trade?

## Scope and content of an optional EU contract law instrument

**Abstract**

Law is one of the rare science that is not of universal understanding. It remains secluded within national frames, with practitioners being, for the most part, blind to the specificities of that of other countries. However, at a time where cross border trade is expanding apace, places with no regulation are spreading alike. There is thus a sharp need for legal securitization, which could be achieved through harmonized instruments that, at first, would adequately be optional to serve as a test for future further legislation.

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# LIST OF ABBREVIATIONS

| | |
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| **ICC** | International Chamber of Commerce |
| **CCBE** | Council of Bar and Law Society in Europe |
| **B to B** | Business to Business |
| **CFR** | Common Frame of Reference |

# EXECUTIVE SUMMARY

The national nature of contract law through Europe leads to such differences that legal practitioners can not develop their professional skills in more than one jurisdiction.

For consumer contract law which is more a common protection law, Europe has been very active through several directives.

It remains that those sectorial directives needs to have their legal principle harmonized in order to be easier to use and to carve common principles of European consumer laws.
This process is well under way.

In relation to B to B contract law Europe has not so far proposed any instrument. Such an instrument cannot derive directly from consumer contract law. In order to appraise the situation it is necessary to understand the real world of B to B transactions.

An illustrative example of a cross border engineering contract between a French and UK company illustrates the fundamental cultural and legal differences. It gives an idea of the scope of additional risks and costs currently incurred by both parties in European cross border transactions.

Although the CFR is a most important and needed comparative law effort its scope and contents do not permit to resolve the practical legal issue in European cross border trade in the years to come.

An optional instrument on European B to B contract law is probably the best solution to securitize cross border transactions and foster European trade.

However in order to be welcomed by the end users for their day to day practice such an instrument need to be proposed and designed with a fresh and tested methodology.

# *KEY FINDINGS*

- *Law is national by essence; there hardly are identical solutions to common issues in various states, however akin is the culture they share, as the case is in Europe. As a result, a lawyer is only allowed to practice in his own country and usually knows, and applies; his own national set of laws impairs the design and implementation of cross-border contracts.*

- *As national as the law is, it is unlikely that harmonisation will naturally emerge and foster cross-border trade.*

- *Considering the foregoing, the attempt for a European contract law, which as of now has led to a common frame of reference, deserves credit. However, the achievements remain quite unsatisfactory, but for consumer relationships, that, particular as it is, can not be a reference for B2B contract law.*

- *Nonetheless, other institutions have proposed some instruments, which proved to be useful. The Vienna Convention on Contracts for International Sales, the UNIDROIT principles, etc...*

- *It remains that the industry does not give a lot of credit to the CFR approach and content for removing the hurdles faced on a day to day basis.*

- *An optional European instrument is necessary to securitize cross border trade and foster European transaction.*

- *However the design of such an instrument needs to be based on a proven assessment and drafting methodology substantially different from the CFR design methodology.*

# 1. INTRODUCTION

## 1.1. The legal science and its practice: a science within closed national borders

In order to assess the possible benefit of an optional instrument on EU contract laws, it is important to remember that law is probably the only science of paramount universal interest which is so different from one country to the other. One could even wonder whether it is a science. The pragmatic answer of a legal practitioner may only be positive since as for any science which impacts on the day to day life it may only be practiced in a useful and safe manner by individuals with proper education, training, and eventually certified qualification. This science is particularly complex since it is based on a fragile and ongoing research of the equilibrium of an acceptable framework of rights and obligations in a society at a given time and taking into account a political vision.

As a result, the level of qualification and certification of the practitioners of legal science has to meet very high standards. The consequences are that in Europe a legal practitioner authorized to practice in a particular country is not authorized to defend the case or to provide legal advice in another jurisdiction. This has been illustrated by the French Minister of Finance Christine Lagarde, who was previously the managing partner of one of the largest US global law firms. She explains that the legal science and its practice is maybe the most topical example of a situation where someone can be recognized as an expert in his country and only a tourist in any other country in the world. The legal practitioner runs the risk in addition to be prosecuted for any attempt to practice his science outside of his registered country.

## 1.2. National contract laws impair the development of cross-border contracts

There is little doubt that this situation in the area of contract law, is impairing legal certainty for cross border contracts. Indeed if one considers that the development of the contract law and its practice in a particular jurisdiction is very much based on the traditional legal culture with important reliance on case law it is not reasonable to expect a natural development of a harmonized contract law between regions and states especially at European level. When assessing a national legal system and its practice, there are little chances that, in spite of globalization, national forces alone could contribute to the development of paramount legal principles, rules and procedures facilitating legal certainty for cross border contracts and fostering cross border trade. It is also clear to the experienced legal practitioners that authorizing a lawyer duly certified for a jurisdiction to practice in the same manner in another will not resolve the matter for various reasons.

## 1.3. Europe has already played a major role in harmonization of contract laws. however this is limited to consumer contract laws

For several decades now this situation has given rise to debates at political and academic level. The comparative law effort throughout Europe in relation to the possible content of European contract law which has resulted in the Draft Common Frame of Reference (DCFR) is without precedent and of very high quality by all academic standards. However, it

remains that for legal practitioners and businesses having to develop and to execute a contract across the European borders, the situation has not much changed in practice in the last decades with the notable exception of consumer laws for which several sectorial directives have been issued leading to a high degree of harmonization. However, even in this matter, it is recognized that the "European consumer contract law" deriving from those directives and commonly refers to as the "Community Acquis" needs to a large extent to be streamlined and drafted in simple terms and appropriate methodology. This has given rise to many comments from the stakeholders including representatives of the legal professions through CCBE all in favor of a horizontal instrument and an umbrella directive which appears to be well under way.

## 1.4. Harmonization of contract law for B to B relationship remains a question with some limited answers

In relation to contract between business entities (the so called B to B contracts) there is no doubt that the general harmonization is in the limbos. Sectorial harmonization efforts have been made but more coming from international treaties, association or business organizations. This is for instance the situation for the Vienna convention on contracts for the international sales of goods (1980), or of the Unidroit principles of international commercial contracts (2004), or Uniform rules for demand guarantees published by International Chamber of Commerce (ICC) (2010), ICC Model Distributorship Contract also published by ICC (2002), etc.

# 2. HARMONISATION OF CONTRACT LAW IN B TO B SITUATION: THE REAL WORLD

## 2.1. A possible optional EU instrument should not be based on the common contractual principles of European consumer laws

The benefit of a possible optional instrument on EU contract law may be assessed from different angles. The answer is likely to be different for Consumer law and consumer acquis and B to B transactions. A basic reason for this relates to the rationale which has been at the origin of the pro active European consumerism effort having given rise to several directives. Consumer Contract Law, as well put by Pr E. Balate from is a "law of fight" ("droit de combat") protecting collectively a weak party and restoring as much as possible a freedom to enter or not into a contract (or at least to enjoy reasonable terms and effective remedies when the contract is concluded). B2B contract relationships, with some notable exceptions of situation of strong economic and commercial imbalance (subcontracting in some areas, small businesses, etc.) are based on the paramount principle of freedom of contract and this is essential for developing entrepreneurship and cross border transactions. This is recognized in all jurisdictions (with some nuances) throughout Europe. The real question for B2B is then: how an optional instrument could be organized in such a way that is does not affect the freedom of contract and at the same time increases certainty and securitize effectively cross border transactions (i.e. with tangible and reasonable results)? First of all, it is unlikely that the contractual definitions, principles and relative rules deriving from the consumer acquis could be usefully referred to since they have an underlying objective far away from the B2B contract law objectives. Then the question cannot be answered without some policy decisions, on the scope of freedom of contract and regulation in some areas (but this is outside of the scope of this note). As any legal practitioner involved for decades in cross border contracts, my contribution to the debate may only come from illustrative examples of the issues faced in the real world of cross border European contracts.

## 2.2. Illustrative example: The development of a cross border engineering service contract

Among many possible examples in various fields of Contract Law, I propose the example of an engineering service contract to be entered into between a French engineering company and a UK client (example: automobile or contracting sector).

### 2.2.1. Fundamental differences in contractual approaches by the business players

In practice, as early as the contract formation stage, a responsible party will have to assess how to exchange in an oral and written form in order to avoid being committed when not intended or not being committed when intended.

It often happens during this process that each party circulates some standard conditions or template used for its domestic transaction. When this is the case, both parties are generally surprised by their respective content and length which in several important areas will appear awkward to the other party and results in misunderstanding. Once the parties have more or less reached a compromise on the main commercial terms of the transaction, the

exchange of the real draft is often a painful and lengthy exercise essentially due to the particulars of each legal culture and contract law.

In order to better appraise the matter, let us assume that each party proposes to the other a draft contract based on its understanding of the commercial terms that it is ready to sign in its normal course of business.

Typically the French part is likely to propose a short document, with few or no definition at the outset, but with substantial whereas summarizing the intention of the parties and their capacity. Then the content of the contract will generally include a concise object clause, followed by more detailed but concise scope, and thereafter a well defined price and conditions of payment clauses. Several short clauses will generally follow, focusing on issue relating to performance and its excuses such as force majeure, then liability event of default clauses, and related consequences including sometimes penalty clauses, terminations clauses, etc.

The contract will often be supplemented by annexes for more specific commercial issues.

Typically, the UK party is likely to propose a more comprehensive document with a substantive list of definitions, some whereas, a limited object clause, followed by a very detailed set of specific clauses on the scope and on price and payment conditions. Thereafter several detailed clauses generally follow, relating to conditions of performance and excuse of non performance, liability, remedies, remoteness and quantum of damages, insurance and several annexes. The contract often includes also some sets of clauses often referred to as "boilers plate clauses" which are rather standards and take care of particular issues deriving from the domestic case law.

In our experience, when such an exchange of initial draft takes place, with the view of securitizing in a contractual format a basic commercial understanding, each party starts having queries about the professionalism or intent of the other party to enter into an agreement for their mutual benefit. The UK party will consider that the French draft contents numerous loopholes, lacks of specificity, and as a result, risky and leading to legal uncertainty.

The French party will struggle in understanding why it is necessary to have so many details, cross references, strange clauses such as "hold harmless" clauses, why the excuse for non performance deriving from outside events is so detailed often with an endless laundry list, why the liability and insurance clauses are so much an headache to understand, etc.

### 2.2.2. Differences are not really commercial: the are deeply rooted in the legal system and the legal reasoning

From there, both parties will have to make a step to understand better the rationale behind the proposal of the other party. This exercise is not an easy one since, as mentioned at the outset, advisers and legal practitioners able to fully translate all the consequences of the French contract provisions in the English legal context, and reciprocally, remain an exception.

The costs involved for limiting the contract law risks more or less at the same level as the one generally acceptable between two players entering into the same kind of contract within one European jurisdiction only are high and this trigger delays. This situation illustrates how much the differences of legal contract law and culture may impair legal certainty and as a result limit cross border trade throughout Europe.

In a nutshell, the rationale behind the French draft contract proposal is imbedded in the legal culture of civil law tradition having been developed through the written codes including an overall definition and organization of concepts and rules in a concise manner which are the main reference for contract interpretation. They amount often to additional umbrella or implied provisions based on some paramount principles such as good faith and force majeure. Contract implementation must be further supplemented by the usage of trade and industry (and of course refined by the Courts). Those principles and rules are generally well accepted both for their content and consequences and the industry players often consider that it is not necessary to reiterate them in details in the contract. This explains why French drafts have few definitions, and are not specific on issues covered for example by the good faith legal principle or by the usage of trade. This is also why the force majeure clause is often limited to a few core principles and some consequences only.

Ultimately, it is essential to remember that in this particular national framework, the legal reasoning for contract interpretation and performance is a reasoning from top to bottom. When an interpretation is needed, reference will be made firstly to the general clauses and to the extent necessary to the whereas, then to the general principles of contract law and published rules, when applicable, and only thereafter on the case law.

The UK part in turn will give paramount importance to the black letter of the contract, and primary reference for interpretation on case law and precedent. In essence in this system there are no real contractual rights and obligations outside of specific contract previsions. Reliance on precedent is a very sophisticated game, substantially different from reference to case law, in the French context. For the UK part, reference to a general principle of force majeure does not make much sense (since this legal system is not really interested in concepts alone). The main focus would be to propose first a definition of force majeure as adapted as possible to the particular situation, and then identify the events through a laundry list and lastly clarify as much as possible the various consequences.

In the UK contract law system, implied provisions such as the far reaching duty to advise which is implied in most services contracts under French laws, or other implied provisions limiting the enforcement of a clear contractual clause due to a lack of good faith behaviour are seen as aliens.

In its own contractual culture and legal framework the UK party is more used to a legal reasoning from bottom to top where a paramount reference for interpretation and implementation is on specific provision of the contract and thereafter essentially on precedents. The trend remains to limit as much as possible the reference to general principles, rules and even statutes which are often viewed by the players in a same way as contract provisions or cases i.e. applied only if clear and specific.

In this overall framework and with such fundamental differences, how is it possible to increase legal certainty in the mind of both parties and as a result to permit them and others across Europe to feel at ease in their cross border contractual B to B relationship from cradle to grave? This example illustrate why the matter needs to be proactively regulated.

# 3. HOW TO BOOST THE B TO B CROSS BORDER RELATIONSHIPS THROUGH HARMONISATION OF EUROPEAN CONTRACT LAWS : FROM THE CFR TO AN OPTIONAL INSTRUMENT.

## 3.1. The CFR and its toolbox approach has little chances to remove soon the B to B contractual hurdles.

It is fair to say that in the real world of contract transactions across Europe, the industry players in search of better contractual certainty have a tendency to address the matter to their professional organisations for exchanges among their respective state organisations.

Those exchanges focus more on the hurdles having given rise to problems than on the general development of European contract law. The European common frame of reference effort is viewed by many as being a legal tool box drafted mostly by the Academics for facilitating the drafting of a European or State legislation and so far they are not paying much attention to it. The solution to their day to day which is to limit the additional risks incurred in cross border transaction is not in the CFR actual implementation which will take several years at least. In addition, when some business organisation analyse the content of the CFR and compare it with the solution they need to remove the main contractual hurdles across Europe, they have a tendency to criticize the CFR. They see it as being at the same time too academic and too detailed. During a conference held in Paris in 2005, (les Entretiens de la Tour Maubourg) critics were addressed to the draft CFR by representatives from the insurance, franchising and banking industries.

In conclusion and at this stage, if the CFR could certainly participate through its unique comparative law outcome to the increase of legal certainty in cross border B to B contractual transactions, it is far from being the instrument which may be of interest to the industry and to the legal practitioners involved in day to day advice in this matter. An instrument is therefore needed, and a European optional instrument appears to be the most appropriate.

## 3.2. An optional instrument in European contract law is necessary for increasing legal certainty and fostering cross-border trade.

The question remains open on the possibility to draft an optional instrument on European contract law which has realistic chances to be accepted and which will increase legal certainty and foster cross border trade.

For the legal practitioners, the answer is very much dependent on a new and very proactive effort focusing on the identification of the true problems areas in contract law for cross border transactions. This should be essentially carried out through a joint exercise between the industry representatives and the legal practitioners' representatives both involved in the day to day relations and of course with the supports of the academics.

When problems areas are sufficiently identified and recognised as deserving a solution at the European level, mostly in terms of progressive harmonization, then the whole CFR work will be most useful in order to test whether the results of comparative law are in line with the expectations of the European users.

For instance, is hardship as currently found in the CFR of real interest for increasing contractual certainty? So far, in the absence of a sufficient level of study, the answer is rather negative.

## 3.3. Conclusion: drafting a useful optional instrument : proposals for a way forward

The way forward in order to pave the way to an optional instrument on EU contract law which is necessary in order to increase legal certainty on the basis of illustrative example outlined above is to design a methodology well accepted by the prospective users.

Such methodology could be outlined as follows:

- The first step should take the form of a well organised and modern due diligence exercise for the identification of the real problems areas. Ideally the problems should be identified by a good leading team co-ordinating various national groups and addressing the issues from various angles not limited to law and case law. This leading team although multidisciplinary in nature should give a lot of attention to the industry representatives for which this instrument is designed and to the legal practitioners advising them and dealing with their disputes. The exercise should of course take care of history, cultural differences, industry usages and drafting practices.

- The second step could be to identify among the various legal and practical solutions at hand in various jurisdictions the ones which may have the best chances to be reasonably accepted by the greater number of real users taking into account also the key objectives of the European Community relating to the fluidity of the internal market.

This should be relatively easy thanks to the excellent comparative law effort having led to the CFR.

The third step should be to test the preferred legal and practical solution identified through an in-depth impact analysis. The analysis should address inter alia the precise effect in law and in practice of contractual principles or contractual clauses or series of clauses which seems prima facie worth to promote in practice.

The end users of such instrument are not only interested in the existence of contractual rights and obligations deriving from contractual terms but also in the consequences of a breach or of a deviation for any reasons.

If this methodology is put in practice in an operational manner with the input of each stakeholders commensurate with the issue at stake there are fair chances that such as an optional instrument on European contract law will become a success.