

## DUSK OVER THE EUROPEAN CONTRACT LAW? COST-BENEFIT ASSESSMENT: A REVIEW

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**Abstract:** *After years of effort, the European Commission aimed to complete a harmonisation of the European contract law with the instrument called 'Common European Sales Law' in order to further facilitate a cross-border trade. However, a strange coalition of both consumer and business organizations was formed against such an instrument. This unexpected turn of events revealed that the proper analysis of not just the benefits of a harmonisation but also its costs may have not been balanced with the respect to various groups of its users. This article deals with the critical cost-benefit assessment of the aforementioned issues to evaluate the current and contemplated path in the European contract law with possible suggestions for further improvement.*

**Keywords:** *contract, economic analysis, European Union*

### INTRODUCTION

One of the fundamental goals of the European Union (and of the European law as one of the instruments used to accomplish the goals) is to support the EU's internal market, its functioning and development. After years of discussions and preparations, in 2011 the Commission finally introduced a draft of CESL,<sup>1</sup> a symbolic culmination of the harmonisation effort in the area of contract law.

The final design of the legislation represented a major compromise between solutions and possibilities as originally intended. Firstly, over time it has proved unfeasible and unrealistic to regulate the contract law as a whole in its entirety (largely due to the substantial heterogeneity of Member States' legal systems), which meant that the draft had to sacrifice a substantial proportion of contract law from its original compass and instead had to focus solely on the commonalities in the area of the sales law (rather than the contract law in general). Secondly, of all the harmonisation options initially contemplated by the Commission<sup>2</sup> – from the mere publication without binding effect, through the use of the so-called optional instrument (to co-exist in parallel to individual national legal systems) to the form of binding regulation (with the full-harmonisation effect) – the second, compromise alternative of the optional instrument finally prevailed with the intention to institute the second regime in individual Member States.

This version of CESL was not enacted in the end (the draft regulation was withdrawn) and its fate remains uncertain, even though the work invested in the effort partially con-

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<sup>1</sup> Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on a Common European Sales Law, COM (2011) 635, final.

<sup>2</sup> Green Paper from the European Commission on policy options for progress towards a European Contract Law for consumers and businesses, COM (2010) 348, final.

tinued in the area of e-commerce regulation.<sup>3</sup> Nevertheless, the dismissive attitude toward CESL from Member States, and from consumers and businesses alike, still warrant a thorough analysis.<sup>4</sup> To this end, this paper conducts a critical cost-benefit assessment of the harmonisation efforts of the European contract law (CESL, as the manifestation of the effort in the field of sales law will serve well for comparative purposes) in order to show not just the estimated benefits of harmonisation, which are already well documented in the literature,<sup>5</sup> but also to reveal some of the obstacles and risks of harmonisation, and of its practical implementation as well. In conclusion, the paper presents the upcoming steps that may be expected from the European Union in this area and formulates recommendations on how to proceed based on the lessons learned.

## CURRENT DISCOURSE ON EUROPEAN HARMONISATION

Harmonisation efforts and tendencies have long been an important topic of research and investigation among legal scholars. Originally, the research focused mostly on the area of international law, and on international treaties in particular. But with the formation of the European Union, the establishment of the multinational legislative body in the way of the European Parliament and the arrival of the entire body of the European legislation, harmonisation of law became a matter of primary interest for many, an interest that has only increased over time.<sup>6</sup>

The current scholarly discourse is in part driven by the European legislature, which frequently presents arguments about the appropriateness and actual benefits of harmonisation in the legislative texts themselves. For example, in the area of consumer protection, it is assumed that the consumers will benefit from the harmonisation as a matter of course.<sup>7</sup> Given the bureaucracy bias, we can hardly expect arguments to the contrary. But it would be unwise to accept such assumptions without scrutiny, just because they have been promoted by a public authority. Consumers themselves do not benefit from the harmonisation *per se*; consumers benefit from and are interested in improving their legal pro-

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<sup>3</sup> Directive (EU) 2019/770 of the European Parliament and of the Council of 20 May 2019 on certain aspects concerning contracts for the supply of digital content and digital services and Directive (EU) 2019/771 of the European Parliament and of the Council of 20 May 2019 on certain aspects concerning contracts for the sale of goods, amending Regulation (EU) 2017/2394 and Directive 2009/22/EC, and repealing Directive 1999/44/EC.

<sup>4</sup> For the general explanation of positions held by the individual stakeholders, please refer to O'HARA, E. The Limits of Contract Law Harmonization. *European Journal of Law and Economics*. 2011, Vol. 33, No. 3, pp. 505–519.

<sup>5</sup> See, *inter alia*, RÜHL, G. Methods and Approaches in Choice of Law: An Economic Perspective. *Berkeley Journal of International Law*. 2006, Vol. 24, No. 3, pp. 801–841, or WAGNER, G., GOMEZ LIGÜERRE, C. G. Ökonomische Analyse des CESL: Das Recht zur zweiten Andienung. *Zeitschrift für Europäisches Privatrecht*. 2012, Vol. 20, No. 4, pp. 797–833.

<sup>6</sup> EU lawmakers choose between different implementation options, between minimum/maximum harmonisation, and between directive/regulation (or other secondary legislative instruments). A more detailed analysis of this matter exceeds the scope of this paper.

<sup>7</sup> See e.g. European Parliament and Council Directive 2011/83/EU of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council, Recital 51: “The main difficulties encountered by consumers (...) concern delivery of goods (...). Therefore, it is appropriate to clarify and harmonise the national rules.”

tection, irrespective of the means used to accomplish such purpose.<sup>8</sup> An explanation that states the need for remedy or even for the improvement of the standard of consumer protection as the reason for harmonisation completely misses the mark. Even empirically speaking, if insufficient harmonisation was the *only* thing that stood in the way of proper consumer protection, consumers (i.e. the prevailing majority of voters) would push for the adoption of CESL as the instrument to standardize and guarantee the quality of their own protection.<sup>9</sup>

Clearly, things are not as simple. Harmonisation may be an excellent instrument to assist in eliminating legal uncertainty and in accomplishing some other goals, but to proceed with it, we must first precisely identify and specify the goals. A comprehensive review of the harmonisation effects is therefore necessary not just to make qualified assessment of their real-life impact, but also to analyse the efficiency of legal regulation in general.

### Arguments for harmonisation of the EU contract law

The concept of EU contract law harmonisation<sup>10</sup> as promoted by the European Union, is supported by arguments made by many leading legal scholars.<sup>11</sup> The principal line of their argumentation focuses on transactions costs associated with the concept of legal uncertainty.

The transaction cost theory is predicated on two categories of arguments, reviewed critically below:

#### (i) Review of the scope of transaction costs

Transaction costs are frequently equated with information costs.<sup>12</sup> But this view of transaction costs only partially overlaps with the total costs that are reduced by harmonisation, as defined by Ribstein and Kobayashi;<sup>13</sup> (a) information costs represent only a small part of the total costs, which include, according to Ribstein and Kobayashi, also:

- (b) inconsistency costs,
- (c) litigation costs,
- (d) externalities, and
- (e) drafting costs.

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<sup>8</sup> O'HARA, E. The Limits of Contract Law Harmonization. *European Journal of Law and Economics*. 2011, Vol. 33, No. 3, pp. 510ff.

<sup>9</sup> For a detailed account, see WAGNER, G. Transaktionskostensenkung durch Europäisches Kaufrecht: Der Blue Button klemmt. *Zeitschrift für europäisches Privatrecht*. 2012, Vol. 20, No. 3, pp. 455–460.

<sup>10</sup> Even if only in part, in certain fields of contract law, accentuating certain stakeholder groups, as observed earlier above.

<sup>11</sup> Cf. GÓMEZ, F., GANUZA, J. J. How to build European private law: an economic analysis of the lawmaking and harmonization dimensions in European private law. *European Journal of Law and Economics*. 2012, Vol. 33, No. 3, pp. 481–503.; HAUPT, S. An Economic Analysis of Consumer Protection in Contract Law. *German Law Journal*. 2014, Vol. 4, No. 11, pp. 1137–1164; LAROUICHE, P., CHIRICO, F. (eds.) *Economic analysis of the DCFR: The work of the economic impact group within the CoPECL*. 1<sup>st</sup> ed. Mnichov: Sellier, 2010, 344 pp.

<sup>12</sup> Cf. WULF, A. J. *Institutional Competition between Optional Codes in European Contract Law*. Wiesbaden: Springer, 2014, pp. 116ff.

<sup>13</sup> RIBSTEIN, L. E., KOBAYASHI, B. H. An Economic Analysis of Uniform State Laws. *The Journal of Legal Studies*. 1996, Vol. 25, No. 1, pp. 138–145.

Some of these categories may not necessarily apply to the EU law to a large extent: (b) inconsistency costs are costs associated with the inconsistent legislation across different countries; however, EU (harmonisation) legislation itself often becomes inconsistent over time due to and in the course of its implementation and application in individual Member States; (e) potential savings in drafting costs, i.e. the costs of drafting a better quality legislation arising from the heterogeneousness of legal systems (or the costs associated with the absence of certain legislation), also do not arise automatically, not least in the European system, where lawmakers of individual Member States draft national legislation anyway.

Still, some of the costs may become rather significant: (c) litigation costs may be largely eliminated by eliminating deadweight losses associated with the contemplated litigation; (d) externalities from the perspective of single internal market may somewhat curtail the attempts of individual Member States to externalize some adverse legal consequence on “foreign” (cross-border) entities, and may inspire or motivate Member States into adopting reciprocal approach to handling such issues.

## (ii) Review of (micro)economic aspects

As noted above, the absence of the macroeconomic model (or mode of thinking) in performing the impact assessment of the European contract law brings forth an important quandary: either the European legislature ignores the macroeconomic impact of the harmonisation because it finds the arguments presented at the microeconomic level compelling enough to allow for the safe dismissal of the macroeconomic concerns, or, the macroeconomic impact is known but unsatisfactory enough to challenge the frequently promoted positive effects of regulation, and thus its legitimacy. Both possibilities are equally upsetting; the legitimacy of legislative instruments (whether directives, regulations or some other alternatives<sup>2</sup>) needs to be explored at both levels. The very nature of the harmonisation’s impact on the functioning of the internal market should be a sufficient argument for a solid macroeconomic anchoring of the entire concept. As observed by Wagner,<sup>14</sup> the analysis at the macroeconomic level allows for the incorporation of the dynamic element in the enquiry and thus opens up the opportunity to assess the impact of the regulation (and its implementation) over time.

Economic growth is predicated on several factors, one of which is the stability of the legal environment. When speaking about the European contract law and its cross-border effects, we should conceive of the stability of the entire system rather than of isolated national jurisdictions. The existing research<sup>15</sup> proves that countries, whose legal systems are based on the same origins, tend to trade with each other on a much larger scale. The reasons are rather straightforward – similar legal systems rationalise a larger market and lead to higher competition, which gives the consumer the benefit of more choice, improves the

<sup>14</sup> WAGNER, H. Is harmonization of legal rules an appropriate target? Lessons from the global financial crisis. *European Journal of Law and Economics*. 2012, Vol. 33, No. 3, pp. 547–564.

<sup>15</sup> See e.g. TURRINI, A., VAN YPERSELE, T. Traders, courts, and the border effect puzzle. *Regional Science and Urban Economics*. 2010, Vol. 40, No. 2-3, pp. 84–85.

distribution and dissemination of know-how, and thus increases the efficiency in the utilization of modern technologies. Higher economic growth in countries with a lower degree of legal uncertainty (better protection of investments, property rights and enforceability of contracts) has been extensively confirmed by research performed by La Porta et al.<sup>16</sup>

In addition, the microeconomic analyses rarely focus on specific stakeholders; consequently, they lack the nuanced view of the groups affected, since the classification into businesses and consumers is hardly sufficient for a detailed examination of the ensuing relationships and effects. Even if we discount the category of entities that do not fall into either the business or consumer category, businesses themselves have different preferences and interests that reflect their nature and objects; for example, some focus on the b2b model rather than on marketing their products directly to consumers (b2c). Similar argument may be proposed for consumers, who can also be differentiated based on various criteria other than their conventional characteristics (age, education, wealth) such as their risk aversion. These objections are not trivial – conceptualizing businesses as a single homogenous group (even if classified by size – by turnover, number of employees) constitutes a disproportional simplification that precludes a thorough microeconomic analysis of harmonisation of law.

### Arguments against harmonisation of the EU contract law

At the opposite side of intuitive promoters of harmonisation we can find its critics, who point out the (i) inadvertent redistribution effect of the harmonisation, (ii) the specific cultural peculiarities of individual countries and the fact that the differences in legal systems are grounded in diverse historical developments, culture, language, politics and so forth, (iii) the unavoidable instability and unenforceability of the harmonized legislation, and (iv) and the high implementation costs of harmonisation. Let us briefly examine these arguments.

(i) Since the research shows that the law is unable to fulfil the redistribution goals adequately (we observed earlier that the assumption of homogeneous stakeholder groups is incorrect),<sup>17</sup> the harmonisation may have a negative impact on different groups of stakeholders. Even assuming that the cumulative discrimination would remain equal, it may still tilt and deflect to the detriment of certain groups, while restricting the opportunity of national lawmakers to regulate the redistribution effect locally, which may vary in its intensity depending on the internal composition and preferences of individual Member States.

(ii) Existence of cultural differences. The proponents of this theory<sup>18</sup> argue that the legal system is a proxy and form of expression of history, culture and politics. The very existence of heterogeneous legal systems and their minimum convergence despite the long-running

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<sup>16</sup> LA PORTA, R., LOPEZ-DE-SILANES, F., SHLEIFER, A. The Economic Consequences of Legal Origins. *Journal of Economic Literature*. 2008, Vol. 46, No. 2, pp. 302ff.

<sup>17</sup> Cf. CRASWELL, R. Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships. *Stanford Law Review*. 1991, Vol. 43, No. 2, pp. 377–398.

<sup>18</sup> See e.g. FAURE, M., SMITS, J. *Does Law Matter? On Law and Economic Growth*. Cambridge-Antwerp: Intersentia, 2011, pp. 6–10.

concerted effort of all concerned should constitute a sufficiently valid argument against harmonisation.

(iii) Instability, unenforceability and difficulty of interpretation. Although the European Union has at its disposal a range of instruments for the harmonisation of contract law, the stability of the legal rules (absence of frequent legislative changes) and their enforceability have a fundamental impact on their application in practice.<sup>19</sup> The process is supervised by the national judiciary, which has the duty to adopt a uniform statutory construction of the European legislation, but even so, differences in practical application still do arise for reasons involving variations in the organisation of the judicial system, willingness to punish illegal conduct and so forth.

(iv) Implementation costs. Vogenauer<sup>20</sup> refers to them as transition costs, meaning the costs associated with the introduction of new legislation, including the drafting costs, the costs of transitional legal uncertainty, training costs, or the opportunity costs associated with the loss of choice in regulating applicable legal issues, and the ensuing loss in competitive ability of the Member States involved.<sup>21</sup> These costs are often neglected.

## DISCUSSION AND CONCLUSIONS

Contracts tend to be the primary source of law regulating *inter partes* rights and obligations, which explains the fundamental significance of this area of law for the proper functioning of the single market and the incessant interest of European lawmakers in regulating it. This begs the question – what can we learn from the failure to enact CESL? Firstly, we need to acknowledge that a *successful implementation is a time-consuming process*. And it is no wonder. The reasons behind the EU's inability to push through CESL at a broader forum clearly include previous excursions of European lawmakers in a similar legislative territory,<sup>22</sup> which has affected both the drafting process of CESL and the decision to enact it in the form of the optional instrument intended to co-exist in parallel to national legislations.<sup>23</sup>

The European contract law primarily focuses on cross-border contractual arrangements and contract law in general is classified as a part of the substantive law. But if the EU legislators wish to regulate this particular domain, care should be taken to account

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<sup>19</sup> WAGNER, H. Is harmonization of legal rules an appropriate target? Lessons from the global financial crisis. *European Journal of Law and Economics*. 2012, Vol. 33, No. 3, pp. 549–557, or ULEN, T. S. The Role of Law in Economic Growth and Development. In: M. Faure – J. Smits *Does Law Matter? On Law and Economic Growth*. Cambridge-Antwerp: Intersentia, 2011, pp. 206–211.

<sup>20</sup> VOGENAUER, S. The Spectre of a European Contract Law. In: S. Vogenauer – S. Weatherill (eds.). *The Harmonisation of European Contract Law*. Oxford and Portland, USA: Hart, 2006, p. 3.

<sup>21</sup> WAGNER, H. Is harmonization of legal rules an appropriate target? Lessons from the global financial crisis. *European Journal of Law and Economics*. 2012, Vol. 33, No. 3, pp. 549–552.

<sup>22</sup> Proposal for a Directive of the European Parliament and of the Council on consumer rights, COM (2008) 614, final.

<sup>23</sup> The Consumer Protection Commissioner Ms. Meglana Kunava from Bulgaria, as a new Member State, was put in charge of this matter. For detailed context, please refer to SCHULTE-NÖLKE, H. The Brave New World of EU Consumer Law – Without Consumers, or Even Without Law? *Journal of European Consumer and Market Law*. 2015, Vol. 4, No. 4, pp. 135–139.



also for *the practical effects of the new regulation within the province of procedural law* (the choice of law v. choice of forum application differences). As shown on the previous page, differences in the application of harmonised (substantive) legal rules by national legislature may have an incongruous – and therefore suboptimal – impact on individual Member States. Not least of these issues is the free-rider problem, which may be expected to arise for at least until the full reconciliation of the application practice; previous experience is a testament to the fact that some Member States tend to be averse to carrying the implementation costs associated with new EU legislation.

*A successful implementation for the most part depends on the similarities of the countries involved* (their economic, cultural or political circumstances).<sup>24</sup> International commerce (and the internal market) may develop successfully across similar countries independently on the *ab externo* regulation (see reviewing (micro)economic aspects). In other words, trade between nations may and does flourish harmoniously even under the conditions of natural competition, and does not necessarily require the (artificial) harmonisation of law. In fact, the elimination of competition in the legislative process produces unwarranted opportunity costs, because (i) harmonised legal rules are less likely to fit the local economic, social and political climate and the pre-existing “native” rules brought about by the long-term needs and trends of individual countries, and (ii) harmonisation reduces and limits competition between different systems of law, as enacted and controlled by the local law-makers, including the positive benefits of such competition.

The instability of harmonised law extends the payback period of the harmonisation investment for all stakeholders. Frequent changes in legal rules generate sunk costs that cannot be recovered later. And a merely formal implementation is insufficient. France<sup>25</sup> is a good example of problems that emerge in national jurisdictions where legal rules change not just at the behest of the legislature but also at the initiative of the judiciary. Considering the authoritative nature of judicial rulings and the extensive interpretation of law prevailing in some other countries,<sup>26</sup> the transition period may last longer than initially contemplated and the associated costs may exceed the expected benefits. Regrettably, this aspect of harmonisation is frequently disregarded or played down by the EU lawmakers.

So, what is the future of the European contract law? The EU regulation of contract law is affected strongly by the proclaimed goal of consumer protection. While pan-European statutory regulation of this area of law is not perceived to be particularly beneficial for businesses, it may appeal to consumers, who represent a large majority of all voters. And since the law of commercial contracts is not attractive politically, we may expect additional fragmentation of the contract law legislation (such as into e-commerce and consumer

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<sup>24</sup> Brexit may help overcome the current impasse in this area; the UK used to be one of the most vocal critics of the CESL harmonisation, quite understandably so, given the nature of its common law legal system (as opposed to the civil law legal system at the Continent) and its emphasis on judicial precedent. For details, please refer to The United Kingdom, Ministry of Justice. *Common European Sales Law: Impact Assessment*. 2011, 27 pp.

<sup>25</sup> Cf. COLLART DUTILLEUL, F., DELEBECQUE, P. In: S. Vogenauer – S. Weatherill (eds.). *The Harmonisation of European Contract Law*. Oxford and Portland, USA: Hart, 2006, p. 150, note 4.

<sup>26</sup> See on the example of Germany: LEUSCHNER, L. AGB-Kontrolle im unternehmerischen Verkehr – Zu den Grundlagen einer Reformdebatte. *Juristen Zeitung*. 2010, Vol. 65, No. 18, pp. 875–884.

protection law), spread across different tiers of harmonisation (optional instrument, Directive, Regulation etc.), as attested by the continued effort to draft the e-commerce segment of the legislation, which was enacted in the form of an EU Directive(s).<sup>3</sup> However, considering the ongoing incursions of consumer protection law into *lex mercatoria* and given the somewhat unexplained relationship between the protection of consumers and the general protection of parties with a weaker bargaining power,<sup>27</sup> our recommendation would be to aim the future harmonisation efforts at the conciliation of this dichotomy instead.

In view of the aforesaid, we are compelled to conclude that the best course of action would be to start utilizing the options already available under the existing systems of law (in their current set-up) and to strive to improve the efficiency of law enforcement in order to preserve the stability of the legal environment. It will take years before the key legal issues are consolidated and settled in case law. If, in the meantime, the EU lawmakers manage to arrive at a persuasive resolution of the estimated consequences of the harmonisation, the adoption of a truly harmonised legislation may become a reasonable way to proceed. Even then, however, such legislation should not be implemented through an optional instrument, which entails the risk of creating a double standard of protection.

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<sup>27</sup> See Recital 7 of the Directive (EU) 2015/2302 of the European Parliament and of the Council of 25 November 2015 on package travel and linked travel arrangements.