



Dear reader,

This issue of *Juridica International* is based on the presentations made at the international conference titled 'European Initiatives (CFR) and Reform of Civil Law in New Member States', held in Tartu on 15–16 November 2007. However, this issue of the journal not only serves to publish the materials of the conference but also offers several other articles that, while they were not presented at the conference, are closely related to the topic of the conference.

The conference served two main objectives: first, to address the significant issues of the Common Frame of Reference (CFR) project and, second, to analyse the development of civil legislation in the new member states of the European Union and what the effect of the so-called model laws (PECL, UNIDROIT Principles, and CFR) has been here. The conference was attended by many who participated in the preparation of the Draft Common Frame of Reference, such as the Study Group on a European Civil Code's Chairman Professor Christian von Bar and members Professor Hugh Beale, Professor Anna Veneziano, Professor Jerzy Rajski, Dr. Stephen Swann, Professor Luboš Tichý, Professor Christian Takoff, and Professor Valentinas Mikelenas, as well as, from the Research Group on EC Private Law (the Acquis Group), Chairman Professor Hans Schulte-Nölke and members Professor Thomas Wilhelmsson and Professor Fryderyk Zoll. Presentations on the development of civil law in new Member States were made by Professor Jerzy Rajski (covering Poland), Professor András Kisfaludi (Hungary), Professor Valentinas Mikelenas (Lithuania), Professor Luboš Tichý (the Czech Republic), Dr. Damjan Možina (Slovenia), Professor Kalvis Torgans (Latvia), Professor Irene Kull (Estonia), Dr. Monika Jurčová (Slovakia), and Professor Christian Takoff (Bulgaria). In addition to the above, well-known experts in the field also made presentations, among them Professor Norbert Reich and Professor Walter van Gerven. As a direct relation to the topic of the conference, the current issue of the journal also offers the reader the articles of Study Group members Professor Eric Clive, Professor Matthias E. Storme, and Professor Kåre Lilleholt, in addition to Dr. Mónika Józson's article on the development of civil law in Romania and articles by the Estonian jurists Dr. Martin Käerdi, Dr. Margus Kingisepp, and member of the Supreme Court Villu Kõve.

One of the main conclusions drawn at the conference was that, at the present point in time, the CFR is of crucial importance mainly for those of the new Member States that are engaged in reforming their civil legislation. Yet the meaning of the CFR cannot be reduced to only being a means in the legislative drafting of countries. The CFR mainly expresses the development of the concept of civil law in Europe, and in the future the CFR should have a central meaning in the formation of a harmonised judicial area in the European Union. What added most definitely to the conference was that many representatives of the ministries of justice of the European Union's Member States also attended. One of the major objectives of the conference was to introduce the ideas of the CFR to the representatives of the Member States; this objective was well attained. This issue of the journal also contains the paper by Dr. Norbert Csizmazia, the representative of the Hungarian Ministry of Justice who attended the conference. I would especially like to highlight the contribution made by Professor Hugh Beale, who made three presentations at the conference and, accordingly, is represented in the journal with three articles as well.

In relation to the successful organisation and realisation of the practicalities of the conference, I would also like to express my greatest gratitude, in addition to the speakers and participants, to Professor Christian von Bar and Professor Norbert Reich, whose initiative and ideas made the conference a success. Both Professor von Bar and Professor Reich are the co-editors of this issue of *Juridica International*. My gratitude also goes to Fritz Thyssen Stiftung, the University of Tartu, and the European Legal Studies Institute for financial support in the preparation of this issue of the journal.

Paul Varul

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The Launch of the Draft Common Frame of Reference

1. The interim outline edition as a first step

Two months after the Tartu conference of 15 November 2007 on ‘Developments in European Law: European Initiatives (CFR) and Reform of Civil Law in New Member States’, the academic draft of that Common Frame of Reference (CFR) has now seen the light of day.¹ The teams of researchers that in 2005 contracted with the European Commission to deliver by the end of 2007 a first proposal have managed to keep their promise. On 21 January, at a launch in the European Parliament, the interim outline edition of the Draft CFR (DCFR) was presented in book form to the Legal Affairs Committee of the European Parliament and to the European Presidency, which was represented by Slovenian Minister of Justice Professor Lovro Ćur. Our publishers, Patrick Sellier and his team, had produced a preliminary (proof) version of the book in less than four weeks. The editors of the DCFR had already sent huge electronic files to the European Commission in the last days of the previous year; these turned out to be too big for a simple e-mail attachment, so copies had to be sent burned onto a DVD. Their contents were meant to be uploaded in part to the Commission’s CIRCA Web site, but even this proved difficult, and it took weeks before that actually happened.

In book form, the DCFR is being published first in an interim outline edition. That edition does not yet contain comments and notes, and it is also not complete in its section setting out the model rules. This is so because model rules concerning some specific contract types (such as loans and donations) are still missing, as are all the model rules on those matters of property law that we intend to cover in the full and final edition: acquisition and loss of ownership in movables, proprietary security rights in movable assets, and trust law.

The European Commission has already received an extensive and illustrative commentary to all the model rules contained in the interim outline edition, and we have also submitted to the commission all the comparative material that so far we have been able to collect and present in the notes — all in all (articles, comments, and notes) some 4,000 pages. The comments are available to every member of the CFR network who has access to the Commission’s CIRCA Web site. The notes, however, are not for publication yet: on account of lack of time, it was impossible to edit them in a way that would meet international standards for publication. The model rules that are still outstanding, all comments, and the completed and properly edited notes will therefore appear in book form only as part of the full and final edition, which should emerge by the middle of 2009. Work on that ‘master copy’, as we call it, began immediately after the Christmas break. The full and final edition will be accompanied by a second edition of the paperback ‘rules only’ version. Its first edition and its successor edition (which we expect to be released to the public around February or March 2009 and which we hope to present as a bilingual — English and French — text) are meant to facilitate discussion and decision-making. The aspiration behind the first paperback is that it will elicit responses and criticisms in

¹ C. von Bar, E. Clive, H. Schulte-Nölke et al. (eds.), *Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR). Interim Outline Edition*. Munich 2008.

time for them to be taken into account in this year's preparation of the full edition. Some constructive and helpful comments have already reached us, immediately following publication of the DCFR Interim Outline Edition on the Internet.^{*2}

We hope that such proposals for improvement will reach us throughout 2008. Many conferences on the DCFR are being planned, amongst them a conference in Ljubljana in April 2008 designed as a follow-up conference to the earlier meetings in London (2005), Vienna (2006), and Stuttgart (2007). As did its UK, Austrian, and German predecessors, the Slovenian EU presidency is paying considerable attention to the work being carried out on the CFR. The French presidency too will organise a discussion forum on the DCFR, to be held later in the year in Paris. Further meetings will be held in the ERA facilities in Trier, in Edinburgh, in Münster and Osnabrück, and in many other places. The research network is doing its utmost to exchange views on the DCFR with as many interested jurists as can be reached. However, the timetable for the finalisation of the full and final edition is very tight. The work has to be completed by the end of 2008, and as this huge work requires much further drafting and vast editorial labour it will be impossible to consider any contributions from stakeholders and other colleagues that come to our knowledge after September 2008.

Although this should go without saying, the editors and all of the academic contributors to the DCFR stress yet again that the DCFR is an academic and not a politically authorised text. It had its origin in an initiative of legal scholars, and it amounts to the compression into rule form of decades of independent research and co-operation by academics from all over Europe.^{*3} It all started in 1982 with the foundation of the Commission on European Contract Law (the 'Lando Commission'). The latter was succeeded in 1998 by the Study Group on a European Civil Code (SGECC), which in 2005 founded, in collaboration with the then newly established 'Acquis Group' and some further teams, a joint research network under the Sixth European Research Framework Programme.^{*4} We cannot say whether — and, if so, with what content, structure, and coverage — our DCFR (or some of its parts) will be turned into an official or 'political' CFR or even, in the form of an 'Optional Instrument', into applicable law.^{*5} These are decisions that do not lie in our hands. The creation of a CFR (and the creation of an Optional Instrument) are questions for the European institutions.

We do, however, hope for their support and that our texts will be read and discussed with care, intellectually, emotionally, and politically. The bare fact that something is now being 'laid on the table' should constitute an important difference from previous discussions because in the latter, not yet focused on a concrete text, some unnecessarily sharp voices with a sort of national undertone for quite a while created a difficult atmosphere. Too many felt that they were not sufficiently informed and involved. Now everybody is in a position to evaluate our interim results and to express views on them, and we are more than ready to consider proposals for the improvement of the DCFR. The creation of the CFR has now become a concrete political option. All that we researchers ask for is a constructive public discussion of our first draft. A chance such as this to promote European private law will not come every year, and Europe's private law community should not let it pass for lack of courage or determination.

² The DCFR Interim Outline Edition (see previous Note) can also be downloaded from <http://www.law-net.eu/>; comments made on that Web site will be appreciated and considered.

³ DCFR Interim Outline Edition (Note 1), pp. 41–48, lists more than 150 names of senior and junior researchers from all Member States, Norway and Switzerland. These lists do not yet include the names of those researchers who kindly wrote (or offered to write) additional notes to complement and update the comparative material already contained in the Principles of European Contract Law (PECL, see Note 12 below).

⁴ For more information on this Network see its homepage at <http://www.copecl.org>.

⁵ At present it is a completely open question whether there will be an optional instrument providing for a further legal system, additional to the national legal systems, which might be chosen under conflicts of laws rules as the applicable law. During the deliberations on the so-called Rome I Regulation on the law applicable to contractual obligations, the provision included originally as article 3 (2) was deleted. (It provided that "[t]he parties may also choose as the applicable law the principles and rules of the substantive law of contract recognised internationally or in the Community"; see COM(2005) 650 final (OJ C 318, 23.12.2006, pp. 56–61).) Its content in terms of legal policy, however, was re-introduced at a later point. The European Parliament insisted on prefacing the text of the articles with a new recital 8a (now recital 13 preceding the final text of the Rome I Regulation published in OJ L 177, 4.07.2008, pp. 6–16), which reads: "This Regulation does not preclude parties from incorporating by reference into their contract a non-State body of law or an international convention" (European Parliament 2004–2009, session document A6-0450/2007 of 21 November 2007; see also the debates of 29 November 2007. Available at <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&mode=XML&reference=A6-2007-0450&language=EN> (10.08.2008)). Unfortunately, however, it is not entirely clear whether the freedom of choice of law provided for in article 14 of the Rome II Regulation (Regulation (EC) No. 864/2007 of the European Parliament and the Council of 11 July 2007 on the law applicable to non-contractual obligations. – OJ L 199, 31.07.2007, p. 40) in relation to non-contractual obligations can also be extended to the (D)CFR.

2. Definitions: The emergence of a rule-based common European legal terminology

Apart from an introduction and some tables and indices, the DCFR Interim Outline Edition contains, as its title explains, principles, definitions, and model rules of European private law. This complies with the scheme set out in the European Commission's communications of 2003⁶ and 2004⁷ and our agreement with the commission.⁸

The purpose of 'definitions' seems self-evident. They are part of the so-called 'toolbox function' assigned to the CFR and serve as suggestions for the development of a uniform European legal terminology. DCFR I.-1:103 (1), therefore, expressly incorporates the list of terminology in Annex 1 as part of the DCFR.⁹ This drafting technique, by which the definitions are set out in an appendage to the model rules¹⁰, was chosen in order to keep the first book ('General Provisions') short.¹¹ (The research teams definitely did not want to conjure up a kind of *Allgemeiner Teil* in the famous abstract BGB style!) This technique also enables the list of terminology to be extended at any time without great editorial labour. The substance is partly distilled from the *acquis communautaire* but is predominantly derived from the model rules of the DCFR.

Our decision to comply with the European Commission's and many stakeholders' requests for such a list of terminology (whose main author and drafter is Professor Eric Clive, Edinburgh) caused us some concerns for a while, because some members of the research teams thought that, in the worst of all political scenarios, it could come to pass that the definitions are accepted while the bulk of our work — the model rules and the comments and notes that accompany them — is put aside! That risk might not be very likely to be realised, but it justifies the remark that, if the definitions are essential for the model rules, it is also true that the model rules are essential for the definitions. There would be little value in a set of definitions that is internally inconsistent. The definitions can be seen as components that can be used in the creation of rules and sets of rules, but there is no point in having components that are incompatible with each other and cannot fit together. In contrast to a dictionary of terms assembled from disparate sources, the definitions in the annex have been tested in the model rules and revised and refined as the model rules have developed. Ultimately, definitions cannot be composed without model rules, nor can model rules be drafted without definitions. A common European legal terminology must be rule-based; otherwise no common legal terminology will ever emerge.

The definitions are drafted in plain and intelligible language; their style is straightforward and as 'simple' as possible. An example extract is this: "*Corporeal*, in relation to property, means having a physical existence in solid, liquid or gaseous form. A *creditor* is a person who has a right to performance of an obligation, whether monetary or non-monetary, by another person, the debtor. *Damage* means any type of detrimental effect. It includes loss and injury. *Loss* includes economic and non-economic loss. *Economic loss* includes loss of income or profit, burdens incurred and a reduction in the value of property. *Non-economic loss* includes pain and suffering and impairment of the quality of life. *Damages* means a sum of money to which a person may be entitled, or which a person may be awarded by a court, as compensation for some specified type of damage. *Compensation* means reparation in money." One definition builds upon another, and every term defined has its source in a rule. Moreover, artificial expressions are avoided. A melted piece of iron, for example, is a 'corporeal' item, but it is certainly not 'tangible'!

⁶ 'Action Plan on a More Coherent European Contract Law' of 12 February 2003, COM(2003) 68 final. – OJ C 63, 15.03.2003, p. 1.

⁷ 'European Contract Law and the revision of the *acquis*: the way forward'. Communication from the Commission to the European Parliament and the Council, COM(2004) 651 final, 11 October 2004. Available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2004:0651:FIN:EN:PDF> (10.08.2008).

⁸ On the latter see C. von Bar, H. Schulte-Nölke. *Gemeinsamer Referenzrahmen für europäisches Schuld- und Sachenrecht*. – *Zeitschrift für Rechtspolitik* (ZRP) 2005, pp. 165–168; C. von Bar. *Der Gemeinsame Referenzrahmen*. – *Zeitschrift für Gemeinschaftsprivatrecht* (GPR) 2005, p. 1.

⁹ The article reads: "The definitions in Annex 1 apply for all the purposes of these model rules unless otherwise provided or the context otherwise requires."

¹⁰ DCFR Interim Outline Edition (Note 1), pp. 329–346.

¹¹ Annex 2 contains rules on computation of time. We thought we should not burden Book I with model rules of a purely technical and therefore somewhat 'dull' or at any rate 'deadening' nature. So the reason for having a second appendage is more aesthetic than substantive.

3. Model rules

The greatest part of the DCFR consists of ‘model rules’ — all in all 640 articles. They reproduce, in the style of a ‘Restatement’ or ‘Code’ document, our understanding of the current law and, where that appeared necessary, our notions for its further development. What in the context of the ‘Principles of European Contract Law’^{*12} and the series of publications of the Study Group^{*13} and the Acquis Group^{*14} have been denoted as ‘principles’ are in the terminology of the DCFR ‘model rules’.

The latter notion also requires some explanation. We are using the adjective ‘model’ to indicate that the rules are not put forward as having any normative force. They are soft-law rules. Whether they are used as a model for any legislation — in particular, for improvement of the internal coherence of the *acquis communautaire* — is for others to decide.

For reasons of space and time, it is impossible here to discuss any of these model rules in detail. An overview of their structure and coverage must suffice. Our model rules are organised into 10 books. Of these, the interim outline edition contains Books I–VII; Books VIII–X will follow in the full edition. Book I (‘General Provisions’) is a short and general guide for the reader on how to use the whole text — dealing, for example, with its intended scope of application, how it should be interpreted and developed, and where to find definitions of key terms. Books II (‘Contracts and Other Juridical Acts’) and III (‘Obligations and Corresponding Rights’) cover the revised material in the existing Principles of European Contract Law^{*15} — general rules on contracts and other juridical acts, and general rules on contractual and other obligations — and the equally revised and adapted material in the *acquis* principles.^{*16} Books II and III have been structured around a clear and coherent use of the key terms ‘contract’^{*17} and ‘obligation’.^{*18} A contract is seen as a type of agreement — a type of juridical act — and distinguished from the legal relationship, usually involving reciprocal sets of obligations and rights, resulting from it. Book II deals with contracts as juridical acts, and Book III deals with the obligations and rights resulting from contracts seen as juridical acts, as well as with non-contractual obligations and rights.

The later books, from Book IV on, gave rise to much less difficulty as far as structure was concerned. It was settled that the order would be as follows: specific contracts and the rights and obligations arising from them (Book IV), benevolent intervention in another’s affairs (Book V), non-contractual liability arising out of damage caused to another (Book VI), and unjustified enrichment (Book VII). Acquisition and loss of ownership in movables will be the subject matter of the forthcoming Book VIII, proprietary security rights in movable assets will form the stuff of Book IX, and trusts Book X.

¹² O. Lando, H. Beale (eds.). Principles of European Contract Law Parts I and II. Prepared by the Commission on European Contract Law. The Hague 1999; O. Lando, E. Clive, A. Prüm, R. Zimmermann (eds.). Principles of European Contract Law. Part III. The Hague, London, Boston 2003. Translations are available, *inter alia*, in French (Principes du droit européen du contrat. Version française préparée par G. Rouhette, avec le concours de I. de Lamberterie, D. Tallon, C. Witz. – Droit privé comparé et européen. Vol. 2. Paris 2003); German (Grundregeln des Europäischen Vertragsrecht. Teile I und II. Kommission für Europäisches Vertragsrecht. Deutsche Ausgabe von C. von Bar, R. Zimmermann. München 2002; Grundregeln des Europäischen Vertragsrecht. Teil III. Kommission für Europäisches Vertragsrecht. Deutsche Ausgabe von C. von Bar, R. Zimmermann. München 2005); Italian (Commissione per il Diritto Europeo dei Contratti. Principi di Diritto Europeo dei Contratti. Parte I & II. Edizione italiana a cura di C. Castronovo. Milano 2001; Commissione per il Diritto Europeo dei Contratti. Principi di Diritto Europeo dei Contratti. Parte III. Edizione italiana a cura di C. Castronovo. Milano 2005) and Spanish (Principios de Derecho Contractual Europeo. Partes I y II. Edición española a cargo de P. B. Bennloch, J. M. E. Irujo, F. M. Sanz. Madrid 2003). For further translations (sometimes of the articles of Books I and II only) see http://frontpage.cbs.dk/law/commission_on_european_contract_law/index.html (10.08.2008).

¹³ So far six volumes have appeared: Principles of European Law. Study Group on a European Civil Code. Service Contracts (PEL SC). Prepared by M. Barendrecht, C. Jansen, M. Loos, A. Pinna, R. Cascão, S. van Gulijk (Sellier, Bruylant, Staempfli, Oxford University Press 2006); Principles of European Law. Study Group on a European Civil Code. Benevolent Intervention in Another’s Affairs (PEL Ben.Int.). Prepared by Christian von Bar (Sellier, Bruylant, Staempfli, Oxford University Press 2006); Principles of European Law. Study Group on a European Civil Code. Commercial Agency, Franchise and Distribution Contracts (PEL CAFDC). Prepared by M. W. Hesselink, J. W. Rutgers, O. B. Díaz, M. Scotton, M. Veldmann (Sellier, Bruylant, Staempfli, Oxford University Press 2006); Principles of European Law. Study Group on a European Civil Code. Personal Security (PEL Pers.Sec.). Prepared by U. Drobnig (Sellier, Bruylant, Staempfli, Oxford University Press 2007); Principles of European Law. Study Group on a European Civil Code. Lease of Goods (PEL LG). Prepared by K. Lilleholt, A. Victorin, A. Fötschl, B.-E. R. Konow, A. Meidell, A. Bjøranger Tjørum (Sellier, Bruylant, Staempfli, Oxford University Press 2008), and Principles of European Law. Study Group on a European Civil Code. Principles of European Law on Sales (PEL S). Prepared by E. Hondius, V. Heutger, C. Jeloscsek, H. Sivesand, A. Wiewiorowska (Sellier, Bruylant, Staempfli, Oxford University Press 2008).

¹⁴ Principles of the Existing EC Contract Law (*Acquis* Principles). Contract I: Pre-contractual Obligations. Conclusion of Contract. Unfair Terms. Prepared by the Research Group on the Existing EC Private Law (Acquis Group). Sellier 2007. In preparation: Contract II: Performance. Non-Performance. Remedies (Sellier 2008) and further volumes on specific contracts and extra-contractual matters.

¹⁵ Note 12 above.

¹⁶ Note 14 above.

¹⁷ In the DCFR Interim Outline Edition Annex I (Definitions) a ‘contract’ is now defined as “an agreement which gives rise to, or is intended to give rise to, a binding legal relationship or which has, or is intended to have, some other legal effect. It is a bilateral or multilateral juridical act” (*loc. cit.* p. 332).

¹⁸ “An *obligation* is a duty to perform which one party to a legal relationship, the debtor, owes to another party, the creditor” (*loc. cit.* p. 340).

It follows from this overview that we went significantly beyond contract law and moved also into the most important areas of non-contractual obligations; moreover, the final edition will explain why and how we have approached the areas of property law just mentioned. On the other hand, all matters that are excluded from the DCFR's intended field of application are listed in DCFR I.–1:101 (2).^{*19} These are primarily family law, the law of succession, and land law.

The reasons for our decision to make the coverage of the DCFR broader than what the European Commission seems to have (or have had) in mind for the coverage of the CFR^{*20} are manifold. (i) The 'academic' frame of reference is not subject to the constraints of the 'political' frame of reference. Although the DCFR is linked to the CFR, it is conceived of as an independent text. The research teams started in the tradition of the Commission on European Contract Law but with the aim of extending the coverage of its work. When this undertaking started, there were no political discussions in progress on the creation of a CFR of any kind, neither for contract law nor for any other part of the law. (ii) Our contract with the Research Directorate-General to receive funding under the Sixth European Framework Programme on Research reflects this; it obliges us to address all of the matters listed above. (iii) Rules on general contract law need to be tested to determine whether or in what respect they have to be adjusted, amended, and revised within the framework of the most important of the so-called specific contracts. (iv) The DCFR cannot and must not contain just rules dealing with consumer contracts. The researchers concur in the view that consumer law does not stand on its own as an isolated area of private law. It involves some deviations from the general principles of private law but cannot be developed without them. (v) 'Private law' for this purpose is not confined to the law on contract and contractual obligations. The correct dividing line between contract law (in this broad sense) and some other areas of law is in any event difficult to determine precisely.^{*21} The DCFR therefore approaches the whole of the law of obligations as an organic entity or unit.

(vi) It is not only the law on specific contracts that has its repercussions for the drafting of the general rules. For example, the work done on unjustified enrichment showed that rather more developed rules were needed on the restitutionary effects of terminated contractual relationships. And the work on the acquisition and loss of ownership in movables (and also on proprietary security rights in movable assets) fed back into the treatment of assignment in Book III. (vii) In order to provide a consistent European legal terminology, the CFR must cover many terms and concepts that are referred to in directives without being defined. It is not only contract law terminology in the strict sense to which these directives refer. Consumer directives frequently presuppose rules on unjustified enrichment law; and those on pre-contractual information refer to or presuppose rules that in many systems are classified as rules of non-contractual liability for damage.^{*22} (viii) A uniform legal terminology is needed not only in the area of substantive law but also in that areas of private international law for which there is already a clear jurisdictional basis in Community law. The difficulties that the authors of the Rome II Regulation faced in respect of 'delict/tort' are a striking example of this.^{*23}

(ix) In cases of doubt, topics should be included. Excluding too many topics from the CFR will result in it becoming a fragmented patchwork, thus replicating a major fault in existing EU legislation on a larger scale. Nor can there be any harm in a broad CFR. It merely provides language and definitions for use, when needed, in the closely targeted legislation that is, and will probably remain, characteristic of European Union private law. (x) The range of subjects that are already part of the *acquis communautaire* today is clearly much broader than the scope of contract law. For example, there is not just the Products Liability Directive with its difficult notion of damage and damages; there is also some private law *acquis* in the area of retention of ownership (or title).^{*24} Should the political institutions someday decide to make use of the intensive work being carried out

¹⁹ DCFR I.–1:101 (Intended Field of Application) reads: "(1) These rules are intended to be used primarily in relation to contractual and non-contractual rights and obligations and related property matters. (2) They are not intended to be used, or used without modification or supplementation, in relation to rights and obligations of a public law nature, or in relation to: (a) the status or legal capacity of natural persons; (b) wills and succession; (c) family relationships, including matrimonial and similar relationships; (d) bills of exchange, cheques and promissory notes and other negotiable instruments; (e) employment relationships; (f) the ownership of, or rights in security over, immovable property; (g) the creation, capacity, internal organisation, regulation or dissolution of companies and other bodies corporate or unincorporated; (h) matters relating primarily to procedure or enforcement. (3) Further restrictions on intended fields of application are contained in later Books."

²⁰ See Notes 6 and 7.

²¹ See, in more detail, C. von Bar, U. Drobnig (eds.). *The Interaction of Contract Law and Tort and Property Law in Europe*. Munich 2004. This study was conducted on behalf of the European Commission.

²² See also the 30th recital prepended to the Rome II Regulation (Note 5), in which the difficulties that European law has with the concept of culpa in contrahendo are perfectly manifest. It reads: "Culpa in contrahendo for the purposes of this Regulation is an autonomous concept and should not necessarily be interpreted within the meaning of national law. It should include the violation of the duty of disclosure and the breakdown of contractual negotiations. Article 12 covers only non-contractual obligations presenting a direct link with the dealings prior to the conclusion of a contract. This means that if, while a contract is being negotiated, a person suffers personal injury, Article 4 or other relevant provisions of this Regulation should apply."

²³ The Regulation consistently opts for the formulation "tort/delict"; in other words, no uniform expression has been found for this area of the law. The DCFR in contrast proposes in Book VI to speak of "non-contractual liability arising out of damage caused to another".

²⁴ See Late Payments Directive (2000/35/EC. – OJ L 200, 8.08.2000, pp. 35–38) article 4 and Insolvency Regulation (Council Regulation (EC) No. 1346/2000. – OJ L 160, 30.06.2000, pp. 1–18) article 7.

on the creation of a Eurohypothech, it will soon become apparent that such a decision requires a suitable legal ‘environment’ for such a security — not only in respect of loan agreements but also in respect of the transfer of dependent and independent security rights.

4. Principles

The title of the DCFR Interim Outline Edition also promises its readers ‘Principles’ of European private law. That notion has different roots, and it consequently caused us much concern. The European Commission’s communications (referred to earlier) related to the CFR employ the concept of principles but do not elaborate on it. One possible interpretation would have been to read this in the sense in which the notion of principles is used within the PECL — i.e., as (model) ‘rules’.²⁵ However, the notion of principles, particularly when they are qualified by the adjective ‘fundamental’, can equally denote the core aims and underlying values of the DCFR. We, the researchers, felt that we should understand the concept in both ways. In the CFR, the most appropriate place to elaborate on such fundamental values might be a set of well-balanced recitals introducing the model rules. For the DCFR, however, it seemed premature to draft such recitals; the public might have easily misconstrued them as evidence of the ‘fact’ that in reality the researchers had drafted a proposal for legislation. We therefore explained in the introduction to the DCFR which values we pursued in our model rules and how they can be traced there: justice, freedom, protection of human rights, economic welfare, solidarity, and social responsibility. Insofar as it is the European Union that shapes private law, some specific aims needed to be added to this list — in particular, promotion of the internal market and preservation of cultural and linguistic plurality. Furthermore, we have given much weight to some more ‘formal’ aims, such as rationality, legal certainty, predictability, and efficiency.

5. Support from Estonia

Countries that are dependent on export trade should have a vital interest in the promotion of a common framework for the exchange of goods and services. This is the core argument, we understand, put forward by the Government of Estonia at the 2007 Tartu conference in support of the CFR and of our work. We are grateful for that support. We sincerely hope that the spirit of that important conference will contribute to good policy-making in the years to come.

²⁵ PECL article 1:101 (1).



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The Nature and Purposes of the Common Frame of Reference

In this paper, I explain what I, as one of the ‘academic researchers’, understand to be the purposes of the Common Frame of Reference (CFR), and why I think it deserves support from academic and practising lawyers and businesspeople across Europe.^{*2}

1. Background: The Action Plan

In the European Commission’s 2001 ‘Communication on European contract law’^{*3} and its subsequent Action Plan on Contract Law, which proposed the CFR^{*4}, the stated aim was to provide “fundamental principles, definitions and model rules” that can assist in the improvement of the existing *acquis communautaire*, and that might form the basis of an optional instrument if it is decided to create one. Meanwhile a parallel review of eight consumer-related directives is being carried out.^{*5} In February, the European Commission adopted its Green Paper on the Review of the Consumer Acquis.^{*6} In the autumn of 2007, it published a summary of the responses.^{*7}

Meanwhile, a separate group led by Professor Hans Schulte-Nölke has prepared an EC Consumer Law Compendium, explaining the different ways in which the eight directives have been implemented in the Member States.^{*8}

¹ The views expressed here are purely personal.

² Earlier versions of this paper have been published in *Internationaler Rechtsverkehr* 2007/1, pp. 25–30 and *ERCL* 2007/3, p. 257.

³ COM(2001) 398 final. The paper is available at http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/communication2001_en.htm (21.08.08).

⁴ See Action Plan on A More Coherent European Contract Law COM(2003) 68 final (OJ C 63, 15.03.2003, pp. 1–44) (referred to below as AP) and European Contract Law and the revision of the acquis: the way forward COM(2004) 651 final, 11.10.2004 (referred to below as WF).

⁵ Directives 85/577, 90/314, 93/13, 94/47, 97/7, 98/6, 98/27, 99/44. See WF paragraph 2.1.1.

⁶ COM(2006) 744 final of 8.02.2007. – OJ C 61, 15.03.2007, pp. 1–23.

⁷ Commission Staff Working Paper: Report on the Outcome of the Public Consultation on the Green Paper on the Review of the Consumer Acquis (undated), see http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/acquis_working_doc.pdf (21.08.2008).

⁸ See http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/comp_analysis_en.pdf (21.08.2008). There is also a database; see <http://www.eu-consumer-law.org/index.html>.

2. Purposes

What are the purposes of the CFR? It is not a criticism of the commission to say that the purpose was only partially explained in the documents it released. To some extent, we have had to work this out as we have gone along, trying to consider what legislators would find helpful. I would like to offer my conclusions.

Let me start by addressing one thing that the CFR is not intended to be: a European civil code, or a single European contract law to replace the various national laws.

It is quite true that an obvious purpose for the Principles of European Contract Law⁹ (PECL) was to be the basis of a European code of contract law that might, one day, replace our 27 or more national and regional laws of contract. Professor Lando himself envisaged as long ago as the late 70s that his principles might form the basis of a harmonising code.¹⁰ And it is fairly evident that when Professor von Bar set up his group, his ultimate end was a European code of private law, which might replace the national laws. But even if that is still a long-term aim for some participants in the project, it seems to be generally recognised that a European civil code, or even a European contract law or code of obligations, is something for the far distant future.

Within the Lando group, there were many who were doubtful about the notion of a European code of contract law. Quite apart from the difficulty of seeing any legal base for a code in the existing treaties¹¹, many members of the Lando group thought that the real value of European principles lay in less ambitious aims. They saw the PECL material as having four immediate targets. These are described in the first PECL article and the introduction and can be described as follows:

1. For parties to transnational contracts to adopt to govern their contract. Under current principles of private international law, the parties cannot adopt the Principles of European Contract Law as a replacement for a national system, but they can agree to incorporate them into their contract. Given that, at least for business-to-business (so-called B2B) contracts, most national laws allow a large degree of freedom of contract and lay down few mandatory rules, the effect will be much the same.
2. For arbitrators to apply when the parties have agreed that the contract is to be governed by 'general principles of law', the *lex mercatoria*, or the like.
3. To serve as a model for courts and legislators faced with either filling in gaps in their national law or revising it to respond properly to new economic conditions. When the Principles of European Contract Law were being finalised, members of the European Commission were very aware that the then-new democracies of central Europe were busy reforming their civil codes.
4. To assist in creating further harmonising measures across Europe.

Equally there are many within the Study Group who think in similar terms — or who think it is simply a valuable academic exercise. And the European Commission has vigorously denied that its aim is unification of contract law across Europe.

So what are the purposes of the CFR? There are several. One obvious one is only briefly mentioned in the commission's documents. This is, just as the PECL and the Principles of European Law (PEL) produced by the Study Group, to inspire national reforms of contract law outside the field of application of the *acquis*.¹² This aspect will be discussed in other papers. I prefer to concentrate on two other purposes, which were much more heavily emphasised in the commission's documents. The first is to assist in the improvement of the existing *acquis communautaire*; I call this the 'legislator's guide' or 'toolbox' function. The second is that the CFR might form the basis of an optional instrument, if it is decided to create one.

⁹ See O. Lando, H. Beale (eds.), *Principles of European Contract Law*. Parts I and II. Kluwer 2000; O. Lando, E. Clive, A. Prüm, R. Zimmermann (eds.), *Part III*. Kluwer 2003.

¹⁰ See the Preface to Parts I and II, p. xi; and the Introduction, p. xxiv.

¹¹ Especially now in the light of the decision of the ECJ in the Tobacco Advertising case *Germany v. Council, Parliament and Commission*, Case C-376/98. – ECR 2000, I-8419. For a very full discussion of the implications of this case for the legal basis see S. Weatherill, *The European Commission's Green Paper on European Contract Law: Context, Content and Constitutionality*. – *Journal of Consumer Policy* 2001 (24), pp. 339–399.

¹² See AP paragraph 62 and WF paragraph 2.1.2.

3. Purposes of the CFR as legislator's toolbox

Let us start with the idea of the CFR as a legislator's guide or toolbox. The European Commission's Way Forward document stated that the CFR would set out:

1. common fundamental principles of contract law, including guidance as to when exceptions to such fundamental principles could be required;
2. definitions of key concepts; and
3. model rules, which would form the bulk of the CFR.^{*13}

Annex I to the paper suggests that the CFR should cover most of the rules of general contract law — for example, most of those to be found in the already-published Principles of European Contract Law^{*14} or the UNIDROIT Principles of International Commercial Contracts^{*15}, with rules for consumer contracts and on topics such as sales and insurance.

I do not want to go into a theoretical discussion of what constitutes a principle, what is a definition, and what is a model rule. It is not clear that the commission has any particular distinction in mind; it may be that they intended the phrase as a composite notion covering whatever the ultimate document was to contain.

However, it seems to me that the division between principles, definitions, and model rules can be explained in terms of the possible functions of the CFR. To describe this, it may be easier to take 'principles', 'definitions', and 'model rules' in the reverse order.

3.1. Model rules

The commission is reviewing, and may revise, eight consumer directives. Part of the review will be concerned with how the directives have been implemented in the Member States, and, in particular, whether the provisions on 'minimum harmonisation' have hindered achievement of the aim of eliminating internal market barriers caused by differences between the laws of the Member States.^{*16} However, the review is also concerned with the coherence and substance of the consumer *acquis*.

If the directives are to be revised, the commission will find it useful to have 'model' rules that it can use or adapt to replace the existing articles of the various directives. For example, the CFR might contain model rules showing how principles that underlie the various sector-specific provisions can be given a wider application, so as to eliminate current gaps and overlaps. This would be a more 'horizontal' approach.

In addition, the Action Plan seems to envisage that the proposed rules in the CFR may go beyond the existing consumer *acquis*. They may include what the authors of the CFR think are, to quote the Way Forward document, the "best solutions" found in Member States' legal orders.^{*17} This might reflect what is to be found in those Member States that give consumers more than the minimum protection required by current directives — an issue that will become particularly important if there is to be a move toward more 'full' harmonisation. States that already have strong measures of protection will not want to give them up, and it may be quite difficult to agree on new, universal standards. It is true that, in its latest document, the European Commission seems to contemplate full harmonisation in only limited, 'targeted' areas (such as the length of withdrawal periods and the means of withdrawing). Nonetheless, 'model rules' for consumer contracts are essential. So are model rules for any other area in which the commission is contemplating legislation in the foreseeable future.

We can see the commission making use of draft 'model rules' already. The Green Paper on the Review of the Consumer Acquis asked questions at a number of different levels — for example, whether full harmonisation is desirable^{*18}, whether there should be a horizontal instrument^{*19}, and whether various additional matters should be dealt with by the Consumer Sales Directive.^{*20} It is clear that many of the questions arise from text in the draft CFR that researchers presented at stakeholder workshops in 2006.

¹³ WF paragraph 3.1.3, p. 11.

¹⁴ Not all the topics covered by Part III of PECL were mentioned in the commission document.

¹⁵ Principles of International Commercial Contracts. Unidroit, Rome 1994; 2nd ed. 2004.

¹⁶ WF paragraphs 2.1.1, p 3; and see H. Schulte-Nölke, C. Twigg-Flesner, M. Ebers (eds.). EC Consumer Law Compendium: The Consumer Acquis and its Transposition in the Member States. Sellier 2008.

¹⁷ "The research preparing the CFR will aim to identify best solutions, taking into account national contract laws (both case law and established practice), the EC *acquis* and relevant international instruments, particularly the UN Convention on Contracts for the International Sale of Goods of 1980": WF paragraph 3.1.3.

¹⁸ Question A3, p. 15.

¹⁹ Question A2, p. 14.

²⁰ Directive 1999/44/EC. – OJ L 171, 7.07.1999, pp. 12–16. See questions H1-M3, pp. 24–32.

3.2. Definitions

Model rules will not be enough, however. Directives frequently employ legal terminology and concepts that they do not define. The classic example, referred to in the European Commission's papers, is the Simone Leitner case.^{*21} The ECJ had to decide whether the damages to which a consumer was entitled under the provisions of the Package Travel Directive must include compensation for non-pecuniary loss suffered when the holiday was not as promised. This head of damages is recognised by many national laws but was not recognised by Austrian law. The ECJ held that 'damage' as referred to in the directive must be given an autonomous, 'European' legal meaning — and in this context 'damage' is to be interpreted as including non-pecuniary loss.

Note that here we are dealing with issues of general contract law. Most of the body of general contract law applies to business-to-consumer contracts as much as it does to B2B contracts. Normally, consumers are given additional rights. Often they are rights that build on the provisions of general contract law, like a right to damages. And it is precisely the terms and concepts of general contract law — such as 'damage' or 'damages' — that are often used in directives without specification of what is meant.

A CFR that contains definitions would be useful in answering questions of interpretation of European legislation. National legislators seeking to implement a directive and national courts would be able to consult the CFR to see what may have been meant. In addition, if comparative 'Notes' sections are included, as they are in the PECL and the draft CFR, these will tell them how, if at all, the CFR definition differs from their existing national law.

The definitions would be even more valuable if they were adopted by the European institutions, preferably by way of an inter-institutional agreement or something equivalent, as a guideline for legislative drafting. It could then be presumed that a particular word or concept contained in a directive was used in the sense in which it is used in the CFR unless the directive or regulation states otherwise (this could be stated in the recitals of the directive). The legislators could then employ these words and concepts with confidence that the meaning will be clear without it having to be defined in the directive. Alternatively, if the legislators so choose, they could vary or exclude the 'CFR meaning' through particular provisions in the legislation.

In other words, at the heart of the CFR as 'toolbox' should be a set of agreed definitions of legal terms and concepts for use in drafting or revising European legislation.^{*22} This is, of course, exactly in line with the original Action Plan.

3.3. Principles

It is less clear what the function of principles would be. In one sense, all of the provisions of the DCFR are 'principles'. It may be that the European Commission used the terms 'principles' and 'model rules' simply to mean the same thing. Alternatively, it may have had in mind the more fundamental articles, such as the presumption of freedom of contract (i.e., that, unless stated otherwise, the parties should be free to agree on the terms of their contract, on the basis of which the rules of the DCFR are mainly 'default rules' only), or the requirement of good faith.

However, there is a third possible meaning of 'principles', according to which they would serve a slightly different purpose. 'Principles' might mean not a series of articles but a statement of the notions that underlie the Draft Common Frame of Reference (DCFR), or of the policy considerations that a legislator should bear in mind when deciding whether or not European legislation is needed and what form it should take. It might be useful to begin the DCFR with a brief summary of its underlying assumptions (such as that freedom of contract is the starting point) — and reminders to the legislator that, for example, freedom of contract should be qualified (for example, through adoption of mandatory rules for consumer protection) only when the case for such protection has been made clearly.

3.4. 'Essential background' information

I think the CFR can also perform another function as a 'toolbox', one that is not mentioned as such in the commission's documents but that is of considerable practical importance. This is to provide the legislator, and those preparing draft legislation, with what I term 'essential background information' about the laws of the different Member States. In fact, I would argue that if we do not recognise this function, the CFR may itself cause a real problem.

²¹ Case C-168/00, Simone Leitner v. TUI Deutschland. – ECR 2002, I-2631.

²² This means that the CFR as toolbox would NOT be legislation in itself. This goes much of the way to meeting the criticisms made by the Study Group on Social Justice in European Law, see below.

The problem is that if the CFR is to include general principles or ‘model rules’ that do not represent the law in every Member State, we need to be absolutely clear about what the CFR (as legislator’s guide) is actually telling the legislator. Let us take as an example the principle of good faith. The principle of good faith is not known in the laws of some Member States — in particular, it is not found in the common law jurisdictions. It is true that even the common law systems contain many particular rules that seem to be functionally equivalent to good faith, in the sense that they are aimed at requiring the parties to act in good faith²³, but there is no **general** rule. Therefore, the legislator cannot assume that whatever requirements it chooses to impose on consumer contracts in order to protect consumers will, in each Member State, be supplemented by a general requirement that the parties act in good faith. If it wants a general requirement to apply in the particular context, even in the common law jurisdictions, the legislator will have to incorporate the requirement into the directive in express language — as, of course, it did with the Directive on Unfair Terms in Consumer Contracts.²⁴ Alternatively, it will need to insert into the directive specific provisions to achieve the results in the common law systems that in other jurisdictions would be reached by the application of the principle of good faith.

In other words, simply to include in the CFR principles that do not reflect the law in every Member State would on its own be highly misleading. To get an accurate picture, the legislator needs to have information about the different laws in the various Member States. This is the function of the comparative notes that are to be included in the final version of the draft CFR. The notes are essential. Without them, the articles might be very misleading.

Moreover, European legislators must know what might be a problem in terms of national laws and what is not. Let me take another example, the question of the duty to disclose information before a contract is made. If every Member State already had a rule that each party to a contract must disclose to the other any information that is necessary in order for the other to make an informed decision about whether to conclude a contract, then European legislation on pre-contract disclosure in cases of consumer contracts might not be needed. The fact is, however, that very few Member States have such principles except as a result of the consumer *acquis*. The legislator needs to be given that information.

I also think that the legislator — or at least the person responsible for the detailed drafting of the legislation — needs to know something about the law in each Member State in order to have hope of producing a draft that is in harmony with the national laws. Where a directive appears to employ completely different concepts and terminology to that used in the Member State concerned, it can be very hard to implement. A directive that is drafted with consideration for the different national laws is likely to be much easier to deal with on the national level.

So I conclude that, in addition to principles, definitions, and model rules, the CFR could usefully contain ‘essential background material’. This would group information about the different laws under headings with which the legislator will be familiar.

4. Coverage of the CFR

The above suggestion prompts one, next, to consider the issue of what topics the CFR should cover. First, clearly it must cover consumer law. The network of researchers set up to produce the draft CFR includes the Acquis Group, which will provide most of the consumer law input.

Second, the European Commission envisages chapters on specific contract types, such as contracts for insurance and sales. The network also includes a group that is producing a ‘Restatement of European Insurance Contract Law’ document. Sales contracts are covered by a team within a third group in the network, the Study Group on a European Civil Code.

We saw earlier that the study group’s project has a very broad scope. Under the contract with Framework Programme 6, draft rules concerning all of its topics will be submitted. It is widely accepted, however, that not everything that is in the ‘academic’ draft CFR will necessarily be incorporated into any ‘political’ CFR that is ultimately adopted. It will not be needed, because it deals with topics that are likely to remain outside the *acquis*. For instance, it is hard to see the consumer *acquis* as ever extending to address benevolent intervention. However, I hope the commission will keep the ‘political’ CFR fairly broad. This is because even rules on tort and unjust enrichment, or on the transfer of property in movables, form part of the essential background of which I spoke earlier.

It can be argued that the essential background material need not be in the CFR itself. It could be in a separate document, such as a published version of the researchers’ report. Nonetheless, at a minimum I would include in the CFR itself at least the general principles of contract law taken as a basis for the CFR. This is for two

²³ See the Notes to PECL article 1:201.

²⁴ Council directive 93/13/EEC, article 3 (1). – OJ L 95, 21.04.1993, pp. 29–34.

reasons: 1) existing directives already refer to almost all areas of contract law, and 2) it is hard to anticipate what contract law definitions will be needed even in the near future. I would prefer to include also tort and unjust enrichment, since these concepts are often referred to, or are assumed to exist, by EU directives. For example, the Product Liability Directive²⁵ clearly invokes liability in tort. The Consumer Sales Directive assumes that there is a law on unjust enrichment when it states that a consumer may be required to make an allowance for the use he or she has obtained from goods he or she has now returned to the seller.²⁶

5. A possible optional instrument

Now I shall turn to the other stated purpose of the CFR, to act as the basis for a possible optional instrument.

At the outset, we should make it clear what is meant by ‘optional instrument’. At least in informal discussions, some commentators on the European Commission’s ‘Communication’ document of 2001 seemed to suggest that, as not all countries would agree to a European contract code to replace national laws, there might instead be a new treaty adopting an optional code to which countries could adhere if they wished. In other words, the situation might be a bit like adoption of the common currency, with another two-speed Europe. But this is not what the communication referred to explicitly²⁷, nor is it what the Action Plan envisages.²⁸ These documents speak of a set of rules that the parties might choose to govern their contract. There is a parallel to the way in which parties in those countries that have ratified the Vienna Convention on International Sale of Goods can, in effect, choose to apply it for international sales. However, the mechanism might be different. The convention has to be made part of the law of the relevant state. The optional instrument, within its field of application, might apply in the stead of the national law that might otherwise apply.

It is evident that, when parties from different Member States are contracting with each other, differences between the laws can add to the transactions costs of the deal. Neither party may know very much about the law of the other party’s country, and to investigate this properly may be quite expensive. True, these costs do not prevent cross-border contracts being made, and, when the contract (or series of contracts being contemplated) is of high value, the cost of finding out about the other party’s law may be comparatively insignificant. When the transaction is relatively small, however, that cost may be an important factor, especially if there is thought to be a significant risk that one or the other party may default such that the associated law matters. For such contracts, neither party may be happy about adopting the other party’s law to govern the contract. They would prefer to have a neutral system, and one that they can use with trading partners in any Member State.

I suggest that this is particularly true for small and medium-sized enterprises (‘SMEs’). Their contracts are not likely to be so large that the cost of legal advice is unimportant, but on occasion the legal risks may be significant. Therefore, I think that we should design an optional instrument that is adapted for use by SMEs, in particular. It should assume that the parties will not be particularly knowledgeable about law and that they cannot afford to take expert legal advice. In other words, the optional instrument should contain a number of protective measures — for instance, controls of unfair terms in standard-form contracts. I believe an optional instrument of this kind would be genuinely useful. I would add, however, that the DCFR can be no more than a first draft of an optional instrument. If an optional instrument is to be based on the CFR, its content should be discussed by stakeholders — by representatives of business in particular.

I believe that an optional instrument would also be valuable for consumer transactions. This is not because I think that consumers are particularly worried about their rights under whatever law they contract under (even though this argument has been used to justify many of the directives). Consumers do not think there is much risk that they personally will get into a dispute with the seller in the conditions of which it will matter what the governing law is. I think the optional instrument would be more for the benefit of businesses that are seeking to sell to consumers from other Member States. For the business, a large number of hoped-for transactions may in the aggregate impose significant legal risk. The business may therefore be reluctant to advertise and sell to consumers in other jurisdictions. Again the concern is particularly strong for SMEs. Larger firms will probably set up a subsidiary in each Member State, and that subsidiary will know and use the local law. An SME is much less likely to be able to afford that. Instead it may wish to export by direct marketing, but it may well be put off by differences between the underlying systems of law. These may be of two kinds. First, there is the risk that the Member State that is the destination of the SME’s potential sales will have given consumers more than the minimum rights required by the various directives. Secondly, there may well be significant

²⁵ Directive 85/374/EEC of 25 July 1985. – OJ L 210, 7.08.1985, pp. 29–33.

²⁶ Directive 1999/44/EC, recital 15.

²⁷ See paragraph 66.

²⁸ See WF paragraph 2.3. WF Annex II contains a very full discussion of the possibilities.

differences in areas of law that are outside the field of application of any directive. For example, in a consumer sale, the buyer's rights to damages and the measure of those damages are governed entirely by national law.

The rules of article 6 of the proposed Rome I Regulation^{*29}, entitling consumers to the protection of the mandatory rules of their 'home' law in a wide set of circumstances, have the potential to create particularly serious barriers to trade of this kind. This will be the case particularly if the 'home law' rule is to be applicable to a consumer who buys on the Internet from a seller in another Member State, on the basis that the Internet seller is targeting consumers in other EU countries. In effect, the Internet seller would be required to be familiar with the law of every Member State. This would be highly problematic, particularly for SMEs, and may well lead to them refusing to accept orders from other Member States.

Short of unification of contract and sales law across Europe, I think the best solution lies in the optional instrument. The seller should be permitted to offer to sell to the consumer **either** on terms giving the consumer the minimum protection of the law of the consumer's home country **or** under the optional instrument, which would be a European contract and sales law. The optional instrument would contain all consumer protection required by the directives, plus general rules of contract law (which together would solve 99% of the cases likely to arise). If the parties choose the optional instrument to govern their contract, they (especially the seller) would be bound by all of the rules of the optional instrument — individual rules would not be optional, save as the instrument has provided.

The consumer could be asked which is his or her home state. If the seller were prepared to contract on terms reflecting the requirements of that law, it could simply accept the consumer's order. If it is not prepared to sell on those terms because (following my argument) it does not know what the law of the consumer's home state demands, it should have the right to refuse the order unless the consumer agrees that the sale should be governed by the optional instrument. The consumer could exercise this choice by pressing a 'Blue Button' on the screen, showing his or her acceptance of the optional European law. Such a Blue Button could be designed in the style of the European blue flag with the 12 stars, possibly with an inscription such as 'Sale under EU Law'. It would make the benefits of European law visible to all businesses and consumers wishing to make use of the internal market.

This kind of opt-in instrument would be a form of legislation, and settling its terms would entail the same kind of political choices — of the kind of rules, the degree of consumer protection, etc. — involved in drawing up any contract code. This is not altered by the fact that it would be 'optional'. Parties would frequently opt in without knowing exactly, or even approximately, what rules would then apply to their transaction and the degree of protection that they would be afforded, and businesses might not have the bargaining power to avoid the optional instrument or something even less favourable. The rules of the optional instrument would not be a purely technical matter; legislative choices would have to be made.

The draft CFR does not purport to be a definitive proposal for an optional instrument. Rather, it is just a first draft that might be used to prepare a detailed proposal. Then some means of ensuring both a reasonable degree of social justice in the provisions of the instrument and a modicum of democratic input would be essential.

6. Will there be a CFR?

At one time, there were serious doubts as to whether the European Commission still wanted a CFR, even in the 'toolbox' sense in which I have described it. This was because at the beginning of 2006 the programme of stakeholder workshops, convened to discuss the researchers' drafts, was abruptly curtailed. Instead of there being workshops on almost every aspect of the DCFR, there were in 2006 six workshops, which dealt only with issues directly related to the review of the consumer *acquis*. The workshops covered:

- pre-contract information,
- cancellation rights,
- unfair terms,
- 'Sales 1': conformity and 'commercial'^{*30} guarantees,
- 'Sales 2': remedies and transfer of risk, and
- consumer rights to damages.

Then the workshops stopped, and some of us feared that the commission was no longer interested in anything wider.^{*31}

²⁹ Proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I): Outcome of the European Parliament's first reading (Brussels, 28–29 November 2007) (3 December 2007).

³⁰ I.e., guarantees voluntarily offered by the seller or producer to the consumer; see directive 1999/44 article 6.

³¹ See H. Beale. The European Commission's Common Frame of Reference Project: a progress report. – ERCL 2006/2, p. 303.

However, in March a conference was held in Stuttgart under the auspices of the German presidency of the EU. Not only was there a most encouraging speech from German Minister of Justice Brigitte Zypries, but Commissioner Dr. Meglena Kuneva, as one of her first acts in the role, announced that, while DG SANCO will not be organising any more workshops, other Directorates General would be doing so. These

...will deal with possible topics like the consistency of information, marketing and distribution requirements in Financial Services legislation, and Unfair Commercial Practice clauses in B2B contracts. Other workshops will cover the possible topics of the Retention of Title clause and threats and abuse of circumstances. The problems relating to substantial validity and interpretation of contract terms would be covered, such as fraud as a ground for avoidance of the contract, damages for fraud, mistakes and misunderstandings as to the terms of the contract, mistake as to the person and maybe non-disclosure and adaptation of contracts.^{*32}

Dr. Kuneva also made a number of references to general contract law. Her speech at the SECOLA conference in Amsterdam in June 2007 was equally encouraging.^{*33}

So far, two workshops have taken place. On 28 November, one was held on pre-contract information in the financial services sector; then, on 5 December, another was held, on unfair competition and commercial practices. We have been told^{*34} that four further workshops are planned, to deal with:

grounds for invalidity,
formation of a contract,
remedies for non-performance, and
prescription.

This is most encouraging, as it will allow the stakeholders the opportunity to discuss issues of general contract law that have not yet been the subject of workshops — and because it demonstrates that the idea of a wide CFR has not been abandoned. I am at least hopeful that we may yet see a CFR that will include definitions related to matters of general contract law as well as model rules for particular consumer and other directives — and perhaps even the ‘essential background information’ I think European legislators need to have if they are to do their job effectively.

7. A legal *lingua franca* for Europe

I will confess that there is another reason I want to see the commission adopt a CFR that is broad in its coverage: to provide us with an agreed set of terms and concepts, not just for drafting EU legislation but for lawyers to apply in dealing with each other.

I am not in favour of a European civil code; I would prefer to maintain diversity, to have plurality.^{*35} We may need to harmonise certain areas where differences in legal traditions genuinely hinder trade. For example, differences in insurance law and the law pertaining to financial services seem to cause real problems.^{*36} We may also need to reach some compromise where there is difficulty because parties in some Member States regularly rely on particular legal institutions that do not exist in the laws of other Member States. I have in mind the law of security in one’s personal property, which varies enormously across Europe. Regardless, we do not need to unify our contract laws or to harmonise every aspect of them.

However, if an approach based on continued diversity is to work, we need to create easier and more accurate ways to find out about each other’s laws and to talk to each other about the similarities and differences. We need to know how a term or concept used in one system ‘translates’ into other systems. The CFR, if it includes the comparative notes contained in the researchers’ draft, will provide that.

Of course, the PECL and the PEL already go a long way in this direction. However, it would help enormously in getting the notion of the CFR as a ‘translation tool’ accepted, particularly by both national and European courts, were the European institutions to give it their imprimatur.

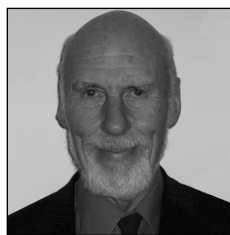
³² Dr. Kuneva’s paper can be found at http://ec.europa.eu/commission_barroso/kuneva/speeches/speech_stuttgart_en.pdf (21.08.2008).

³³ See ECLR 2007/3, p. 257.

³⁴ See Information Note to CFR Net Experts and Member States’ Experts, 25 October 2007 (unpublished).

³⁵ See H. Beale. Finding the Remaining Traps instead of Unifying Contract Law. – S. Grundmann, J. Stuyck (eds.). An Academic Green Paper on European Contract Law. Kluwer 2002.

³⁶ See the responses to the Commission’s Communication on European Contract Law (COM(2001) 398 final). A summary of the responses is available at http://europa.eu.int/comm/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/summaries/sum_en.pdf (21.08.2008).



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European Initiatives (CFR) and Reform of Civil Law in New Member States:

Differences between the Draft Common Frame of Reference and the Principles of European Contract Law

1. Introduction

The Draft Common Frame of Reference (DCFR) incorporates a revised and updated version of the Principles of European Contract Law (PECL). This was done with the permission of the Commission on European Contract Law (the Lando Commission), who created PECL.¹ The DCFR also includes a lot of new material. The purpose of this contribution is to explain why, and how, PECL has been changed. It will concentrate on changes of a general nature rather than specific changes in the content of particular articles, and it will concentrate on Books I to III of the DCFR because those are the books that overlap with PECL. Later books contain entirely new material. This will be mentioned but not explored in detail.

Nothing said here should be regarded as detracting in any way from the outstanding merits of PECL. It will be obvious to anyone who reads both texts that PECL was the indispensable basis for Books I to III of the DCFR. PECL is carried forward in these books, not only in substance but also in form. But time does not stand still, and inevitably there are some changes. There is a reason for every single change made to the PECL rules. There will not be space here to go through the articles one by one and comment on every slight drafting change. However, the reasons for major changes will be explained and the general factors that have resulted in many small changes will be mentioned.

The first version of the DCFR is in English, and so some of the following remarks will be of particular relevance for provisions drafted in English. Some may be of little relevance with respect to non-English versions. The fact that the DCFR will be translated into many languages has, however, been taken into account in its preparation. Following the example of PECL, it tries to avoid technical legal terms derived from one particular legal system and to prefer ordinary descriptive language that can be translated without the danger of using the wrong technical term or carrying unwanted baggage.

¹ Several members of the Lando Commission are also members of the Study Group on a European Civil Code ("Study Group" from now on).

2. Seven omitted articles

Virtually the whole of PECL is incorporated in Books I to III of the DCFR. Only seven articles from PECL have no equivalent in the DCFR.

Two general articles² near the beginning of PECL are omitted. These articles attempted to regulate the way in which PECL might be used as an optional instrument, and the effect on national mandatory rules of an opt-in by contracting parties. These are not matters that can be regulated from within a soft-law instrument. They have to be regulated from outside. The inclusion of articles on these lines would have been particularly inappropriate in the DCFR, given that the question of its use as the basis for an official optional instrument is currently under debate.

Article 1:107 of PECL has also been omitted. This provided that these principles applied with appropriate modifications to agreements to modify or end a contract, to unilateral promises, and to other statements and conduct indicating intention. The reason for omitting the first part (agreements to modify or end a contract) is that such agreements would already be contracts under the definition of the word used in the DCFR.³ The reason for omitting the second part is that the technique of applying contractual rules to unilateral juridical acts is not entirely satisfactory. The rules on interpretation, for example, are different because in the latter case there can be no reference to the common intention of the parties. It is not easy for the reader to know what appropriate modifications to make. The rules on formation also have to be different. The DCFR therefore deals specifically with unilateral juridical acts in many later articles. Any gaps would be filled by the application of the general rules on interpretation and development of the rules, which already provide in effect for application by analogy.⁴

The remaining four omitted articles⁵ are all in the chapter on the authority of agents and all deal with the topic of indirect representation. There will be indirect representation where A mandates B to do something for A in relation to a third party but in such a way as not to involve A in any direct legal relationship with the third party. For example, A mandates B to look for and buy, in B's own name, some rare object and agrees to buy it from B at the price B paid for it plus a commission. The material on this topic fitted rather uneasily in the chapter on the authority of agents. Its inclusion was criticised at a stakeholders' meeting, and, after further discussion and consideration, the co-ordinating committee of the Study Group on a European Civil Code⁶, at a meeting held in Tartu in December 2005, decided to delete it, at least from that chapter.⁷ The internal relationship between the principal and the representative under such contracts is governed by the 'Part on Mandate' in Book IV, and some special rules on the transfer of ownership of property acquired or transferred by the representative will be included in a later book on the transfer of ownership in movables.

3. New material in Books IV to X

The DCFR includes not only the material from PECL but also model rules for particular contracts and contractual relationships. Already in the Interim Outline Edition there are model rules on sale of goods; lease of goods; services (including construction services, processing services, storage services, design services, information and advice services, and treatment services); mandate; commercial agency, franchise, and distributorship; and personal security. Model rules on loans and donations will be added later in 2008.⁸ This new material is potentially important in the European context. Some of these topics ought, in theory at least, to be among the first to be considered for uniform regulation at European level. Comprehensive uniform rules (as opposed to partial and fragmented rules) on the sale or lease of goods, and the provision of services, and on the establishment and regulation of marketing framework relationships, would seem, for example, to be rather appropriate for an internal market and pre-eminently the sort of thing that could be achieved only by action at European level.

The DCFR also already includes in the Interim Outline Edition model rules on benevolent intervention in another's affairs, unjustified enrichment, and non-contractual liability arising out of damage caused to another.

² Articles 1:103 and 1:104.

³ See Annex 1 — A 'contract' is an agreement which gives rise to, or is intended to give rise to, a binding legal relationship or which has, or is intended to have, some other legal effect.

⁴ See I.-1:102 (Interpretation and Development) paragraph (4).

⁵ Articles 3:102, 3:302, 3:303 and 3:304.

⁶ The "Study Group" from now on.

⁷ The question of its possible inclusion elsewhere was left open.

⁸ Model rules on other special contracts and contractual relationships could be added later if this were thought to be useful. Book IV is designed for expansion.

Rules on trusts and proprietary securities will be added later on in 2008. The ‘internal market’ argument for uniform European rules concerning these topics is perhaps not so immediately apparent. And yet it can hardly be denied that there would be benefits to the European insurance industry in having uniform rules on non-contractual liability for damage, and that there would be a more level playing field in European commerce generally if there were uniform rules on proprietary securities and as to what could be done by the use of trusts. The rules on benevolent intervention and unjustified enrichment differ significantly from country to country at present (more significantly than the rules on contracts and on contractual rights and obligations). These branches of the law play a useful supplementary role in filling gaps and preventing injustice. It is clear that distortions could occur if other rules were uniform but these were not.

Thus, the most immediately obvious difference between the DCFR and PECL is that the DCFR includes a great deal of material on special contracts and other matters that is of great potential relevance for the development of European private law. This material takes account of, and sometimes follows quite closely, existing EU directives, but it has been drafted so as to fit well, at the technical level of drafting and terminology, with Books I to III of the DCFR.

4. Acquis Group material in Books II and III

Books II and III of the DCFR contain substantial blocks of rules derived from material provided by the European Research Group on Existing EC Private Law (the Acquis Group). There are rules on non-discrimination in the provision of goods and services available to the public⁹; on marketing and pre-contractual duties¹⁰; and on the right of withdrawal from certain contracts within a short ‘cooling-off’ period.¹¹ There are more extensive rules on unfair contract terms.¹²

One of the challenges in producing the DCFR was to merge the ‘classical’ contract law approach of PECL with the newer, more overtly functional and ‘policy-based’, approach of the *acquis*. Adjustments were necessary in both directions. For example, the Acquis Group’s approach to ‘writing’ and ‘signature’ (designed to cater for the electronic age)¹³ has been adopted throughout the DCFR. The same applies to the Acquis Group’s use of the term ‘business’ rather than ‘professional’. These decisions in themselves account for a number of changes to the PECL rules. On the other hand, the rules provided by the Acquis Group often had to be adjusted at the drafting level to fit in with the rest of the DCFR, and this process of verbal adjustment sometimes threw up problems of a more substantive nature, which had to be resolved.

It is for the reader to judge whether the task of combining PECL rules and Acquis Group rules has been successfully accomplished. What is quite clear is that it had to be attempted. An interesting aspect of the attempt was confirmation of the perception that it is becoming increasingly difficult to preserve a rigid distinction between private law and public law. The distinction has been preserved in the DCFR for the time being. Whether it is worth preserving forever is another debate, for another time. There is clearly a public law background, to say the least, to rules on such topics as discrimination and unfair contract terms. A similar remark could be made about the distinction between substantive law and procedural law. The inclusion of material from the *acquis* has made it even clearer than it was already that any attempt to reformulate European private law in the early 21st century is going to push at some boundaries — and quite rightly so.

5. Other new material in Books II and III

There is a new rule on mixed contracts in the DCFR.¹⁴ The need for this became obvious as work proceeded on the special contracts in Book IV. Many contracts are a mixture of sale and services, or a mixture of different kinds of services. Other kinds of mixes are also common. It is useful to have some indication of how various rules are to apply in such cases. Of course, the presence of this rule is not meant to indicate that every new kind of contract is to be regarded as a mixture of the nominate contracts that are specifically mentioned in Book IV. The principle of freedom of contract remains paramount.

⁹ Articles II.–2:101 to II.–2:105 and III.–1:105.

¹⁰ Articles II.–3:101 to II.–3:201 (the rules in II.–3:301 to II.–3:401 had their equivalent in PECL).

¹¹ Articles II.–5:101 to II.–5:202.

¹² Articles II.–9:401 to II.–9:401. Some of these rules, but not all, had equivalents in PECL.

¹³ See DCFR articles I.–105 and I.–1:106.

¹⁴ II.–1:108.

There is a new rule on the effect of failure to notify a non-conformity in goods or services supplied to a person who is not a consumer.^{*15} The reason for the inclusion of this rule in Book III was to generalise a rule that was appearing in unnecessarily different forms in different Parts of Book IV.

There are new rules on unilateral juridical acts^{*16}, a matter that, as already noted, was dealt with only by analogy in PECL. There are also new rules on time-limited rights and obligations^{*17}; on the variation and termination of rights, obligations, or contractual relationships by agreement^{*18} or by notice^{*19}; on the extinctive effect of performance^{*20}; and on the extinction of obligations by merger.^{*21} There is a new rule addressing when, in a case of plurality of creditors, different types of right arise.^{*22} These rules are not inconsistent with anything in PECL, and their content will not, it is hoped, be surprising. The reason for their inclusion is simply to fill gaps.

There is a new rule on the basic requirements for an assignment of a right to performance.^{*23} PECL had said that certain things were not required but did not say what **was** required. Related to this is a new rule on entitlement to assign.^{*24} There is also a new rule on the most important effect of the assignment of a right to performance — namely, that the assignor ceases to be, and the assignee becomes, the creditor.^{*25} These additions to the assignment chapter were prompted to some extent by the discussions on the topics of proprietary securities and the transfer of ownership of movables and by a desire for greater consistency of treatment.

6. More definitions

The DCFR contains more definitions than PECL. Not only are there more definition articles in the body of the text but there is also an annex of definitions containing 147 entries. The main reason for the increased use of definitions is that it was made clear by the representatives of the European Commission that definitions of key terms would be particularly useful. Of course, there are good drafting reasons for using definitions anyway, provided that they are used wisely and in moderation. The use of definitions was found useful in preparing the DCFR. On several occasions, the presence of a definition served to resolve a doubt that had arisen in discussion, and the fact that a word had been defined for the purpose of earlier articles often made it easier to draft later articles.

7. Expansion of some rules

Some of the PECL rules are to be found in a more developed and expanded form in the DCFR. For example, the rules on the effect of a stipulation in favour of a third party^{*26} are considerably more developed than the equivalent rules in PECL.^{*27} This reflects changes in national laws and further thinking since the PECL rules were formulated.^{*28} The rules on cure by the debtor in an obligation are also expanded.^{*29} This took account of work done for the part of Book IV on sales of goods, which itself took account of exiting EU law. It was found useful and appropriate to generalise the sales rules and to put them in Book III. In both of these areas, the results are closer to the approach taken in the UNIDROIT Principles^{*30} than to the former PECL approach. There has also been expansion of the rules on the restitution of benefits after termination of a contractual

¹⁵ III.–3:107.

¹⁶ Articles II.–4:301 to II.–4:303 (Formation) and II.–8:201 to II.–8:202 (Interpretation).

¹⁷ III.–1:107.

¹⁸ III.–1:108.

¹⁹ III.–1:109.

²⁰ III.–2:114.

²¹ III.–6:201.

²² III.–4:203.

²³ III.–5:104.

²⁴ III.–5:111.

²⁵ III.–5:113.

²⁶ Articles II.–9:301 to II.–9:303.

²⁷ Article 6:110.

²⁸ See, e.g., the English Contracts (Rights of Third Parties) Act 1999.

²⁹ Article 8:104 of PECL. Articles III.–3:202 to III.–3:204 of the DCFR.

³⁰ See the UNIDROIT Principles of International Commercial Contracts 2004 articles 5.2.1 to 5.2.6 and 7.1.4.

relationship on grounds of fundamental non-performance.^{*31} Here the work on unjustified enrichment had shown that a number of questions had been left unregulated by the PECL provisions.

PECL has only a limited provision on the computation of time. It applies only to the computation of time in relation to “a period of time set by a party in a written document for the addressee to reply or take other action”.^{*32} The lack of more general rules was noted and regret expressed during the preparation of the chapter on prescription. The DCFR now has more comprehensive provisions^{*33}, which draw on existing European law.^{*34}

8. Some verbal clarifications

There is an impatience in some quarters with legal concepts. Concepts are old-fashioned — professors’ play-things. New model rules should be functional rather than conceptual. They should concentrate on the real world. That is all very well. Of course, new rules should be functional. Of course, they should relate to the real world — a world that is constantly changing and that contains many surprises and many more sets of circumstances than could readily be imagined. But rules have to be expressed in words and are unlikely to fulfil their function very well if they are expressed in words that are used in a loose, overlapping, and confusing way. Some of the changes to PECL are designed to express in more precise words rules having exactly the same function.

8.1. Contract or contractual relationship

PECL uses the word ‘contract’ in different ways. Usually it refers to a type of agreement — a bilateral or multilateral juridical act. Sometimes it refers to a continuing relationship resulting from such an act. This can be confusing even within the one language. For example, a meeting could have a long and heated debate about whether something is a contract only to find that people are using ‘contract’ in different senses and that both sides are right! And to use ‘contract’ in different senses can lead to even more confusion when texts are translated and when rules are applied in different national systems. The Study Group, after considering the prevailing usage in EU directives and in European and international instruments, including soft-law instruments like PECL itself, decided to use ‘contract’ for a type of bilateral or multilateral juridical act and to use the term ‘contractual relationship’ for the continuing legal relationship that often results from a contract. This turned out to be a considerable aid to clarity of thinking in relation to such topics as third-party rights and termination for fundamental non-performance. For example, it is obviously not a contract as a juridical act that is terminated. It is a continuing contractual relationship that is terminated. One can consider the analogy of a wedding and the continuing marital relationship resulting from it. A divorce terminates the continuing marital relationship. It does not affect the fact that the wedding took place as a matter of history. It does not, and cannot, terminate the wedding.

8.2. Duty or obligation

PECL does not distinguish clearly between ‘duty’ and ‘obligation’. This causes a lot of difficulty in relation to those few provisions that employ the concept of duty rather than obligation, including the provision on good faith.^{*35} Is a breach of the duty of good faith a non-performance of an obligation with the consequence that all of the remedies for non-performance of an obligation are available? If so, why is it not called an obligation? Or is it not such a non-performance, in which case we have a duty without a sanction? Either the drafting is defective or the result is defective. The DCFR distinguishes between a duty and an obligation.^{*36} A duty is rather more vague and rather more general. It need not involve a specific creditor. One can, for example, have a duty to be a good citizen or not to harm other people in certain ways. A duty need not have a legal sanction. So any provision imposing a duty should state clearly the effects of a breach (as the provision on good faith

³¹ Articles III.–3:511 to III.–3:515 of the DCFR. Articles 9:307 and 9:308 of PECL.

³² Article 1:304.

³³ See Annex 2.

³⁴ The rules in Annex 2 reflect rules which are commonly found in national systems and which have been found to be commercially convenient. The actual wording is derived, with minor drafting changes, from the EEC/Euratom regulation No. 1182/71 of the Council of 3 June 1971 determining the rules applicable to periods, dates and time limits.

³⁵ PECL article 1:201.

³⁶ See Annex 1.

in the DCFR now does). Under the DCFR, an obligation is a duty to perform that is owed by one party to a legal relationship (the debtor) to another party in that relationship (the creditor). The creditor will have a corresponding right to performance. Unless otherwise stated, non-performance of the obligation will bring into play the remedies for non-performance set out in the DCFR. It follows that, under the scheme of the DCFR, all obligations are duties but not all duties are obligations.

Another question in relation to the word ‘obligation’ is whether an obligation is a bilateral relationship or a unilateral duty owed by the debtor. The former usage — seeing the obligation as a tie or *vinculum* — has a long and respectable history, but the latter usage is now more prevalent — and it is the latter usage that was expressly adopted by the Study Group at its Warsaw meeting. The debtor has an obligation, and the creditor has a corresponding right. The obligation is not the whole relationship but the debtor’s part of the relationship.

8.3. Assignment or act of assignment

PECL uses ‘assignment’ sometimes in referring to the contract or other juridical act that is intended to effect a transfer of a right to performance^{*37} and sometimes of the actual transfer itself.^{*38} The DCFR distinguishes between the two. It uses ‘assignment’ for the actual transfer and ‘act of assignment’ for the contract or other juridical act that is intended to effect the transfer.

8.4. Performance or benefit received by performance

PECL sometimes uses ‘performance’ for the act of performing an obligation and sometimes for the benefit received via the performance.^{*39} The two are quite different. An act of performance, once completed, does not, for example, have a market value. Car dealers sell cars, not the acts by which those who sold the cars to them performed their contractual obligations. The DCFR tries to reserve ‘performance’ for the act of performing and to refer to the benefits received through performance where this is what is meant.^{*40}

8.5. Void/voidable/invalid/ineffective

The meaning of the words ‘void’, ‘voidable’, ‘invalid’, and ‘ineffective’ is not always clear in PECL. These words are quite important and quite useful. The DCFR attempts to clarify them.^{*41}

8.6. End or terminate

Some articles in PECL talk of a contract being ‘ended’.^{*42} For example, “A contract for an indefinite period may be ended by either party by giving notice of reasonable length.”^{*43} Others talk of termination. For example, a party who has demanded an assurance of due performance and who has not been provided with such an assurance within a reasonable time “may terminate the contract” by notice in certain situations.^{*44} There is a danger of confusion here. The two words ‘end’ and ‘terminate’ mean the same thing in ordinary English. It would be possible to define ‘terminate’ in such a way that it refers only to termination on certain grounds and to use ‘end’ for termination on other grounds but that would be highly undesirable. Definitions should not produce traps for readers by giving unnatural meanings to ordinary words. The DCFR uses ‘termination’ in its ordinary sense of bringing to an end with prospective effect, except where otherwise provided.^{*45}

Under the DCFR, as already noted, it would be the contractual relationship (and not the contract) that would be terminated. PECL, however, sometimes used ‘contract’ to refer to the continuing contractual relationship rather than the juridical act giving rise to it.

³⁷ See, e.g., article 11:104 (Form of Assignment).

³⁸ See, e.g., article 11:201 (Rights Transferred to Assignee).

³⁹ See, e.g., article 9:401 (1) (Right to Reduce Price).

⁴⁰ See, e.g., article 3:601 (1) (Right to Reduce Price).

⁴¹ See Annex 1.

⁴² See, e.g., articles 2:106; 6:109; 6:111.

⁴³ Article 6:109.

⁴⁴ Article 8:105 (2).

⁴⁵ See Annex 1. In fact when a contractual relationship is terminated there may be restitutionary effects and some rights and obligations (such as those relating to the resolving of disputes) may survive termination. So the words “except where otherwise provided” are important.

9. Other drafting changes

PECL is very well drafted. Nonetheless, the close scrutiny it received in the course of the work of the Study Group revealed various small ways in which the drafting could be improved. A few of these will be mentioned. There is no doubt that the close scrutiny that the DCFR will receive will lead to suggestions for further drafting improvements. That is good. That is how progress is made.

9.1. Party

Often, but not always^{*46}, in dealing with the non-performance of an obligation, the English text of PECL uses the term ‘aggrieved party’ to describe the creditor and the term ‘non-performing party’ to describe the debtor. The French text generally uses the concepts of *créancier* and *débiteur*.^{*47} There is nothing wrong with describing parties to a legal relationship as ‘aggrieved’ (if they are actually aggrieved) or ‘non-performing’ (if it is made clear what it is that they are not performing)^{*48}, but it is unnecessary if the terms ‘creditor’ and ‘debtor’ are already available. It infringes against the drafting principle of not multiplying terms unnecessarily. The DCFR uses ‘creditor’ and ‘debtor’ in these situations.

9.2. Gender-neutrality

Both PECL and the DCFR try to adopt gender-neutral drafting. This is important, particularly in English, because of the way in which personal pronouns are used. It would be objectionable to give the impression that in the Europe of the 21st century only men were legal actors. Women and legal persons are also legal actors. So both PECL and the DCFR avoid using ‘he’ to mean ‘he, she, or it’. The articles in the first nine chapters of PECL avoid this problem by using ‘it’ to refer to a party, or a debtor or a creditor. There are also many references to ‘a party which’ does something. However, this is not quite right either. It rather gives the impression that only companies and legal persons, and not natural persons, can be legal actors. It avoids one trap but falls into another. It also sounds rather strange and ungrammatical to an ordinary user of the English language. The DCFR tries to avoid both traps and to conform to ordinary English usage. Sometimes this leads to a slightly awkward repetition of a noun, but that is a price worth paying.

9.3. Supposed knowledge

A problem arises when a provision must refer to a situation where a person did not actually know something but could reasonably be expected to have known it. To deal with this situation PECL sometimes uses ‘ought to have known’^{*49} and occasionally ‘could not have been unaware’.^{*50} The ‘ought’ formula implies that there is a duty to know, which usually will not be the case.^{*51} The ‘knew or could not have been unaware’ formula, although it now has a long pedigree, is not a very satisfactory one either. ‘Could not have been unaware’ means ‘must have been aware’. A person who must have been aware of something was aware of it. So, logically, the formula says ‘knew or was aware’ which just means ‘knew or knew’. The DCFR generally uses ‘knows or could reasonably be expected to know’ or some variant of that formula (depending on the appropriate tense). It should be noted that there is no implication in that formula that a person is expected to make enquiries. Everything depends on what is reasonable in the circumstances. There will be many circumstances in which a person could not reasonably be expected to make enquiries or conduct investigations. Sometimes, when the policy is that there should definitely not, in any circumstances, be an expectation of enquiries or investigations, the DCFR uses a formula that makes this clear.^{*52}

⁴⁶ Contrast, for example, article 9:101 (“creditor”) with article 9:102 (“aggrieved party”).

⁴⁷ See, e.g., article 9:504.

⁴⁸ See above.

⁴⁹ See, e.g., article 4:111 (2).

⁵⁰ See, e.g., article 3:205 (3) (a).

⁵¹ Sometimes, however, this will be the case and then there is no objection to the “ought” formula.

⁵² See, e.g., IV.C.–2:108 (5) “obvious from all the facts and circumstances known to the service provider without investigation”.

9.4. Juridical act

PECL does not use the expression ‘juridical act’. Instead it refers to statements and conduct indicating intention.^{*53} That, however, is too broad. “I am going out to buy a newspaper” is a statement indicating intention. Lifting a soup spoon and moving it in the direction of a plate of soup is conduct indicating intention. Neither needs to be regulated by rules on grounds for invalidity, interpretation, and so on. The DCFR defines a ‘juridical act’ — actually one of the key building blocks of a system of private law, along with legal relationships, obligations, and rights — as “any statement or agreement or declaration of intention, whether express or implied from conduct, which has or is intended to have legal effect as such. It may be unilateral, bilateral or multilateral.”^{**54}

9.5. Performance of what?

PECL sometimes refers to ‘performance of a contract’.^{*55} However, a contract is not performed — and this is true whether the word is used to refer to a juridical act or to a relationship. What is performed is an obligation that arises from the contract and is part of the legal relationship between the parties.

10. More transparent structure

PECL covers one major category, ‘contract law’, and 17 subcategories — (1) general provisions, (2) formation of contracts, (3) authority of agents, (4) validity, (5) interpretation, (6) contents and effects, (7) performance, (8) non-performance and remedies in general, (9) particular remedies for non-performance, (10) plurality of parties, (11) assignment of claims, (12) substitution of new debtor: transfer of contract, (13) set-off, (14) prescription, (15) illegality, (16) conditions, and (17) capitalisation of interest. Some of these subcategories are subdivided, but that need not concern us here. The important point for present purposes is that everything is grouped under contract law. This is obviously unsatisfactory. Subcategories 2, 3, 4, and 5 above are not confined to contracts but apply also to other juridical acts. The material in subcategory 6 deals partly with contracts and partly with contractual obligations. That in subcategories 7 to 9 may have been intended to deal only with contractual obligations but is often framed in terms of obligations, whether contractual or not. Subcategories 10 to 14 pertain to obligations in general and corresponding rights to performance. Subcategory 15 involves contracts and other juridical acts. Subcategory 16 (as drafted in PECL) concerns contractual obligations, and, finally, subcategory 17 deals with delay in the payment of money and is not limited to money payable under a contract.

There are two criticisms of the PECL structure. Firstly, it is misleading to put all of this material under the heading ‘Contract Law’; secondly, there is a certain lack of organisation of the subcategories. In relation to both criticisms it must be kept in mind, however, that PECL developed over many years. What was to be included by the end, and how it was to be included, may not have been foreseen at the beginning. This excuse was not available to the drafters of the DCFR. The DCFR had to adopt a more transparent structure.

The Study Group gave a lot of thought to the question of structure, a problem that has caused difficulty for centuries but that is probably of greater theoretical interest than practical importance. A sound structure can make material easier to use, understand, and change. A poorly formed or non-existent structure can lead to inaccessibility and avoidable confusion. Would readers look for rules on obligations in general in a book on contract? At the same time, it has to be said that structure is not all that important. Systems with very different structures, some of which must seem rather poor to any thoughtful observer, survive and serve their users well.

In the present context there are two faults to be avoided. One, illustrated by PECL, is to put too much under the ‘contract’ heading. Even if this term is used loosely to include not only contracts as juridical acts but also the legal relationships arising from them, it is still too narrow to cover non-contractual obligations and corresponding rights. And, of course, if ‘contract’ is narrowly defined as a type of juridical act, then even contractual obligations should be under another heading. The other fault is to place too much under ‘obligations’. A contract seen as a juridical act may be a source of obligations and corresponding rights. A contract seen as a legal relationship will generally involve obligations and corresponding rights. But, on either view, a contract is not an obligation any more than an obligation is a contract.

⁵³ Article 1:107. Principles apply with appropriate modifications to “unilateral promises and to other statements and conduct indicating intention”. See also article 1:303 (6) “In this Article, ‘notice’ includes the communication of a promise, statement, offer, acceptance, demand, request or other declaration”.

⁵⁴ See article II.–1:101 (2) and Annex 1.

⁵⁵ See articles 6:111 (2); 8:107; 9:302; 9:502.

The DCFR tries to avoid both of these pitfalls. It distinguishes between contracts and other juridical acts (Book I) and obligations and corresponding rights (Book II). This distinction became all the more necessary after it had been decided to use the word ‘contract’ only of the juridical act and to use the word ‘obligation’ only of the debtor’s side of a legal relationship between debtor and creditor. The topic of marketing and pre-contractual duties is included in Book II because of its close connection to contracts. The other material in Book II deals with formation; cooling-off periods (rights of withdrawal); representation (referring to the effect of concluding a contract or other juridical act as a representative of someone else); grounds of invalidity; interpretation; and the contents and effects of contracts. The remaining PECL material is in Book III. However, more of the articles in Book III are generalised to cover all obligations within the scope of the DCFR and not just contractual obligations. This just carries a step further what was already done in PECL, but in a more transparent way. If it were decided to use the DCFR for an instrument relating only to contracts and contractual rights and obligations — which would give it a narrower scope than PECL and would considerably reduce its potential value — it would be an easy matter to provide that for the purpose of such an instrument ‘obligation’ means ‘contractual obligation’. Very few provisions⁵⁶ would require anything more than that.

11. Expanded and updated national notes

The Interim Outline Edition consists only of articles, with an ‘Introduction’ section and other appendages. It does not include explanatory comments or notes on the solutions adopted by the laws of the Member States. However, the full version of the DCFR will include national notes. They will include material from the Member States that have joined the EU since PECL was written. The notes on the laws of the older Member States will be updated.

12. Conclusions

The cover page of the Interim Outline Edition of the DCFR says that it is “based in part on a revised version of the Principles of European Contract Law”. I have tried to explain some of the ways in which PECL has been revised for the purposes of the DCFR. However, it is worth repeating the point that Books I to III of the DCFR are still essentially and recognisably PECL. That PECL has been found entirely suitable for this purpose by a greatly expanded group of lawyers from a greatly expanded European Union is a tribute to its underlying strength. It is to be hoped that the minor changes made to PECL in the DCFR, not all of which have been mentioned above, will be regarded as improvements. If they are not, there are plenty of commentators from all over Europe who will be able to say so.

⁵⁶ E.g., article III.–7:202 dealing with the period of prescription of a right established by legal proceedings and related articles.



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From the *Acquis Communautaire* to the Common Frame of Reference — the Contribution of the Acquis Group to the DCFR

1. Introduction

The recently published Draft Common Frame of Reference (DCFR) has been prepared by two main research groups, the Study Group on a European Civil Code and the research group on the existing EC private law, commonly called the Acquis Group.*² I have been asked to offer a few words on the way the Acquis Group has achieved its output, the *acquis* principles (ACQP)*³, and how the ACQP contributed to the DCFR. To that end, it seems useful to elucidate a little of what the Acquis Group is doing and what the purposes of its activity are, then to conclude with some remarks on the input this group has made to the DCFR.

2. PECL as starting point of the *acquis* research

The impulse for the research the Acquis Group is undertaking is closely linked to the situation in the second half of the 1990s, when the first parts of the now world-famous Principles of European Contract Law (PECL), commonly called the Lando Principles, were published.*⁴ As readers will know, the PECL include 'Rules', 'Comments', and 'Notes' material. The 'Rules' were elaborated on the basis of comparative research by the

¹ Paper presented at the conference Developments in European Law: European Initiatives (CFR) and Reform of Civil Law in New Member States in November 2007 at Tartu. Some notes have been added.

² Principles, Definitions and Model Rules of European Private Law — Draft Common Frame of Reference (DCFR), Interim Outline Edition. Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group), edited by Christian von Bar, Eric Clive and Hans Schulte-Nölke and Hugh Beale, Johnny Herre, Jérôme Huet, Peter Schlechtriem†, Matthias Storme, Stephen Swann, Paul Varul, Anna Veneziano and Fryderyk Zoll (Munich 2008).

³ Principles of the Existing EC Contract Law (Acquis Principles). Volume Contract I — Pre-contractual Obligations, Conclusion of Contract, Unfair Terms. Prepared by the Research Group on the Existing EC Private Law (Acquis Group) (Munich 2007); hereinafter ACQP; further volumes planned for 2008 and 2009.

⁴ O. Lando, H. Beale (eds.). Principles of European Contract Law Parts I and II. Prepared by the Commission on European Contract Law. The Hague 1999; O. Lando, E. Clive, A. Prüm, R. Zimmermann (eds.). Principles of European Contract Law Part III. The Hague, London, Boston 2003.

so-called Lando Commission, a group of comparative lawyers representing many European jurisdictions. The PECL aim to reflect commonalities of these jurisdictions, if any, or, if the national jurisdictions diverge greatly in their approach, to express a ‘best solution’ chosen from among them. The ‘Comments’ of the PECL explain the meaning of each rule and illustrate its application by way of examples. The most ambitious, and perhaps also most important, part of the PECL are the ‘Notes’, which contain comparative information on the corresponding rule in each Member State that belonged to the EC at the time when the PECL materials were developed.

However, when the PECL came out, those colleagues who were specialists in EC private law were, to some extent, disappointed. With a few exceptions, the PECL did not take into account the existing EC law in their field, the so-called *acquis communautaire*. This is not meant as a criticism of the PECL authors. When the work started, at the beginning of the 1980s, there was not much EC private law. The majority of the relevant directives were enacted after 1985, only becoming a regular phenomenon during the 1990s. The foundation of the Acquis Group in 2002⁵ and of its predecessors in the mid-1990s⁶ was strongly motivated by the lack of EC law in the PECL. One of the original ideas was simply to supplement the Notes of the PECL with the references to EC law that were lacking. However, it became immediately obvious that there were loopholes and gaps not only in the Notes but also in the Rules. In particular, rules were missing on pre-contractual duties, distance selling, e-commerce, non-discrimination law, withdrawal rights, unfair terms⁷, and late payment. Thus, mainly, but not solely, protective rules stemming from the consumer and SME policies of the EU were non-existent.

3. The *acquis* approach

Over time, the project to supplement and complete the PECL with regard to the lacking EC law developed slightly further than just filling the gaps in the PECL. The new idea was to apply the method developed by the Lando Commission to address the many individual pieces of EC legislation and to elaborate standalone ‘Principles of the Existing EC Private Law’. These ‘*acquis* principles’ were not meant to become a competitor to the PECL. The PECL were just used as a kind of standard, especially with respect to matters of structure and style of formulation. By contrast, the ACQP have been drafted for a different purpose. Their core function was to illustrate the current state of EC private law. The ACQP were developed to inform the reader of what already exists in the vast areas of EC law. Thus, the Acquis Group’s first task was to take stock of matters — i.e., to harvest provisions and cases with relevance for private law, contract law in particular, from the many different areas of EC law. As the quantity of EC law was wider than expected, for reasons of practicability a choice had to be made on what to include in the work. It was decided that the ACQP should concentrate first on matters closely related to general contract law and, thus, partly mirror the PECL, in particular its Parts I and II.

The next step was to arrange the rules contained in the material harvested from EC law into systematic principles that illustrate commonalities and underlying ideas of the rather incoherent individual pieces of EC law. The core element of the ACQP is the commentaries, where one can read, with regard to each rule, which individual directives or other parts of the body of EC materials lie behind the rule. The main function of the rules is to form ‘hangers’, hooks on which the relevant EC law can be placed. In this way, the ACQP were to create a new gateway to the existing EC private law.

4. Methodological challenges

The Acquis Group generated general principles from the individual rules and cases that formed the existing EC law. These individual rules were found in the EC directives and regulations as well as in the primary law and in case law. The main challenge was that the existing EC law, mainly directives, is a rather holey patchwork stemming from very different policies of the European Union.⁸ It is questionable whether it is possible to condense this material into a coherent set of principles. It is also doubtful whether an autonomous interpretation of the EC law is really possible or, by contrast, it is impossible to understand EC law without reference

⁵ On the foundation of the Acquis Group see, e.g., H. Schulte-Nölke. Europäische Forschergruppe zum geltenden Gemeinschaftsprivatrecht (“Acquis-Gruppe”) gegründet. – Zeitschrift für Europäisches Privatrecht (ZEuP) 2002, pp. 893–894.

⁶ Predecessors were the Training and Mobility Networks on ‘Common Principles of European Private Law’ (1997–2002, co-ordinator Reiner Schulze) under the 4th EU Research Framework Programme and on ‘Uniform Terminology for European Private Law’ (2002–2006, co-ordinator Gianmaria Ajani) under the 5th EU Research Framework Programme.

⁷ One exception is PECL article 4:110 which is modelled along article 3 of the Unfair Terms Directive 93/13/EEC.

⁸ This is underlined in particular by N. Reich. A Common Frame of Reference (CFR) — Ghost or Host for Integration? – ZERP Diskussionspapier 2006/7, p. 30; to be downloaded from http://www.zerp.uni-bremen.de/deutsch/pdf/dp7_2006.pdf.

to the national private law systems.^{*9} The answer to these questions and the solutions chosen by the ACQP lie somewhere in between.

The first problem was the ‘minimum’ character of many directives. It was necessary to add something, at least to an extent. The solution was to take a look at what the Member States had done in transposing the minimum directives.^{*10} Often, the way in which many Member States had made use of the minimum clauses turned out to be rather similar. In such cases, the ACQP could follow the result of such comparative analysis, thereby going slightly beyond the minimum required by the relevant directive. An example of this technique is the proposed uniform withdrawal term of 14 days in ACQP article 5:103 (DCFR II.–5:103), which is based on the transposition carried out by several Member States.^{*11}

Another challenge was that the basis for the *Acquis Group*’s work is mainly a set of interventionist rules concerning, in particular, consumer law. Thus, some doubts as to whether, in general, it would be possible to generate a systematic European contract law from the very specific EC regulations relating to contract law are well justified.^{*12} It could also be questioned whether the fragmented EC regulations with their very functionalist approach can be a starting point for the creation of general principles of contract law. Aware of that challenge, the *Acquis Group* attempted to work out which general rules could be found within the interventionist directives. In addition, the embedding of the interventionist rules within the national law systems gave an idea of the relation between these rules and general (contract) law. An example is those rules in EC law that have only a limited scope of application. The question to answer was whether such rules can be generalised to a broader scope in the ACQP. The method used then was often a ‘plausibility test’. It was pondered whether the rule would be rational in a more general context, whereupon the researchers used their national experience as a background in this consideration.^{*13} For instance, ACQP article 4:105, which requires that certain pre-contractual statements issued by a business be binding for that business under a contract, is derived from the Consumer Sales Directive (1999/44/EC) and the Package Travel Directive (90/314/EEC). Nevertheless the *Acquis Group* considered this not just as a specific protective measure for sales and package travel contracts, but also to be the expression of a general principle.^{*14}

The generalisation of rules, in particular, proved to be a rather tricky issue. Often the *Acquis Group* had to feel its way. In part, this involved an attempt to distil those elements that several individual rules have in common. Often individual rules contain expression of a general principle that forms their underpinning. An example is unfairness controls — particularly with regard to standard terms. The *acquis communautaire* includes a rather broad set of unfairness controls for consumer contracts in the Unfair Terms Directive (93/13/EEC). However, also for business-to-business contracts, the Late Payment Directive (2000/35/EC) provides an unfairness control for contract clauses concerning the time of payment and also the interest rate for late payment. The *Acquis Group* thought that such examples were the expression of a general principle on unfair contract clauses. It may be worth noting that the Lando Group applied the same methods when it generalised a provision stemming from the Unfair Terms Directive for all contracts.^{*15}

Furthermore, in the *acquis communautaire* there are rules that give rise to an exception to unspoken principles. The task was also, in particular, to find and to draft the general rule or principle behind the exception. For example, the rules on form may be seen as an exception to the principle that a contract or another legal transaction does not, as a rule, require a certain form in order to have validity, which is expressed in article 1:303 of the ACQP.

The *Acquis Group* also had to deal with the differing density of regulation in EC law. The requirement was to find a way of balancing those fields manifesting dense EC regulation — for example, consumer law — with the areas where only a few provisions could be found. In areas of dense legislation, an attempt was made to reduce the density — e.g., by condensing the many lengthy catalogues of pre-contractual information duties into a short set of pre-contractual obligations, set forth in articles 2:201–2:207 of the ACQP. In the fields with less EC regulation, there were gaps to fill. Sometimes this was done by inserting ‘grey rules’ — i.e., taking something from the PECL or the forthcoming DCFR. Otherwise, where there was little or nothing in the *acquis*, the gaps were just left. This is the case, for example, for validity issues, to which a full chapter is devoted in the PECL, which has no counterpart in the ACQP.

⁹ Cf. N. Jansen, R. Zimmermann, Grundregeln des bestehenden Gemeinschaftsprivatrechts? – Juristenzeitung (JZ) 2006, p. 1113 ff., who misconceive the *Acquis Group*’s approach in this respect; see the clarification by F. Zoll, Die Grundregeln der *Acquis Gruppe* im Spannungsverhältnis zwischen *acquis commun* und *acquis communautaire*. – Gemeinschaftsprivatrecht (GPR) 2008, p. 106 ff.

¹⁰ Cf. in particular the study by H. Schulte-Nölke, Ch. Twigg-Flesner, M. Ebers (eds.), EC Consumer Law Compendium — The Consumer *Acquis* and its Transposition in the Member States. Munich 2008.

¹¹ Cf. ACQP (Note 3), Commentary to article 5:103 No. 6 (p. 177).

¹² Cf. N. Reich (Note 8), pp. 23, 30.

¹³ N. Jansen, R. Zimmermann (Note 9) p. 1124, criticise that this plausibility test is a political or normative, rather than a juridical decision.

¹⁴ Cf. ACQP (Note 3), commentary to article 4:105 No. 2 (p. 140 ff.).

¹⁵ PECL article 4:110.

5. Style of the rules

Concerning the style of formulation of EC-based rules, there are two main archetypes, which can be called the ‘duty style’ and the ‘sanction style’. The distinction can be illustrated by the discussion on how to make the provision requiring standard terms transparent. An example of a pure ‘duty-style’ rule can be found in ACQP article 6:302.^{*16} The rule states that there is a duty without stating anything on possible sanctions. The reason for this technique in the ACQP is that the underlying EC law often only specifies duties and leaves it to the Member States to regulate appropriate and effective sanctions. In many cases, the ACQP have maintained the duty style but make some proposals as to which sanctions have to be introduced in order to comply with the requirement of the *effet utile*. By contrast, a pure ‘sanction-style’ version of the rule on transparency of terms was discussed (and finally rejected) when this rule was to be inserted into the DCFR. The rejected rule could have read (simplified): “A standard term that has not been drafted and communicated in plain, intelligible language is not binding on the party who did not supply it.” The DCFR combines the two styles. Thus, the rule on transparency of terms in DCFR article II.–9:402 contains in paragraph 1 a duty of transparency and in paragraph 2 a sanction for infringement of this duty.^{*17} The duty style was maintained because the DCFR should be drafted with a view to its addressees. Thus, the parties to a contract should be instructed in what to do — and not be forced to come to a conclusion concerning their duties on the basis of sanctions for *contra-legem* behaviour. Moreover, a duty-focused style facilitates the application of the law with regard to possible injunctions under the Injunctions Directive (98/27/EC). It is far easier for the enforcing bodies to be given a duty of conduct than to find out the duties only from sanction-style provisions. The question of style is something more; it is a matter of the purpose of the principles. Shall there be provisions concerning the individual parties to a certain contract only, or should there be regulations on behaviour in the market, too? Obviously, the ACQP and the DCFR aim at both.

6. Aims and functions of the ACQP

The idea of the Acquis Group was to complete the existent *acquis* along the lines that were already there. Thus, on the one hand, the ACQP are more than a simple compilation of EC law assembled into a systematic set of rules, because gaps were filled and general principles were worked out on the basis of individual rules. On the other hand, the Acquis Group tried not to deviate too much from the existing EC law. It is therefore important to say what the ACQP are not. The ACQP are not a set of ‘best rules’ as the PECL and the DCFR aim to be. That is, they are not a draft common frame of reference.

As was stated at the beginning of this paper, the ACQP are meant to be a knowledge base (or gateway) for finding out what is in the *acquis communautaire*. To this extent, the *acquis* research can serve as an aid in finding relevant EC legislation and case law. The simple structure, which follows the PECL model, should allow one to find what one is looking for easily. In addition to this, the ACQP might illustrate how the characteristics of the EC law differ from those of the laws of the Member States. Last but not least, the *acquis* research aims to provide tools and a harmonised terminology that might be helpful for improving the legislative quality of EC law. Consequently, the ACQP provide building material for the DCFR and, it is hoped, also for a political common frame of reference.

7. Input to the DCFR

Besides the functions of the ACQP as a standalone set of principles, the idea behind the work was, of course, to contribute to the DCFR. In a rather late stage in the preparation of the DCFR, many rules from the ACQP were incorporated into the DCFR, mainly in the area of general contract law, in Book II of the DCFR. In particular, Chapter 2 (on non-discrimination), Chapter 3 (on marketing and pre-contractual duties), Chapter 5 (on the right of withdrawal), and the rules on unfair terms in Chapter 9 (‘Contents and effects of contract’) in Book II of the DCFR are broadly based on the corresponding chapters of the ACQP. In many other areas, individual provisions are taken (or will be taken) from the ACQP. Examples are provisions on form requirements, e-commerce, and late payment.

¹⁶ The article reads: “Not individually negotiated terms must be drafted and communicated in plain, intelligible language”.

¹⁷ DCFR article II.–9:402 (Duty of Transparency in Terms Not Individually Negotiated) reads: “(1) Terms which have not been individually negotiated must be drafted and communicated in plain, intelligible language. (2) In a contract between a business and a consumer a term which has been supplied by the business in breach of the duty of transparency imposed by paragraph (1) may on that ground alone be considered unfair.” Please note that also article II.–9:408 paragraph (1) DCFR sets out a sanction in case of intransparent terms.

A closer look reveals that the above-mentioned provisions are not just ‘copy-and-paste’ transfers from the ACQP into the DCFR. Most rules taken from the ACQP have undergone slight changes. The reasons for these changes may differ. In some cases, only the terminology has been harmonised. Very often, the rules taken from the ACQP have been reformulated and references to other provisions have been added in order to spell out more clearly to which other rules in the DCFR the rules stemming from the ACQP relate and, in particular, what the sanctions are if duties are not fulfilled. In general, one can say that the rules taken from the ACQP have ‘charged’ the DCFR with a great many consumer protection and other interventionist rules. I very much look forward to the debate on whether the ACQP and the DCFR have found the right balance.



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The Open Method of Convergence

Much has been written about European harmonisation, even unification, of comprehensive parts of private law, particularly in that field of the law of obligations including consumer law. Contrariwise, little attention has been given to convergence of differences in laws, legal mentalities, and methodologies, and to educating and stimulating lawyers to understand those differences and make them converge. That comes as even more of a surprise in view of the fact that there is no legal basis in the European Treaties to allow the European institutions to adopt comprehensive uniform legislation, or codification, of private law¹ — meaning that it can only be achieved by concluding an international agreement among the now 27 EU Member States — while there is a legal basis in article 149 (1) of the EC Treaty for developing quality education, and a duty for the Community (expressed by the word ‘shall’) to act accordingly. That means, in particular, according to article 149 (2), that the Community shall develop the European dimension in education “by encouraging cooperation between Member States and, if necessary, by supporting and supplementing their action, while fully respecting the responsibility of the Member States for the content of teaching and the organisation of education systems and their cultural and linguistic diversity”.

In the long run, education is indeed the best, if not the only, way to build sufficient legal cohesion to bring laws together in areas such as private law for which the European institutions do not have regulatory competencies, and to keep them together in areas, such as consumer law, for which they have, and have exercised, regulatory competencies. Only through educating and teaching lawyers from different Member States to understand one another’s legal systems, mentalities, and methodologies will it be possible to lay the foundations for a convergence of minds and laws that will allow uniform laws, if and where needed, to stick together. Comparative law courses at universities are essential in that regard but do not suffice, as they come in too early a stage of one’s professional life. More rewarding is to stimulate contacts throughout the EU between agents of the law, of whatever age or rank and in whatever capacity they act. In the words of German legal historian Coing, recalling the formation of our common legal heritage in the Age of Enlightenment, “It was academic training based on European ideas that created a class of lawyers animated by the same ideas, and it was the European lawyer who preceded the European law.”² To lay such foundations and to promote this convergence of minds, mentalities, and methodologies, and of laws, we need to put in place a common framework for reference **and** teaching, as advocated in the first issue of the European Journal of Legal Education (2004), or, in terms of new methods of governance, an open method of convergence as will be expounded upon hereinafter.

¹ For an exhaustive study of legal basis in view of harmonising private law, see M. Ludwigs. *Harmonisierung des Schuldvertragsrechts in Europa – Zur Reichweite der gemeinschaftlichen Zuständigkeit für eine Europäisierung des Privatrechts.* – A. S. Hartkamp et al. *De invloed van het Europese recht op het Nederlandse Privaatrecht.* I. Kluwer 2007, pp. 243 *ff.*

² H. Coing. *European Common Law: Historical Foundations.* – M. Cappelletti (ed.). *New Perspectives for a Common Law of Europe* 1978, p. 44.

1. Differences in legal mentalities

Differences in legal mentality certainly exist. They have been admirably described by R.C. van Caenegem in lectures held in Cambridge, published under the title *Judges, Legislators and Professors*.³ In these lectures, Van Caenegem compares the peculiarities of English, French, and German law, the first being judge-made law; the second being shaped by legislation; and the third bearing the imprint of scholarly, Pandectist, learning.

Anyone who wonders whether these differences in legal mentality still exist should compare judgments of the House of Lords with those of the French *Cour de cassation* and of the German *Bundesgerichtshof*. Only in a common-law system is it possible for a judge to say in his decision that “[t]he state of a man’s mind is as much a fact as the state of his digestion”⁴ or, more prosaically (and more recently), is it possible for a Law Lord to express himself on a delicate issue of ‘wrongful life’ in the following terms: “I have not consulted my fellow travellers on the London Underground but I am firmly of the view that an overwhelming number [...] would answer the question with an emphatic No.”⁵ By contrast, who would contradict the famous American judge Cardozo when he describes the decisional practice of German judges as “march[ing] at times to pitiless conclusions under the prod of a remorseless logic which is supposed to leave no alternative”?⁶ And, as Cartesian as French judges may be, that does not show in the cryptic judgments of the *Cour de cassation*, which, following the style of legislative pronouncements, expresses its opinion with a minimum of justification or explanation. All in all, English judgments continue to reflect the spoken language of a judge sitting on the bench, whilst German judgments continue to resemble highly reasoned academic legal writings, and French judgments continue to be formulated in the same authoritative way as statutes promulgated by a legislature. Each of these judicial styles reflects the mentality characteristic of judges, legislators, and professors, as described in van Caenegem’s legal narrative — that is, characteristic of, respectively, judge-made law, codified law, and scholarly law. These characteristics of style are the result of deep-rooted differences between the three legal traditions embodied in case-oriented English law, rule-oriented French law, and concept-oriented German law.

To be sure, with the times, these differences tend to diminish between the EU Member States’ legal systems in consequence of the growing body of Community rules and case law.⁷ But that applies only to a limited field of the law — i.e., in areas for which the Member States have conferred competencies upon the Union (see articles 5 and 7 of the EC Treaty) — and does not affect the vast areas that remain within the sole jurisdiction of the Member States. Nor do these rules and case law change the foundational differences in mentalities and methodologies between the major legal families as represented by the English, French, and German legal systems, differences that, in turn, are responsible for other attitudinal differences. Two of them are the attitude these legal families adopt *vis-à-vis* binding legislation — more specifically, (the desirability of) codification — and the different ways in which lawyers are trained (doctrinal or informal) as well as the teaching materials used for this teaching (textbooks or casebooks).⁸

2. Uniformity v. convergence

So far, the European Commission has focused its harmonisation efforts in the field of private law on contract law in general.⁹ That, in itself, is a remarkable choice: general contract law is supplementary law that can be set aside by contracting parties if they wish; moreover, it has not been the object of much creative case law on the part of the Community courts.¹⁰ From that viewpoint, tort law might have been a better choice.¹¹ Be that

³ Goodhart lectures held in Cambridge in 1984–85. Van Caenegem, a Belgian legal historian, professor at the University of Ghent.

⁴ Quoted by Markesinis, ‘A Matter of Style’. – Law Quarterly Review 1994, p. 608, from *Edgington v. Fitzmaurice* (1885) 29 Chancery Division of the High Court (UK), p. 483, per Bowen LJ.

⁵ Lord Steyn in *Macfarlane v. Tayside Health Board*, in excerpt in W. van Gerven, J. Lever, P. Larouche. *Cases, Materials and Text on National, Supranational and International Tort Law*. Oxford: Hart Publishing U.K. 2000, p. 96.

⁶ Quoted by Markesinis, ‘A Matter of Style’ (Note 4). The author also observes at p. 609 that German judges quote much academic literature in their judgments.

⁷ For examples see W. van Gerven. *Bringing (Private) Laws Closer to Each Other at the European Level*. – F. Cafaggi (ed.). *The Institutional Framework of European Private Law*. Oxford University Press 2006, pp. 41–42.

⁸ *Ibid.*, pp. 42–45.

⁹ The Commission’s efforts were a follow up of the Principles of European Contract Law, Parts I, II and III, prepared by the Commission on European Contract Law (O. Lando, H. Beale (eds.)). The Hague: Kluwer Law International 2000 (Parts I and II) and 2003 (Part III).

¹⁰ See my contribution on “The ECJ Case-Law as a means of Unification of Private Law?”. – A. Hartkamp et al. (eds.). *Towards a European Civil Code*. 3rd ed. The Hague: Kluwer Law International 2004, pp. 113–121.

¹¹ Or administrative law, then in the area of public law, see J. Schwarze. *The Convergence of the Administrative Laws of the EU Member States*. – European Public Law 1998 (4), pp. 191–210. Tort law has been the subject of study groups working on Principles; thus the European Group on Tort Law (European Centre of Tort and Insurance Law, Vienna) which published the result of its activities in May 2005: *Principles of European Tort Law, Text and Commentary*. Wien, New York: Springer 2005.

as it may, following public consultation, the commission has abandoned its original idea of unifying general contract law and has now opted for a common frame of reference, and (possibly) for an optional code — which is more in line with the principle of party autonomy in the field of contract law. Obviously, one of the reasons for this policy change is, as mentioned, the absence of a legal basis in EC Treaty law to regulate contractual relations in general.^{*12} Because of this lack of general competence, Community law must focus on specific subject matter (mainly consumer law) for which the Community has certain limited (and often incoherent) competencies. That situation is responsible for the ‘patchwork’ appearance of Community legislation in relation to matters of private law and, therefore, also of the case law of Community and national courts interpreting EC legislation and implementing national laws in this area and others.

Apart from absence of a legal basis, there is another factor militating against (excessive) uniformity of laws, which is that uniformity should not be an objective in itself, because it is *not*, of itself, a higher good than diversity is. Having regard to the great diversity of the legal families within the EU, and their cultural and linguistic environment, and therefore the resources needed to bring codification to its end, uniformity and unification should occur only when there is good justification for it.^{*13} Within the framework of EC law, such justification for uniformity consists mainly in the necessity to create and operate an internal market with a (sufficiently) level playing field, which implies the elimination of concrete legal impediments in the laws of the Member States. More particularly, apart from the necessity to set aside such specific legal impediments related to the functioning of the internal market, as a general rule there will be no justification for harmonisation concerning matters that touch closely on national identity or culture, including legal culture, or other matters of national interest for which Member States are not (yet) prepared to adopt common legislation.^{*14} To bring the instruments addressing those matters closer to each other, more appropriate mechanisms have to be put in place than the traditional method of binding legislation. That is where the concept of convergence comes in, which is understood here as including not only approximation of laws through institutionalised legislative and judicial processes but also the growing together of rules through voluntary or even spontaneous action — on which this contribution is focused.^{*15}

3. Open method of convergence

The term is used here as a paraphrase of the term ‘Open Method of *Coordination*’. That method is one of the so-called new modes of governance, which became popular after the European Council meeting at Lisbon in March 2000.^{*16} It is a mode of governance based on voluntary co-operation between all stakeholders concerned — public and private, at the national, supranational, and international level — all of whom are to be included in a transparent and openly organised policy-making process and to be involved in its implementation tailored to the needs of the different Member States. Its objective is not in the first place to issue binding legislative acts but, rather, to fix targets, guidelines, and timetables for achieving the goals set; to establish qualitative indicators and benchmarks based on best practices and examples; and to organise periodic monitoring, evaluation, and peer review as part of an ongoing mutual learning process.^{*17} Based as it is on close co-operation between the EU institutions, Member States, and agencies (often private ones), the method can be used as well in sectors for which the EU institutions possess only limited competencies and thus, for example, to support, co-ordinate, or supplement the actions of the Member States in addressing matters in areas such as education, vocational training, youth, and culture (see articles 149–151 of the EC Treaty).^{*18} It can even be

¹² See further W. van Gerven. Codifying European Private Law? Yes if...! – European Law Review (E.L.Rev) 2002 (27), pp. 156–176. For a thorough analysis, see M. Ludwigs (Note 1).

¹³ Compare to article 151 EC where the Community institutions are invited to “contribute to the flowering of the cultures of the Member States, while respecting their national and regional diversity and at the same time bringing the common cultural heritage to the fore.” On the question of whether legal diversity has a constitutional foundation in EU law — the answer is in the affirmative — see F. Cafaggi. Introduction. – F. Cafaggi (Note 7), pp. 10–12.

¹⁴ The basic ECJ judgment interpreting the competences of the Community legislature in a limitative way, even in matters of internal market, is the judgment in Case C-376/98, Germany v. European Parliament and Council. – ECR 2000, I-8419. The Court stated therein that “a mere finding of disparities between national rules and the abstract risk of obstacles to the exercise of fundamental [economic] freedoms or of distortions of competition liable to result there from, [is not] sufficient to justify the choice of Article [95] as a legal basis [...]”. If such a mere finding were sufficient “judicial review of compliance with the proper legal basis might be rendered nugatory”.

¹⁵ See further W. van Gerven (Note 7), p. 65.

¹⁶ See W. van Gerven. The European Union. A Polity of States and Peoples. Oxford: Stanford University Press & Hart Publishing 2005, p. 197 with further references.

¹⁷ For an article on the new modes of governance, and more particularly the Open Method of Coordination, see A. Héritier. New Modes of Governance in Europe: Increasing Political Capacity and Policy Effectiveness? – T. A. Börzel, R. A. Cichowski (eds.). The State of the European Union. Oxford University Press 2003, pp. 105–146.

¹⁸ In those matters the Community is not permitted to take measures to harmonise Member State laws and regulations: see articles 149 (4), 150 (4), 151 (5) EC Treaty.

used in sectors over which the EU has no specific competence but for which the European Commission has been authorised by the other institutions and the Member States' representatives to act "as a motor of European integration [...] and to pave the way for future Community legislation"*¹⁹ — that is, in the area discussed herein, if eventually (and unexpectedly) a legal basis for private law legislation were created by amendment of said treaty or a turnaround in the case law of the European Court of Justice (ECJ) would occur.

The 'Open Method of Coordination' as a new form of government is currently applied in fields as diverse as economic policies, employment policies, and social policies (concerning, for example, social inclusion). It can serve as a model for an 'Open Method of Convergence' of private law. The method would consist of setting up a frame of co-operation or an Action Plan (see *infra*) between Community institutions and Member States' authorities, with the active involvement of the European and national parliaments, and with the participation of private actors; academics, such as the existing study groups; or practitioners, such as bar associations. In its capacity as a motor of European integration (see *supra*), the European Commission could be asked to co-ordinate the process in a general fashion. The whole effort would have two parts, the first one focusing on 'practitioners' of the law (legislatures, judges, and regulators primarily) and the other focusing on 'educators' in the law, mainly professors and teachers in university and postgraduate curricula. Apart from the Bologna reform and exchange programmes, the second part has thus far been largely neglected. To make the effort of convergence more visible and to steer it in a more (but not too) systematic way, an 'Action Plan on Convergence' document could be devised containing an outline of how to stimulate and support the various parts and stages of the ongoing convergence effort. I will return to this later but will first describe the techniques of voluntary convergence actions that are already being undertaken by legislatures, courts, regulators, and educators on the basis of, respectively, 'spill-over' legislation on the part of national legislatures, mutual learning between supranational and national courts, exchange of best practices between European and national regulators and administrators, and preparation of educational materials and techniques between academics and universities. I have developed these techniques in earlier publications*²⁰ and will describe them hereinafter in a more succinct fashion.

4. Legislatures: Spill-over legislation

It is a well-known factor in various spheres that European primary law (i.e., the establishing treaty) and secondary law (regulations and directives, basically) have, apart from a harmonising effect on and between the Member States' legal systems, also a de-harmonising (or patchworking) effect within each Member State's legal system. The reason therefor is that the European legislature has only limited competencies (see articles 5 and 7 of the EC Treaty). The consequence is that, when treaty provisions, regulations, or directives (and also case law relating thereto) affect a specific area of Member State law (e.g., competition law) that until then had been in each Member State regulated only by that state's regulation, that specific area will be subjected partly to European rules (insofar as relations between states are concerned) and partly to national law (where intra-state relations are concerned).

If the national legislature wishes to remedy that de-harmonising effect and maintain coherence within that (specific) area, it can only do so by subjecting, of its own will, the non-European-affected part of national law to the same European rules to which the European-affected part is subjected. That is what is called the spill-over effect (*débordement*, *Überschüssung*, *uitwaaiing*) of European law. As it is brought about by the national legislator's own will, and not imposed by Community law, it is an application of the first characteristic of the open method of convergence: voluntarism. In more general terms, spill-over consists in transplanting or transposing a legal measure from one part of national law (one that *is* affected by Community law) into another part of the same area of national law (that is *not* affected by Community law).^{*21} Competition law is an illustration thereof. Because of articles 81 and 82 of the EC Treaty (and related regulations and case law), each EU member state has two sets of rules, one concerning anti-competitive behaviour when it affects interstate commerce, which is regulated by EC competition rules, and another for similar anti-competitive behaviour when it affects purely intra-state commerce, which is regulated by national competition rules. To restore internal coherence within a Member State, many national legislatures (e.g., in Belgium, the Netherlands, and the UK) have decided to pattern their national laws as closely as possible after the European rules — which

¹⁹ See L. Senden. *Soft law in Community law*. Oxford: Hart Publishing 2004, p. 479.

²⁰ See W. van Gerven (Note 7).

²¹ Interestingly enough, this type of legislative convergence is not limited to relations among the EU and its Member States. It also occurs in relations of the EU with third countries, and thus by spill-over from one jurisdiction into another jurisdiction. This is the case of Switzerland where the Federal Council decided in 1988 to bring Swiss legislation with international applications voluntarily in line with EU standards. See S. Breitenmoser. *Sectoral Agreements between the EEC and Switzerland: Contents and Context*. — CMLRev. 2003 (40), pp. 1137–1186. The same is true for the few remaining EFTA countries: there however, on the basis of an obligation that these states have undertaken as regards the EU. See C. Baudenbacher. *The EFTA-Court An example of the Judicialisation of International Economic Law*. — ELRev. 2003 (28), pp. 880–899.

at the same time allows their authorities and courts to benefit from rulings issued by European regulators and courts and to apply them to similar factual situations but relating to intra-state behaviour.^{*22} The spill-over effect can also be a result of national case law related to European law or inspired by it. An example is the judgment of the House of Lords in *M. v. Home Office* in which Lord Woolf, in his speech, suggested that the Community (case) law ruling that, under Community law, a citizen is entitled to obtain injunctive relief in the UK against the Crown be applied also, for reasons of consistency of the law, to purely internal situation (i.e., in situations where British law is not affected by Community law). The House of Lords followed this suggestion and decided that also in purely internal situations there would be jurisdiction to hear an action against the Crown.^{*23}

5. Courts: Mutual learning and comparing notes

A second characteristic of the open method of co-ordination/convergence is mutual learning, which is typical of courts of law, both between the two European courts, the European Court of Human Rights (ECtHR) and the European Court of Justice (ECJ), and between Member States' courts.

(i) First, I consider mutual learning (and avoiding collisions) in interaction between the two *supranational courts*. So far, the EU has not acceded to the European Convention on Human Rights (ECHR), as was envisaged in article I-9 (2) of the draft Constitution and is now in article 6 (2) of the EU Treaty as revised by the Lisbon Treaty.^{*24} That implies that the ECtHR has no competence to examine the compatibility of Community acts with the ECHR — only the ECJ has jurisdiction over the EU institutions^{*25} — but it does have competence over the EU's Member States, even when they act in their capacity as Member States in the preparation of Community legislation.^{*26} This can lead to delicate jurisdictional questions, the more so because there has been an increasing trend for applicants to bring proceedings before the ECtHR against all Member States in circumstances in which these applicants feel that an act attributable to the Community has infringed their rights.^{*27} Obviously, concurrency of jurisdiction entails the risk of the two supranational courts rendering decisions conflicting with the other's rulings.^{*28} For example, in the *Emesa Sugar* litigation before the ECJ^{*29}, the applicant relied on the *Vermeulen* judgment of the ECtHR^{*30} in arguing that the lack of opportunity to reply to the Advocate General's opinion in cases pending before the ECJ constituted a violation of the right to adversarial proceedings laid down in article 6 (1) of the ECHR. In its decision, the ECJ ruled that the *Vermeulen* case law of the ECtHR (concerning the Procurator General before the Belgian Court of Cassation) was not transposable to the opinions of the ECJ's Advocate General because of "the organic and the functional link between the Advocate General and the Court".^{*31} With regard to the ECtHR's well-established case law, it was not at all certain that the Strasbourg court was going to agree with the Luxembourg court on the occasion of later litigation. The answer came with the judgment of the ECtHR in *Kress v. France*.^{*32} In that case, the applicant alleged a violation of article 6 (1) of the ECHR in that she could not, before the French *Conseil d'État*, inspect the submissions of the *Commissaire du Gouvernement* before they were made at the hearing and that she was unable to address that court in reply after she had spoken. On this point of law, the ECtHR ruled that there were sufficient other safeguards to ensure compliance with the principle of adversarial proceedings, including the fact that the applicant could have asked the commissioner, before the hearing, to indicate the

²² The spill-over effect of Community competition rules occurred also in the new (2004) Member States many of whom have reformed their national competition laws with a view to accession by incorporating the European competition rules almost literally into their internal national law. See J. Schwarze, *Enlargement, The European Constitution, and Administrative Law*. – *International & Comparative Law Quarterly* (ICLQ) 2004 (53), pp. 976–977.

²³ See further my contribution (Note 7), pp. 66–67.

²⁴ The accession of the EU necessitated also an amendment of the ECHR provisions, which has been achieved by Protocol No. 14 adding a provision to article 59 of the ECHR.

²⁵ See further W. van Gerven (Note 16), p. 131 *ff.* (in comparison with the U.S.).

²⁶ See for an exhaustive study S. Douglas-Scott, *A tale of two courts: Luxembourg, Strasbourg and the growing European human rights acquis*. – *CML Rev.* 2006, pp. 629–665 where the recent and now leading *Bosphorus v. Ireland* case (Appl. No. 45036/98, judgment of 30 June 2005) is discussed at pp. 637–639.

²⁷ See further R. Hamsen, *National Responsibility for European Community Acts under the European Convention on Human Rights: Recasting the Accession Debate*. – *European Public Law* 2001 (7), p. 641 *ff.* and now, more recently, S. Douglas-Scott (Note 26).

²⁸ See P. Craig, G. De Búrca, *EU Law, Text, Cases and Materials*. 4th ed. Oxford University Press 2008, pp. 425–427.

²⁹ Case C-17/98, *Emesa Sugar v. Aruba*, Order of 4 February 2000. – ECR 2000, I-665. For the judgment on the merits of the case, see Judgment of 8 February 2000. – ECR 2000 I-675.

³⁰ *Vermeulen v. Belgium* (1996) Reports & Decisions I, 224.

³¹ Order in *Emesa Sugar* (Note 29), at recital 16; see also the two preceding recitals.

³² Judgment of the ECtHR of 7 June 2001 on Application No. 39594/98. Available at <http://cmiskp.echr.coe.int/tkp197/search.asp?skin=hudoc-en> (10.08.2008). For a short overview, see Human Rights Survey. – *ELRev* 2002 (27) Human Rights/134–135.

general tenor of his submissions; that she had availed herself of the opportunity to reply to the submissions by memorandum before the judges' final deliberations; and that the procedure of the *Conseil d'État* provided that, when appropriate, the presiding judge would give leave to allow the applicant to present arguments. Interestingly enough, in *Emesa Sugar* as well as in *Kress*, both the ECJ and the ECtHR³³ were careful to quote the other court's case law, showing that they both wanted to avoid conflicting judgments.³⁴

(ii) I now turn to mutual learning between *Member States' courts*. The easiest way to describe the phenomenon is by reference to the case law of the House of Lords. That is not because the UK's supreme court has a monopoly on comparative jurisprudence — although its members are more used to it on account of the UK's Commonwealth past — but because, due to differences in style, it will use comparative arguments more openly than do, for example, its French or German counterparts. Indeed, as pointed out above³⁵, the legal style of French or German judgments is less apt than that of British ones to incorporate arguments and solutions borrowed from other legal systems. An example showing that also other supreme courts *do* rely on comparative material in dealing with controversial issues is the judgment of the French *Cour de cassation* in *Epoux Brachot v. Banque Worms*. In that judgment, the French court introduced into French law a new procedural remedy in insolvency proceedings.³⁶ Two recent decisions of the House of Lords indicate how convergence between judicial decisions can be achieved through mutual learning. They both relate to the law of obligations. In the first decision, convergence was deemed to lie not in the outcome of the case but in the manner of reasoning; in the second decision, convergence was said to lie in the outcome.

In the first judgment, in *Macfarlane v. Tayside Health Board*³⁷, the question arose as to whether parents who already had four children could claim damages in negligence for the cost of maintaining until majority a fifth healthy child, born despite a vasectomy that the father had undergone in the defendant's clinic. The House of Lords held that the mother's claim for award of damages for pain, suffering, and distress relating to the pregnancy and birth should proceed to trial but dismissed the claim for compensation for the cost of raising the child. Interestingly enough, two of the Law Lords who expressed their opinion on the issue gave different reasons for concluding that the defendant Health Board had no duty of care to the parents with regard to the cost of maintenance. For Lord Slynn, the reason for the non-existence of a duty was the lack of proximity between the physician and the parents as regards that head of damage. In so doing, he avoided basing his judgment on public policy factors (the criteria of the 'just, fair, and reasonable'). On the other hand, Lord Steyn analysed the case from the standpoint of distributive justice, which is concerned with the just distribution of burdens and losses among members of society. He concluded that it would not be morally acceptable, relying on principles of justice, to grant compensation for cost of maintenance. In reaching his conclusion, Lord Slynn referred to (among other material, much from Commonwealth countries) the judgment of the Dutch *Hoge Raad* of 21 February 1997.³⁸ In that judgment, the Dutch Supreme Court, deviating from the strongly reasoned opinion of Advocate General J. Vranken, granted the parents' claim, also with regard to the cost of maintenance, in a similar factual and legal context. Although the supreme courts differed in their judgments on the facts, they examined the same kind of arguments, many of an ethical nature, while attaching different weight to the arguments for and against.

The second judgment in point is the decision of the House of Lords in *Fairchild v. Glenhaven*.³⁹ The case concerns the issue of double or multiple causation — that is, whether a victim who has suffered a legal wrong can obtain compensation for harm caused by one of several possible persons (all having acted in breach of duty), even though it has not been possible for the plaintiff to prove which of those people was the real culprit.

³³ *Emesa Sugar* defended its case also before the ECtHR, this time against the Netherlands, Application No. 62023/00. However, the Strasbourg court declared the case inadmissible holding that the facts relating to matters of taxation (customs duties) fell outside the scope of article 6 of the ECHR which concerns only disputes about the determination of "civil rights and obligations": Judgment of 13 January 2005 (available at <http://cmiskp.echr.coe.int/tkp197/search.asp?skin=hudoc-en> (10.08.2008)). Also in that judgment the Strasbourg court, in relating the facts of the case, quoted extensively from the ECJ's Order of 4 February (referred to in Note 29).

³⁴ This tendency has been confirmed in later case law: see S. Douglas-Scott (Note 26), p. 662.

³⁵ See text accompanying Notes 3–6 *supra*.

³⁶ Cass. Civ. 1^{re}, 19 November 2002, with Opinion of A. G. Sainte-Rose, annotated by Chaillé de Néré. — *Juris-classeur périodique* 2002/II, 10.201; see also the annotation by Khairallah, *Dalloz*. 2003, 797. For further comment, see H. Muir Watt, *Injunctive Relief in the French Courts: A Case of Legal Borrowing*. — *Cambridge Law Journal* 2004 (62). Another example, but then not of a national court, is the considerable amount of comparative research in view of judicial decision-making in concrete cases which is contained in notes prepared by the research department of the ECJ — which, unfortunately, are not published but kept in the Court's archives.

³⁷ Excerpts from the speeches of Lord Slynn and Lord Steyn are reproduced in W. van Gerven, J. Lever, P. Larouche, *Cases, Materials and Text on National, Supranational and International Tort Law*. Oxford: Hart Publishing 2000, pp. 92–96. For an overview of United Kingdom law, see Lord Rodger of Earlsferry, *Wrongful birth in United Kingdom Law*. — S. C. J. J. Kortmann, B. C. J. Hamel (eds.), *Wrongful Birth en Wrongful Life*. Deventer: Kluwer 2004, pp. 43–52.

³⁸ The judgment was already reproduced and discussed in the first (and short) edition of van Gerven et al. *Tort Law. Scope of protection*. Oxford: Hart Publishing 1998, at pp. 161–165, and it is through this source that the Lords were informed of the Dutch judgment. In the second (and enlarged) edition (Note 37), the judgment is reproduced and discussed at pp. 133–136. For a later wrongful birth case (relating, however, to a handicapped child named Kelly) decided by the Dutch *Hoge Raad*, see judgment of 18 March 2005. — *Rechtspraak van de Week* 2005 (42).

³⁹ The judgment, of 20 June 2002, concerns three joined cases, [2002] UKHL 22.

The harm consisted in contracting mesothelioma from inhaling asbestos during the victim's employment at different times by two employers. In his leading speech, Lord Bingham put the issue in a wider perspective, examining not only immediate judicial precedents but also wider case law from other jurisdictions, including civil law jurisdictions, mainly Germany and the Netherlands.^{*40} Referring to one of these sources, Lord Bingham observed that it was unfortunate that the House of Lords had, in the past, retreated from earlier case law at a time when laws in other countries were converging on the point of law at issue: accepting liability in the case of multiple causation.^{*41} On the basis of these and other arguments, Lord Bingham, and with him the House of Lords, allowed the plaintiff to obtain compensation.^{*42}

6. Regulators: Communicating and sharing good practices

A good example of co-operation and communication between regulators of the now 27 Member States is laid down in what is an essential ingredient of the so-called Lamfalussy Process on the regulation of European securities markets.^{*43} Under that process, two committees — the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR) — have been set up. It is one of the tasks of the latter to strengthen co-operation between national regulators to ensure consistent and equivalent implementation of level 1 (framework) and level 2 (implementation) Community legislation in the Member States (level 3). In its own words, the “CESR should fulfil this role by producing administrative guidelines, interpretation recommendations, common standards, peer reviews and comparisons of regulatory practice to improve enforcement of the legislation concerned”.^{*44} The CESR proposes to pursue this objective via three different avenues: co-ordinated implementation of EU law in the Member States, regulatory convergence, and supervisory convergence. In this context, regulatory convergence is the most important. In the words of the CESR, this is “the process of creating common rules. The legitimacy of the role of CESR at level 3 comes from the fact that CESR members take individual decisions on a daily basis that create jurisprudence. [...] [I]n an integrated market, the jurisprudence created by supervisors produces effects that cannot be limited to national jurisdictions and therefore must be faced at EU level. [...] [On the basis of that jurisprudence] the members of CESR will introduce [...] guidance, recommendations and standards in their regulatory practices on a voluntary basis.”^{*45}

Regulatory convergence, as conceived of by the CESR, is a powerful instrument for making national regulations and practices converge in the area of financial services. It illustrates how convergence may be put to use, in the hands of national regulators, to lay down uniform rules and standards on the basis of good practices, benchmarking, and peer review. Although not binding, these rules and standards are complied with voluntarily through mutual confidence between regulators and are applied by these regulators, in consultation with private actors, to relations between producers and users of financial services occurring within their jurisdiction. In diverse working parties within the CESR, rules of practice, common interpretations, common guidance, recommendations, and even standards are being developed. “These documents, accessible on CESR's website, will guide market participants and supervisors as well in their efforts applying and interpreting the different community provision[s],” we are told.^{*46} It is clear that a gathering of regulators like the CESR — and there

⁴⁰ In that respect, he referred to Christian von Bar's book on the Common European Law of Torts, to Markesinis and Unberath's book on the German Law of Torts, and to van Gerven's casebook on Tort Law (Note 37).

⁴¹ Lord Bingham quoted in paragraphs 23 and 25 of his speech arguments taken from the casebook referred to *supra* in Note 36. He also referred to a well-known decision from the Dutch *Hoge Raad*, known as the DES daughters' case, which is excerpted and commented on in the casebook (Note 37), at pp. 447–452.

⁴² At the end of his thorough overview of case law in many Commonwealth and European countries, Lord Bingham observed: “This survey shows, as would be expected, that though the problem underlying cases such as the present is universal the response is not... But it appears that in most of the jurisdictions considered the problem of attribution [of legal responsibility to multiple causes] would not, on the facts such as those of the present cases, be a fatal objection to a plaintiff's claim... Development of the law in this country cannot of course depend on a head-count of decisions and codes adopted in other countries around the world, often against a background of different rules and traditions. The law must be developed coherently, in accordance with principle, so as to serve, even-handedly, the ends of justice. If, however, a decision is given in this country which offends one's basic sense of justice, and if consideration of international sources suggests that a different and more acceptable decision would be given in most other jurisdictions, whatever their legal tradition, this must prompt anxious review of the decision in question.” (Note 39).

⁴³ For a description and analysis of the Lamfalussy process, see N. Moloney. *New Frontiers in EC Capital Markets: From Market Construction to Market Regulation*. – CMLRev. 2003 (40), pp. 809–843. Also K. Coppenhelle. *Reflections on Regulatory Developments in the European Union*. – *European Banking & Financial Law Journal* 2004/1, pp. 5–41. For an inside view, see E. Wymeersch. *CESR. A Building Block in Europe's Future Financial Regulatory System*. – *EUREDIA* 2007–2008/1, pp. 15–17.

⁴⁴ The Role of CESR at “Level 3” under the Lamfalussy Process. Consultation Paper 2004 (ref: CESR/04-104b).

⁴⁵ *Ibid.*, pp. 7–8.

⁴⁶ E. Wymeersch (Note 43), p. 16.

are many others in a variety of sectors — plays a beneficial role in bringing private laws together. It is true, however, that the method is not without danger from the standpoint of political accountability and the rule of law, and “the multiplication of non-binding rules at level 3 should not lead to a grey area where legal certainty is absent and political accountability is unclear”.⁴⁷ That is so because networks of the kind of the CESR are operating, with regard to the above-mentioned level 3, at the purely national level — that is, for the implementation of Community law in the Member States. In that respect, the Community, more particularly the Commission, does not have regulatory or decisional competencies (only remedial and punitive ones: articles 226 and 228 of the EC Treaty). Legal action, if any, undertaken by the network as a body therefore cannot “be directly submitted to judicial scrutiny by courts of law at national or Community level”.⁴⁸

7. Educators: Preparing European teaching materials and reforming law curricula

As mentioned in the introduction to this paper, the best way to promote convergence on a deep level of understanding is to educate open-minded young lawyers and, in view thereof, to prepare materials that can be used by teachers (and students) throughout the Union but also by judges and other practitioners who want to examine, and draw benefit from, other legal systems.

(i) The materials most apt for learning and understanding a legal system are, in my opinion⁴⁹, casebooks (and other sourcebooks), such as the ones published in the *Ius Commune* Casebooks for the Common Law of Europe.⁵⁰ These are books that, in a European context, focus on actual cases decided by national and supranational courts and in prime legislation and compare the various legal orders in order to discover common traits and explain differences at the pan-European level. Such a ‘bottom-up’ approach is needed to supplement, and support, more concept- and rule-oriented approaches, which clearly have the preference of the European legislature.

In concrete terms, the different stages of the bottom-up approach can be described as follows, taking tort law as an example.⁵¹ Firstly, materials (judgments in the first place but also statutory rules and excerpts from academic writings) are collected from national legal orders — as many as possible, but at least one for each of the four large families (that is including the Nordic countries) — and adding relevant material from the two supranational (ECJ and ECtHR) and international legal orders. The materials are selected by reason of their similarity in the factual and legal context of the concrete situation, and they are grouped around ten or more selected themes of tort law. Secondly, the materials are placed in the context of the legal system to which they belong, identifying the procedural, constitutional, and political peculiarities of that legal system and describing the place that the excerpted material takes in the legal system and the contribution it can make to convergence or integration in the wider context of European integration. Thirdly, the role that abstract concepts, general principles, and specific rules play in reaching the specific judicial or statutory solution found in the excerpted material is examined and defined, and it is compared with the role these elements play in the other legal systems. Fourthly, the impact of meta-legal or meta-judicial considerations, often of an ethical,

⁴⁷ Thus the Inter-Institutional Monitoring Group. Third Report monitoring the Lamfalussy Process, Brussels, 17 November 2004, p. 28. Available on the Commission’s website http://europa.eu.int/comm/internal_market/securities/monitoring/thirdreport/2004-11-monitoring_en.pdf.

⁴⁸ *Ibid.*, p. 29. Networks like CESR are in that respect to be distinguished from the European Competition Network (ECN) set up, pursuant to article 11 of Council regulation 1/2003 on competition, to organise a close co-operation between the Commission’s Competition Directorate General and the 27 Member State Competition Authorities. That is a network whose activities are steered by the Commission and is working under the umbrella and the legal and political accountability of the Commission. Obviously convergence between administrators is also fostered within that (very active) network. For an exhaustive description, see S. Brammer. Horizontal Aspects of the Decentralisation of EU Competition Authorities, doctoral thesis law. Leuven 2008, chapter 2. By contrast CESR is set up by a Commission Decision of 6 June 2001, pursuant to a resolution of the Stockholm European Council, to serve as an independent body for reflection, debate and advice for the Commission in the securities field. It is to “contribute to the consistent and timely implementation of Community legislation in the member states by securing more effective cooperation between national supervisory authorities, carrying out peer reviews and promoting best practice.” Thus recital 9 of the preamble of the aforementioned decision of 6 June 2001.

⁴⁹ Not only my opinion. The famous German scholar Rudolf von Ihering wrote in 1881: “Nobody who has had any experience as an examiner will doubt that a student is only able truly to comprehend those ideas which he can conceptualise in the concrete form of actual cases”: quoted by B. Markesinis. Bridging Legal Cultures. – *Israel Law Review* 1993, p. 374.

⁵⁰ See following Note.

⁵¹ See Note 37, the reference to the case book devoted to this branch of the law in the series Casebooks on the common law of Europe (W. van Gerven (general editor), D. Droshout (project co-ordinator)). For further information, see <http://www.law.kuleuven.ac.be/ccle> (10.08.2008). As yet, four full casebooks have been published (by Hart Publishing Oxford): one on Torts (W. van Gerven, J. Lever, P. Larouche (eds.)) (Note 37)); one on Contract Law (H. Beale, A. Hartkamp, H. Kötz, D. Tallon (eds.)), 2002; one on Unjustified Enrichment (J. Beatson, E. Schrage (eds.)), 2003; one on Non-discrimination Law (D. Schiek, L. Waddington, M. Bell (eds.)), 2007. Case books on Property law (S. van Erp et al. (eds.)) and Consumer Law (J. Stuyck, H.-W. Micklitz (eds.)), are forthcoming.

sociological, economic, or political nature, on the (judicial or statutory) decision-making process is analysed in connection with the excerpted material and compared with the impact these considerations may have on material from the other systems.

Producing and using a casebook is not an easy matter but is worth the effort, as it allows the author and the reader to reach a level of understanding that one does not achieve when reading a textbook, however well-written it may be. That is because learning the law through cases helps one to see how rules operate in a concrete situation that looks familiar to the reader because, if the cases are chosen from daily life (and similar daily-life cases exist in all legal systems), they are fully recognisable to him or her. To understand the case fully, the author and reader will have to grasp the peculiarities of the system from which the case is drawn. Moreover, they must try to familiarise themselves with the legal position adopted, and the arguments used, by the litigating parties, and with the legal reasoning and arguments that induced the court and/or legislator to decide on the case or adopt the rule as it did. That is a question not just of understanding the legal reasoning but also of understanding the underlying interests and value judgments that led the court or legislator to choose the solution it did over one that could have been reached through a different line of reasoning.

(ii) Preparing casebooks and sourcebooks that can be used throughout the EU is one thing; reforming the educational system within the EU and the university curricula to present national law teachings in a European comparative context is another. In order to achieve this and to promote, to borrow the terminology of EC article 149 (2), ‘the European dimension in education’, there is an urgent need to build further on the Bologna reforms, which were focused primarily, from an internal market perspective, on facilitating the exchange of students. Further reform should focus instead on contents of education and therefore on:

- 1) how to reorganise the curricula of law schools in a less national and a more European perspective,
- 2) how to revise teaching methods to allow more space for the less doctrinal approach in countries where that approach has been neglected, and
- 3) how to develop teaching material that can be used in master’s programmes throughout the Union.

Indeed, it is not enough to encourage the exchange of students and to allow students to follow courses in a university of another Member State — however useful that may be. It is more essential to the benefit of all students, whether studying at their home university or at a university abroad, to reform the curricula of all law schools from a less national and a more European perspective. That does not mean that the study of national law should be neglected; quite to the contrary, it should remain the foundation of a student’s legal knowledge, without which insight into other legal systems is impossible. Teaching national law does not mean, however, that, within the limits of time and knowledge, said law cannot be taught in a wider European perspective by professors who have a solid comparative law background, on the basis of teaching materials used throughout the EU — though this teaching may not necessarily occur in the first year or in all classes.

8. Toward an Action Plan applying the open method of convergence

As mentioned above, convergence refers to the coming together of legal systems not only as a result of legal or judicial harmonisation processes but also, and mainly, as a result of voluntary co-operation among legislators, judges, regulators, and academics. It has in common with the method of co-ordination that it is based on voluntarism and the inclusion of all actors concerned and that it tries to steer the relevant process by means of flexible soft-law instruments rather than via traditional binding instruments as are characteristic of the formal legislative or judicial harmonisation procedures. The instruments of convergence already in play have been identified and described above. They include processes of spill-over on the part of legislators’ actions, mutual learning on the part of courts, exchange of good practices among regulators, and preparation of teaching materials among academics within curricula reoriented in a European perspective. What this kind of convergence in the area of private law or elsewhere needs is an Action Plan steering the whole voluntary process in a more visible and more systematic way — without institutionalising it too strongly. Such a plan would have two parts: one focusing on practitioners of the law (legislators, judges, and regulators) first, the other focusing on educational aspects.

(i) In the first part mentioned, the Action Plan should address the ways in which methods of voluntary convergence can be encouraged and problems inherent in the process can be solved. With regard to the phenomenon of voluntary spill-over legislation⁵², specific areas of Community-affected national law (*cf. supra*) should be

⁵² The phenomenon of *überschiessende Umsetzung* of Community directives has drawn much attention in German legal literature. See for references, M. E. Storme, *De Redactie Privaat*. — *Tijdschrift voor Privaatrecht* 2006, p. 1255, n. 5.

identified where spill-over into non-Community-affected national law existing in the same specific area would be beneficial and feasible in the Member States from the standpoint of coherence within a Member State's legal system and, in the same vein, between the Member States' legal systems.⁵³ In conjunction therewith, questions to be resolved would arise, such as the use for spilled-over legislation of similar methods of interpretation to those used in relation with Community-affected national law — more specifically, the method of conforming interpretation. It is clear that such study work should involve committees with representatives of national parliaments who, in co-operation with the EU Parliament, would make it their speciality to search for appropriate areas where convergence through spill-over would be most appropriate.

With regard to stimulating voluntary convergence in the **case law** of the Member States' courts through mutual learning techniques, here again a number of areas or broad subjects or themes should be identified around which pilot projects could be set up and resources made available allowing judges and other practising lawyers to meet in working sessions, to communicate and exchange decisions in a common working language, and to look for the best solutions.⁵⁴ Such projects could have as a general theme the impact of national law — in this instance, mainly case law — on the formation of Community law.⁵⁵ The projects could be constructed around finding 'general principles the Member States have in common', a task that, in respect of tort liability, is given to the EU courts in EC article 288 (2), and by virtue of ECJ case law (*Francovich*, *Bergaderm*, and *Courage*) also to the national courts, as well as, in respect of constitutional principles and human rights, in EU article 6 (1). The method to be used in these projects should be a bottom-up approach, proceeding from solutions in the case law of the Member States.

With regard to promoting convergence in the rule-making and decision-taking activities of the many **networks** of Community and national **regulators** of the two kinds (Community-steered networks in respect of the application of Community rules and national-regulator-steered networks in relation to the coherent transposition of Community rules in the Member States, as discussed above), there is a well-functioning example of both of these kinds: respectively, the European Competition Network (ECN)⁵⁶ and the Committee of European Securities Regulators⁵⁷, which can serve as a model of how convergence between Community and national regulators' good practices and procedures can be made effective and efficient — not the least because of electronic communications and good personal relations between its members. Surely, legal problems may and will arise — for example, regarding judicial review of the decision-making process — especially, but not only, with regard to committees of the second kind.⁵⁸ It is important that these problems be tackled in an appropriate way; not solving them could, in the long run, jeopardise the convergence process.

(ii) As already mentioned, the second (educational) part of the Action Plan would have as its task to reorganise the curricula of law schools in view of a more European perspective, to revise and diversify teaching methods, and to prepare common materials that can be used in graduate and postgraduate classes and training programmes throughout the Union. The last of these objectives involves a matter that can be addressed through organised co-operation between academics. The series of casebooks for a common law of Europe, a common initiative of the Catholic University of Leuven in Belgium and the University of Maastricht in the Netherlands, could serve as an example. Already, academics from different Member States are working in teams in the preparation of the various casebooks.⁵⁹ The intention is to cover a variety of areas of private and public law, but that will take many years to come to pass, unless the initiative could be broadened to include a larger group of universities or institutions, and to find European institutions that are ready to co-finance the project. The reorganisation of curricula and, in conjunction therewith, the diversification of teaching methods is a matter of a different kind, as it would require institutional measures, such as the setting up of an independent European law curriculum commission as a jumping-off point from which the revision of law curricula for universities can be undertaken — a suggestion I made years ago but that has proved so far to be wishful thinking.⁶⁰ However, "Point n'est besoin d'espérer pour entreprendre, ni de réussir pour persévérer."

⁵³ On spill-over, see also F. Cafaggi. Introduction. — F. Cafaggi (Note 7), p. 5.

⁵⁴ Currently there is an Association of the ECJ and the Councils of State or Supreme Administrative Courts of the Member States which was the basis for the constitution of a network that has two objectives: to provide a forum through which the EU institutions could obtain opinions of supreme courts and to stimulate discussion and exchange of ideas.

⁵⁵ On this subject, see the several contributions from Supreme Court judges in *Actes du Colloque pour le cinquantième anniversaire des Traités de Rome*, Luxembourg, 26 mars 2007, published by the Luxembourg Office des publications officielles des Communautés européennes 2007.

⁵⁶ See in this respect the contributions to Ph. Lowe, M. Reynolds (eds.), *Antitrust Reform in Europe: A year in practice*. International Bar Association publications@int-bar.org2005, pp. 91–166. See also S. Brammer (Note 48).

⁵⁷ See Notes 43–48 and accompanying text.

⁵⁸ On the rule of law in connection with the ENA, see D. Arts, K. Bourgeois. *Samenwerking tussen mededingingsautoriteiten en rechtsbescherming: enkele bedenkingen*. — *Tijdschrift Belgisch Mededingingsrecht* 2006, pp. 26–47. Also S. Brammer (Note 48), Chapters 4 and 7.

⁵⁹ *Supra* Note 49 and 50 and accompanying text.

⁶⁰ *Supra* Note 12, p. 176.



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Pre-contractual Obligations: The General Contract Law Background

In my first paper in this volume¹, I argued that one of the functions of the Common Frame of Reference (CFR) as a legislator's guide or 'toolbox' would be to provide the legislator with 'essential background information'. Firstly, the CFR necessarily includes some rules that do not reflect the law in every Member State. Instead, they may reflect the 'best solutions' to an issue, solutions found in only some of the laws. To include these without explaining what rules apply in the laws of the other Member States would be highly misleading. To gain an accurate picture, the legislator needs to have information about the different laws in the various Member States. This is the function of the comparative notes that will be included in the final version of the Draft Common Frame of Reference (DCFR). Secondly, European legislators need to know what is a problem in terms of national laws and what is not. If a particular issue is already regulated adequately in the laws of the Member States, and this is done in a reasonably harmonious fashion, then there is no reason for the European legislator to apply harmonisation measures. Thirdly, if legislation at the European level is to be enacted, it should as far as possible be drafted in terms that will be understandable from the standpoint of each national system, and which can achieve a reasonable 'fit' with that system. Again, therefore, the European legislator — or at least the person responsible for the detailed drafting — needs to know how particular issues are treated in the laws of the different Member States.

Thus, in addition to principles, definitions, and model rules, the CFR should contain what I term 'essential background material'. Information about the different laws would be made available in the notes to each article, so that it would be grouped under headings with which the legislator will be familiar.

In this paper, I want to give a practical example of this role in providing essential background information. Wilhelmsson's paper² deals with pre-contractual information duties in the existing *acquis* and the DCFR — in particular, the information that a business is required to give to a consumer. But all Member States, as part of their general law, have some rules that apply when a party has entered into a contract on the basis of inaccurate or incomplete information about the facts. These are the rules on fraud, misrepresentation, and mistake, and — in some countries — the duty to disclose. These provisions of general contract law normally apply to consumer ('B-to-C') contracts as well as to contracts between businesses ('B-to-B') and contracts between private parties ('C-to-C').³ In order to decide whether it is necessary to maintain or extend the directives that require disclosure of information before a contract is made, the legislator needs to know what rules the Member States already apply as part of their general laws of contract.

I will also show consider the provisions of the DCFR as 'model rules' that might be adopted as part of, for instance, an optional instrument. How do they differ from the national laws, and how suitable are the DCFR provisions for an optional instrument?

¹ The Nature and Purposes of the Common Frame of Reference, above, pp. 10–17.

² Below, pp. 51–57.

³ In theory, the general rules might be displaced by specific consumer rules but this is unlikely: normally consumer law gives the consumer additional rights or remedies but does not take away the consumer's rights under the general law.

Thus, in this paper I deal with the rules of general contract law that may give a party a remedy when they have entered a contract under some form of ‘misapprehension’ of the facts — for example, about the characteristics of what they are buying or the circumstances of the contract.^{*4} (I prefer to use the neutral term ‘misapprehension’ rather than ‘mistake’, because the word ‘mistake’ often carries with it an implication that a kind of mistake is involved that is legally relevant. As we will see, in some systems only a very narrow range of ‘mistakes’ may be grounds for relief; in others, a far wider range of ‘mistakes’ may be legally relevant.)

The misapprehension may be the result of one party being given incorrect information by the other, or by a third party, or it may be the result of the party’s own misunderstanding, in which case we can call it ‘self-induced’. The DCFR contains rules on all of these topics. To what extent do these rules merely state principles that are common to all Member States? Are there substantial differences meaning that, in some Member States, consumers or other parties who enter contracts under a misapprehension are significantly better protected than they are in other Member States? Might such differences constitute hindrances to the internal market?

What I will attempt here is a brief survey of the treatment of these issues in the laws of some of the Member States, and a comparison to the provisions of the DCFR. Because space is limited, I hope I may be forgiven for dealing only with the laws of England, France, and Germany. Even with these I will have to resort to some broad generalisations, with the consequent risk that many of the nuances of each system may be lost. I will also have to limit the discussion to selected topics. Thus I will deal only very briefly with the case in which self-induced misapprehensions are shared by both parties^{*5}; and I will not deal at all with the complex problem of contracts entered into on the basis of incorrect information from third parties.^{*6} I hope, however, to be able to say enough to demonstrate the need for a toolbox to provide the kind of background information I have described.

1. Harmonisation?

Given the title of the volume, we should begin by asking whether this area is one in which there has been, to date, any degree of harmonisation. This might seem to be a field that is ripe for harmonisation. As we will see, at first sight the laws of the Member States mentioned above differ markedly, particularly as to mistake and duties of disclosure. I will argue that, if we look behind the variety of concepts and terminology, and concentrate on the actual results reached in concrete cases — this adaptation of the well-established ‘functional approach’ is the basis on which the Principles of European Contract Law^{*7} (PECL), for example, are founded — the differences become much less. Nonetheless, this is one of the areas of general contract law in which there are some very striking differences.

Obviously, there has been some harmonisation through implementation of the EC directives that require certain types of pre-contract information to be given — for example, the Distance Selling Directive^{*8} and the Package Travel Directive.^{*9} However, these apply only to B-to-C contracts. On B-to-B and C-to-C contracts there is very little. The Commercial Agents Directive, for example, says nothing about pre-contract information, though arguably commercial agents need to be properly informed before they enter into a contract.^{*10} It is, of course, true that ‘soft law’ instruments such as the UNIDROIT Principles of International Commercial Contracts^{*11} (UPICC), the PECL materials, and even the DCFR itself contain provisions that are set forth in broadly similar terms. However, soft law of itself does not achieve harmonisation. The most it can achieve on its own is some harmonisation of practice. Thus, there will be some harmonisation in practice if these instruments are adopted by the parties to govern their contract (so far as that is permissible under the applicable national law: under the Rome Convention, it is not possible to adopt such soft law to displace the governing national law entirely), or if the soft laws are applied by arbitrators as statements of ‘internationally accepted principles’ and the like.^{*12}

^{*4} I will not deal with mistakes and misunderstandings over the terms of the contract, for example when a party sends a written offer to sell goods for £10 when he meant to write £100.

^{*5} See below, p. 46.

^{*6} On this, see DCFR articles II.–7:208 and II.–9:102.

^{*7} O. Lando, H. Beale (eds.). *Principles of European Contract Law. Parts I and II.* Kluwer 2000; O. Lando, E. Clive, A. Prüm, R. Zimmermann (eds.). *Principles of European Contract Law. Part III.* Kluwer 2003.

^{*8} Directive 97/7/EC of 20 May 1997, article 4. – OJ L 144, 4.06.1997, pp. 19–27.

^{*9} Directive 90/314/EEC of 13 June 1990, articles 3 and 4. – OJ L 158, 23.06.1990, pp. 59–64.

^{*10} Cf. *Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference (Interim Outline Edition.* Sellier 2008) (DCFR), Book IV.E–2:101.

^{*11} 2nd ed., 2004.

^{*12} For these uses, see PECL article 1:101 and the Preamble to the UPICC, section 4.

What in time I hope we will be able to say is that the soft law instruments have led to some degree of convergence between the laws, as national legislators and courts have drawn on them when reforming or developing national law. This is the subject of other papers in the volume, and I will not discuss it here, save to say that this process is only just beginning — with Estonia setting the pace!

2. Mistake caused by incorrect information given by the other party

I will start my comparison with the case in which a party has entered a contract under a misapprehension about the subject matter or the surrounding circumstances that was caused by incorrect information given by the other party. Since we are dealing with general contract law, I will resort to disembodied characters. Let us call the (female) party who claims she entered into the contract under the misapprehension party ‘A’ and the other (male) party to the contract — the one who gave A the incorrect information — party ‘B’.

2.1. Shared principles and terminology: Fraudulent misstatements

I begin with a case in which we find a good deal of similarity between the systems, not only in results but in the terminology and concepts used. This is where A entered into the contract under a misapprehension because B had deliberately given A information that B knew to be incorrect. It is normal to refer to this as a case of fraud. In some systems, it is called fraudulent misrepresentation, while in others it might be more common to call it mistake induced by fraud, but the difference in these concepts seems to be minimal.^{*13} The remedies are also broadly similar in the different systems. Thus, even if the fraud is related to a fairly minor matter, A will have the right to avoid the contract; and B will also be liable to pay damages. The liability for damages will normally be non-contractual (tort, delict, civil responsibility), with the aim being to compensate A for her reliance loss (‘negative’ interest).

Thus, it was hard to agree on the PECL^{*14} fraud article, which in its DCFR version reads as follows (in part^{*15}):

II.–7:205: Fraud

- (1) A party may avoid a contract when the other party has induced the conclusion of the contract by fraudulent misrepresentation, whether by words or conduct [...]
- (2) A misrepresentation is fraudulent if it is made with knowledge or belief that the representation is false and is intended to induce the recipient to make a mistake [...]

Likewise, the DCFR provides that A may recover damages from B. The damages are “to place the aggrieved party as nearly as possible in the position in which that party would have been if the contract had not been concluded”^{*16}.

2.2. Different concepts, similar results: B gives incorrect information without fraud

In the next category we find that the systems apply different concepts and terminology but the practical results are very similar. This is the case when A enters into the contract under a misapprehension because of incorrect information given to her by B but B was not acting fraudulently — B did not know that the information was incorrect.

In many systems, including French and German law, this case would be treated as one of mistake. Firstly, A would be permitted to avoid the contract on grounds of mistake, provided that the mistake had a certain seriousness: in French law, if it related to some *qualité substantielle* of the subject matter^{*17}; in German law, if it was “as to those characteristics of a [...] thing that are regarded in business as essential”^{*18}.

¹³ I will discuss one major difference — that in some systems keeping silent may amount to fraudulent conduct, below.

¹⁴ Article 4:107.

¹⁵ See further below, p. 48.

¹⁶ DCFR article II.–7:214 (2).

¹⁷ E.g., Cass civ, 23 novembre 1931, D.P.1932.1.129, n. Jossierand; Gaz.Pal, 1932.1.96; see H. Beale, A. Hartkamp, H. Kötz, D. Tallon. Cases, Materials and Text on Contract Law. Hart 2002 (“Ius Commune Casebook”), p. 369.

¹⁸ BGB § 119 (2).

Secondly, if B was at fault — if he should have known that the information was inaccurate — it seems that B would be liable to pay damages to A. In French law, this would be on the basis of CC article 1382. In German law, the claim would be on the basis of *culpa in contrahendo*.^{*19} The usual remedy for *culpa in contrahendo* is an award of the negative interest in damages under BGB § 249.^{*20} It seems that in either system there may be liability under these headings even if the conditions for avoidance for mistake are not met, for example, because the mistake is not sufficiently serious.^{*21}

It should be noted that in both systems A may have relief from the contract in more cases than I have just mentioned. Later we will see that in both systems there may be relief on the ground of mistake in further cases; additionally, there are a number of other doctrines which may also afford relief: for example, in French law, absence of *objet* or of *cause*, or in German law, initial impossibility.^{*22} However, I want to confine my discussion to the case where B gave incorrect information, and to relief on the ground of mistake, in order to show how other systems may reach similar results but by a very different route.

The principal comparison here is to the common law systems. As we will see in more detail later, English law^{*23} would seldom give relief on grounds of mistake in such a case. Just as in the case of fraud, English lawyers would normally say that A's remedy is given because of B's fraudulent misrepresentation, rather than on the basis of A's mistake, so in this case relief would be granted on grounds of misrepresentation. In the 19th century it was established that a contract that has been entered into as a result of a misrepresentation may be avoided by the misrepresentee, even though the misrepresentation was not fraudulent but 'innocent'.^{*24} Until 1967 it would have been possible for A to avoid the contract even if the incorrect statement concerned some minor matter^{*25}, but now, by statute, where there was no fraud the court has discretion to refuse to permit rescission.^{*26} The court would probably exercise its discretion where the misrepresentation was as to something minor.^{*27} The same statute creates liability for damages if B was negligent in giving the incorrect information.^{*28} Again, damages will be on the tort measure.^{*29}

Thus, in the second situation I pose, the concepts and language employed by the three systems are quite different but the actual results are similar. If A's misapprehension was as to something important, she will be able to avoid the contract whether or not B was at fault in giving the incorrect information. If B was at fault, B will be liable in damages (measured on the negative interest basis) whether or not A can avoid the contract. Again it was not too hard for the Commission on European Contract Law to agree on the substance of the results that should be produced by the common principles.

There was, however, a difficulty over the form, the terminology, to use in stating the 'rules'. Which concepts and language should be used — the Continental language of 'mistake', the English language of 'misrepresentation', or possibly some neutral but unfamiliar term like 'misapprehension'? It is not surprising that the Commission on European Contract Law followed the UPICC^{*30} in adopting a 'mistake-based' model^{*31}, and this is followed in the DCFR in II.–7:201: Mistake:

- (1) A party may avoid a contract for mistake of fact or law existing when the contract was concluded if:
 - (a) the party, but for the mistake, would not have concluded the contract or would have done so only on fundamentally different terms and the other party knew or could reasonably be expected to have known this; and
 - (b) the other party:
 - (i) caused the mistake (otherwise than by merely leaving the mistaken party in error) [...].

¹⁹ See Ius Commune Casebook (Note 17), p. 405; also PECL article 4:117, Note 1. Moreover, B would lose any claim to compensation under BGB § 122.

²⁰ See Münchener Kommentar, under BGB § 275, paragraph 194.

²¹ See Ius Commune Casebook (Note 17), pp. 404–405.

²² *Ibid.*, pp. 381–382.

²³ I believe the same is true of Irish law, but not always of American law, where the grounds of relief mistake have been broadened.

²⁴ *Redgrave v. Hurd* (1881) 20 ChD 1; Ius Commune Casebook (Note 17), p. 401.

²⁵ Though possibly there is no remedy if it is not 'material' in the sense that it is so minor that it would have no influence at all on the reasonable person; see Chitty on Contracts (29th ed, 2004) § 6–036.

²⁶ Misrepresentation Act 1967, § 2 (2).

²⁷ Cf. *William Sindall Ltd. v. Cambridgeshire CC* [1994] 1 WLR 1016.

²⁸ See § 2 (1), which gives B the burden of proving that he had reasonable grounds for believing what he said.

²⁹ *Royscot Trust Ltd. v. Rogerson* [1991] 2 QB 297, CA.

³⁰ See now UPISCC article 3.5.

³¹ See PECL article 4:103.

This needs to be read alongside DCFR II.–7:204 ('Liability for Loss Caused by Reliance on Incorrect Information')³², which provides that a party who has concluded a contract in reasonable reliance on incorrect information given by the other party in the course of negotiations has a right to damages for loss suffered as a result if the provider of the information was at fault.

2.3. Different results: Self-induced misapprehension

When we turn to my last category, we find not only that the systems use different language but that they reach very different results. This is the category of case in which A has entered the contract under some misapprehension that was not caused by anything B did or said; in other words, the misapprehension was 'self-induced'. Within cases in this category there are variations possible. Firstly, B may or may not have been under the same misapprehension. Secondly, B may or may not have known that A was under the misapprehension.

For reasons of space, I will not deal with the case where the two parties shared the same misapprehension. All of the systems give relief in some cases of shared mistake, though under rather different conditions. In French and German law, the right to avoid is subject to the normal test that the mistake must be as to something of importance.³³ The common law gives relief for shared ('common') mistake only in very extreme cases. If fulfilment of the contract, or the contractual venture as conceived by both the parties, is in fact impossible, the contract will be void. In other cases there will be no relief.³⁴ The DCFR follows the Continental approach.³⁵

2.3.1. B knew about A's mistake

If, when the contract was made, B knew that A was entering into it under a misapprehension about the subject matter or circumstances but B dishonestly decided to keep silent, in many Continental systems B will be deemed guilty of fraud. In French law, this would be a case of *dol par réticence* and A would have the same remedies as in a case of fraudulent misrepresentation. German courts have also held that non-disclosure can amount to fraud if A may expect disclosure in keeping with the requirements of good faith and fair practices in accordance with BGB § 242.³⁶ However, the German courts may be less demanding than the French: A cannot always expect disclosure.³⁷ This seems to depend on factors such as how important the fact is and how hard it would have been for A to discover the truth.³⁸

Further, even if B was not acting dishonestly, if A's misapprehension was as to something of importance, A will be able to avoid the contract on grounds of mistake.

Under English law, by contrast, keeping silent cannot amount to fraud. There is no duty for B to point out A's mistake, even if it is perfectly obvious that A would never enter the contract if she knew the truth. Only in exceptional cases, such as with contracts of insurance³⁹, is there any duty of disclosure in common law. Nor will A get any help from the doctrine of mistake. A self-induced mistake as to the facts — the nature of the subject matter or the circumstances — made by one party but not the other simply does not constitute grounds for relief in English law.

2.3.2. A's mistake was unknown to B

The last scenario is that A entered into the contract under a mistake that was unknown to B. In French law, A may avoid the contract, provided that the mistake was as to some matter that B knew was a matter of importance. Under German law, the same is true, but the relief for A is subject to an important qualification. If A avoids the contract, she may be required to compensate B for losses incurred in reliance on the contract, unless B did not know and had no reason to know of the mistake.⁴⁰ In English law, there would be no relief at all in this situation.

In these cases, therefore, we see a real divergence in substance between the three legal systems. I would say that this difference is probably the greatest that we encountered in preparing the PECL. It is clearly important to flag for the reader that whatever rules on this topic are contained in the CFR are definitely **not** shared by all

³² Derived from PECL article 4:106.

³³ See above, pp. 44–45.

³⁴ See *Great Peace Shipping Ltd. v. Tsavlis Salvage (International) Ltd.*, *The Great Peace* [2002] E.W.C.A. Civ. 1407, [2003] Q.B. 679.

³⁵ See II.–7:201.

³⁶ E.g., BGH, 3 March 1982. – NJW 1982.1386; *Ius Commune Casebook* (Note 17), p. 415.

³⁷ E.g., BGH, 13 July 1988. – NJW 1989.763.

³⁸ See *Ius Commune Casebook* (Note 17), pp. 417–419.

³⁹ Contracts of insurance are described as contracts 'of the utmost good faith' and the parties (in practice, the would-be insured) must disclose all material facts. Similar rules apply to a few other kinds of contract; see Chitty on Contracts § 6–139. *ff.*

⁴⁰ BGB § 122.

of the Member States. Rather, the researchers, like the Commission on European Contract Law before them, have made a policy choice. The divergence also illustrates the need to provide the European legislator with information about what is out there in the laws of the Member States. For example, were a legislator to assume that the position in French law reflects ‘the norm’ throughout Europe, it might well conclude that it is not necessary to provide any additional protection, even for consumers. This also illustrates the need to make sure the legislation fits with the different systems. For instance, it would be no good for the legislation to provide that “a party’s duty of disclosure shall include X and Y” when in English law there is no such duty.

3. The DCFR solution

What approach does the DCFR take? It will come as no surprise for one to find that the DCFR, like the PECL before it, adopts a compromise position. Firstly, in some cases B’s failure to point out to A that A is making a serious mistake may amount to fraud. But, as under German law, this is only when failure to point this out would be a breach of the duty of good faith and fair dealing. Thus article II.–7:205 (1) provides that there is fraud not only where there has been fraudulent misrepresentation^{*41} but also where there was “fraudulent non-disclosure of any information which good faith and fair dealing required that party to disclose”. Equally, there is a compromise on mistake. Secondly, the DCFR allows avoidance on grounds of mistake in cases where only one party is under a self-induced misapprehension, but under more limited conditions than in French or German law. Self-induced mistake by A is grounds for relief but only when B shared it^{*42} or

(ii) knew or could reasonably be expected to have known of the mistake and, contrary to good faith and fair dealing, left the mistaken party in error [...] ^{*43}

These articles serve as not just an example of a political compromise between two opposing positions, however. We think they provide a more workable approach than do either of the extreme positions represented by English law, on one hand, and French law, on the other.

For a long time, English lawyers have recognised that in many situations their rule of non-disclosure is out of step with morality. As long ago as in 1871, Chief Justice Cockburn said that the law was different from the moral position:

The question is not what a man of scrupulous morality or nice honour would do under such circumstances. The case put of the purchase of an estate, in which there is a mine under the surface, but the fact is unknown to the seller, is one in which a man of tender conscience or high honour would be unwilling to take advantage of the ignorance of the seller; but there can be no doubt that the contract for the sale of the estate would be binding [...]. ^{*44}

It is not wholly clear why English law has adhered to this rule of non-disclosure. One possibility is that English morality is out of line with that of our fellow Europeans. I doubt that. I think it is more likely to be the result of the fact that English law is very heavily influenced by the heavy diet of commercial cases that are heard in English courts. Many of these are contracts between very sophisticated players in highly competitive markets in which good faith probably would not require any disclosure to be made in any event. If one takes a case like the leading French case, in which the seller of a country cottage deliberately did not tell the buyer that a neighbouring farmer was about to open a pig farm^{*45}, I suspect that even the most hardened English lawyer would say that the law ought to require the seller to say something. I think what has happened is that the rule has only ever been challenged in commercial cases, and these have produced a rule that has been said to apply to all cases but is not appropriate for all of them.

Conversely, however, it has been argued even by French authors that some of the French cases go too far — particularly, cases such as the celebrated case of the Poussin painting, in which it was held that the buyer of a painting (the Louvre) should have disclosed to the sellers that there was a chance that it was by that famous artist, whereas (to the buyer’s knowledge) the sellers were under the impression that it could not be by Poussin.^{*46} That rule seems to prevent a party from capitalising on information that it may have expended a great deal of time and money to acquire.^{*47} It has been argued persuasively that it may be right to require a party to disclose

⁴¹ See above, p. 44.

⁴² See above, p. 46.

⁴³ DCFR article II.–7:201 (1) (a) (ii). PECL article 4:103 was to the same effect.

⁴⁴ *Smith v. Hughes* (1871) LR 6 QB 596.

⁴⁵ Cass Civ 3, 2 octobre 1974, Bull.civ. III.330, D.1974, IR.252; RGLJ 1975.669, n. Blanc; *Ius Commune Casebook* (Note 17), p. 412.

⁴⁶ Cass Civ 13 decembre 1983, JCP 1984.II.20186 and Cour d’appel versailles, 7 janvier 1987, Gaz.Pal.34; *Ius Commune Casebook* (Note 17), p. 373.

⁴⁷ For a valuable discussion of the problem from a law-and-economics viewpoint, see A. Kronman. *Mistake, Disclosure, Information and the Law of Contracts*. – *Law & Society* 1978 (7) 1 and further pieces cited in *Ius Commune Casebook* (Note 17), p. 428, n. 303.

information about his own *prestation* but not to require that he give the other party information about that other's own *prestation*.^{*48} It seems a better rule to say that B should have to point out A's mistake when in the circumstances a failure to do so would be contrary to the general standard of good faith and fair dealing. As we have seen, this is what the DCFR's articles II.–7:205 ('Fraud') and II.–7:201 ('Mistake') do. However, since good faith and fair dealing is not a standard that is well known in all legal systems, the DCFR tries to give more precise guidance as to when disclosure is required. Article II.–7:205 continues thus:

- (3) In determining whether good faith and fair dealing required a party to disclose particular information, regard should be had to all the circumstances, including:
 - (a) whether the party had special expertise;
 - (b) the cost to the party of acquiring the relevant information;
 - (c) whether the other party could reasonably acquire the information by other means; and
 - (d) the apparent importance of the information to the other party.

One sees here that the DCFR takes a compromise rule. We researchers think that, were the European legislator ever to contemplate a directive to harmonise the laws on the general duty of disclosure, this would be a good model, at least one from which to start the negotiations that inevitably would take place on exactly what the rule should say. Likewise, we think this would be an appropriate rule to include in an 'optional instrument', whether that were to be aimed at B-to-C contracts or at B-to-B contracts, especially those involving SMEs.^{*49}

4. Indirect duties of disclosure

So far I have discussed only the rules on fraud, mistake, and non-disclosure. It is worth pointing out that, in all legal systems, in practice these form only part of the picture. There are other rules that have the indirect effect of requiring one party to make a disclosure to the other party. I will mention just a few of these.

4.1. Unfair exploitation

Many legal systems allow a party to claim relief if said party has been a victim of deliberate exploitation by the other party — what is sometimes called 'qualified lesion'.^{*50} The DCFR, like the PECL^{*51} and UPICC^{*52}, contains a provision on this, in its II.–7:207 ('Unfair Exploitation'):

- (1) A party may avoid a contract if, at the time of the conclusion of the contract:
 - (a) the party was dependent on or had a relationship of trust with the other party, was in economic distress or had urgent needs, was improvident, ignorant, inexperienced or lacking in bargaining skill, and
 - (b) the other party knew or could reasonably be expected to have known this and [...] exploited the first party's situation by taking an excessive benefit or grossly unfair advantage.

One form of advantage-taking is where one party exploits the other's ignorance by buying property at well below its market price while knowing that the seller has no idea of its value. It is obvious that an indirect effect of this rule is to make the buyer warn the buyer of the true value.

Another example is the indirect effect of the obligations related to conformity in contracts such as those for sale of goods. If the goods are not in conformity with the contract, the seller will be liable^{*53} — unless, before the contract was made, the seller pointed out the defect in the goods to the buyer.^{*54}

When these indirect obligations are taken into account, the practical differences between the laws of the Member States are reduced even further, yet, in those cases falling outside these rules, the fundamental differences I identified earlier remain.

⁴⁸ M. Fabre-Magnan, *Duties of Disclosure and French Contract Law*. — J. Beatson, D. Friedmann (eds.), *Good Faith and Fault in Contract Law*. Oxford: Clarendon 1995, pp. 99–120.

⁴⁹ See my first paper, above, p. 10–17.

⁵⁰ See *Ius Commune Casebook* (Note 17), pp. 460 *ff*.

⁵¹ PECL article 4:109.

⁵² UPICC article 3.10.

⁵³ See DCFR article IV.A–2:102.

⁵⁴ See DCFR article IV.A–2:307.

4.2. Duties of disclosure in special contracts

I end my survey by considering some specific requirements to disclose information that appear in the DCFR, though they are far from being recognisable in all legal systems and therefore may appear striking, even shocking. In the Book on Services Contracts, there is a general duty set forth for the service provider to warn the client if there is a risk that the service requested may cause damage or injury to the client's other property or interests, and even to warn that the service may not achieve the results the client wants. Article IV.C-2:102 ('Pre-contractual Duties to Warn') states the following:

- (1) The service provider is under a pre-contractual duty to warn the client if the service provider becomes aware that the service requested:
 - (a) may not achieve the result stated or envisaged by the client, or
 - (b) may damage other interests of the client, or
 - (c) may become more expensive or take more time than reasonably expected by the client.

The category of service contracts addressed in the DCFR is so broad — "It applies in particular to contracts for construction, processing, storage, design, information or advice, and treatment"⁵⁵ — that this almost amounts to a provision of general contract law. It goes further than either the article on fraud (which specifies that the service provider may not deliberately aim to mislead the client) or that on mistake. The mistake article applies only if the mistake results in the terms of the contract being fundamentally different from what would have been agreed upon had the client known the true position, which is not a requirement of article IV.C-2:102.

At first sight, I thought, article IV.C-2:102 simply cannot represent anything like the 'common principles' of the laws of the Member States, but, when I thought about it more carefully, I realised that it is not actually so radical. It merely **seems** radical, for at least two reasons. Firstly, we are not used to seeing 'rules' on service contracts — in most legal systems, there is little by way of legislation on them. Secondly, again we need to consider function, not form. Even in my own system, which I think may fairly be characterised as espousing highly individualistic values and imposing few information duties, there are cases that come very close to this. We have cases of courts holding that a surgeon is under a duty to a patient to explain the risks involved in a course of treatment, including both the risk that the operation may cause further injury⁵⁶ and the risk that the operation or treatment may not work.⁵⁷ They are rather 'hidden', however, by the fact that cases of professional negligence are more often discussed in books on liability in tort than in books on contract law — if only because in a country in which at least some operations are carried out under the National Health Service, the patient has no contract with the surgeon and must therefore sue in tort. However, when the operation is performed 'privately', the patient may sue the surgeon for negligence in either contract or tort (English law has no rule of *non-cumul*). At least some of the decisions are explicitly based on contract.⁵⁸ Similarly, there have been cases in the common law world holding a builder liable as negligent for failing to point out defects in a design.⁵⁹

Thus, we can see that the rule quoted above is not so radical, and to me it makes a lot of sense. If a woman takes her favourite vintage dress to the dry cleaners, is it unreasonable to require the dry cleaner to point out that the fabric may no longer be strong enough to withstand the treatment, or that the treatment will not remove a stain that is 20 years old? I don't think it is.

What is more radical, perhaps, is to require the client to give information to the service provider about the risks the latter faces. Article IV.C-2:102 continues thus:

- (4) The client is under a pre-contractual duty to warn the service provider if the client becomes aware of unusual facts which are likely to cause the service to become more expensive or time-consuming than expected by the service provider or to cause any danger to the service provider or others when performing the service.

So if you employ a builder to build an extension to your house, and you happen to know that running across the site there is an old drain that the builder doesn't know about and that is likely to cause him problems, you should warn him. Again, it does not seem unfair that the duty should be reciprocal. As we say in England, what is sauce for the goose is sauce for the gander.

⁵⁵ DCFR article IV.C-1:101 (2).

⁵⁶ E.g., *Sidaway v. Governors of the Bethlem Royal and Maudsley Hospital* [1985] AC 871, HL.

⁵⁷ See *Thake v. Maurice* [1986] QB 644, CA (surgeon negligent in not warning private patient that a male sterilisation operation might reverse itself naturally.)

⁵⁸ *Thake v. Maurice*, above.

⁵⁹ *Brunswick Construction Ltée v. Nowlan* (1974) 21 Building LR 27 (Supreme Court of Canada).

5. Conclusions

I have tried to show the function of the CFR in order to provide essential background information — and indeed I hope I have provided some background to more specific discussion of pre-contract information duties in the *acquis*. I have also shown how the CFR can provide model rules that should be considered — were there ever to be European legislation dealing with general contract law. Harmonisation of the general contract law in the Member States — via a directive on general contract law, for example — seems most unlikely, but (as I argued in my first paper) there is a case for developing an optional instrument that parties could use to govern their contract in place of national law. Obviously, the model rules of the DCFR could form a first draft for discussion.



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Various Approaches to Unfair Terms and Their Background Philosophies

1. The importance of the principle of fairness — and of its background philosophies

The issue of regulating unfair terms has occupied an important position on the European contract law agenda ever since the agenda was formed in the late 1980s. The first piece of European secondary legislation stepping into the core areas of contract law was the Unfair Contract Terms Directive.^{*1} The issue is, of course, dealt with both in the Principles of European Contract Law^{*2} and in the recently published preliminary version of the Draft Common Frame of Reference.^{*3}

It is to be expected that this issue will be one of the most debated in the further discussion on the development of European contract law. The reasons are of both a practical and theoretical nature. How law should react to contract terms that appear one-sided, unbalanced, or unfair is certainly a practical problem both in general contract law and in consumer contract law specifically. However, the controversies also relate to the position of the fairness principle in the basic understanding of contract law as such. The approach to unfair terms is an important, perhaps even the most important, reflection of the various ideological-theoretical underpinnings of thought on contracts. Therefore, the issue attracts great interest, despite the fact that fairness rules even in the most fairness-friendly jurisdictions are applied relatively seldom.

Questions like the following are at the core of the debate on what the European fairness rules should look like in future:

- What scope should a fairness rule have? Should it include individual contract terms or only standard terms (or, as an intermediate position, terms that have not been individually negotiated^{*4})? Should it be applied to the main subject matter of the contract and the price, and to what extent? Should it relate to consumer contracts only, or to business-to-business contracts as well?

¹ Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. – OJ L 95, 21.04.1993, pp. 29–34.

² PECL: O. Lando, H. Beale (eds.). Principles of European Contract Law. Parts I and II (The Hague, Kluwer Law International, 2000) as well as O. Lando, E. Clive, A. Prüm, R. Zimmermann (eds.). Principles of European Contract Law. Part III (The Hague: Kluwer Law International 2003). On unfair terms see article 4:110.

³ DCFR, published by Sellier 2007. On unfair terms see articles II.–9:401–411.

⁴ As in the Unfair Contract Terms Directive.

- What kinds of arguments should primarily be used in assessing the unfairness of a contract? Should one mainly look at the possible one-sidedness of the procedure when the contract was made (procedural unfairness), or should one instead consider the outcome of the procedure — that is, the content of the contract (substantive unfairness) — or, rather, what interrelationship should the procedural and substantive arguments have in the assessment of fairness?

Various answers, in various combinations, can be given and have been given to these questions. I claim that those answers are not primarily legal-technical but relate to more general conceptions of justice as well as to our understandings of human beings, society, and law.

In this paper, I will present and discuss some of the background variables. My purpose is not to defend any particular solutions to the contract law issues mentioned above but, rather, to make explicit some fundamental reasons that in the debate often remain hidden behind more concrete surface-level reasoning.

2. Unfair terms and four conceptions of justice

The issue of how to guarantee or promote fairness of contracts is often described in terms of dichotomies like freedom of contract versus fairness or freedom versus paternalism. However, this easily oversimplifies the issue. For example, to position procedural fairness rules opposite freedom of contract can be misleading. Rules that require a party who uses standard terms to let the other party acquaint itself with the terms and even to particularly ‘flag’ onerous terms can equally well be understood as devices to make sure that the decision-making of the party receiving the terms is sufficiently informed and ‘free’. The term ‘paternalism’ in a similar fashion has been combined even with libertarianism.⁵ In addition, the term — often used to discredit regulation in this area — is misleading. It is intended to convey a picture of the state ‘paternalistically’ intervening in private relationships against the will of the parties. However, even if mandatory private law rules may prevent one party from relying **in court** on terms conflicting with those rules (that is, in fact, to use the state — the *pater* — to enforce those terms), the parties are free to do what they want as long as they agree and there is no dispute between them. Only administrative or criminal law’s collective control of contract terms could be called paternalistic in the true sense of the word.

So, the issue of fairness is certainly more complex than is often appreciated. The rules to be found in this area have many possible purposes that reflect different forms of justice.

Firstly, in contract discourse, the problem of unfair contract terms is often raised in connection with regulation concerning standard-form conditions. The use of such conditions poses obvious problems for traditional contract thinking, which emphasises autonomy and the will or consent of the parties as basic legitimating factors behind the binding force of contracts. How can one, with such a starting point, accept that a party, who might not even have read the conditions and knows nothing about their content, can be bound by them? If this is the perceived problem, the purpose of regulation that attempts to remedy the problem is to safeguard the actual consent of the party or, in more general terms, the actual freedom of contract of that party. Rules that have this aim are focused less on the content of the outcome and more on the procedure for achieving a contract. They are based on a form of **procedural justice**. Procedures of negotiation and information are central in such an approach.

Secondly, the focus may be on the substance of the contract rather than on the procedure of making contracts. In contract law it is natural, as a starting point, to look at fairness with regard to the substantive relationship between the parties to a contract. Discussion often focuses on the balance between what the parties have promised to perform for each other. It is considered important that contracts be balanced, or, rather, that they not appear too unbalanced. To the extent that the purpose of the rules is the promotion of contractual balance with regard to the substance of contracts, the rules are based on the idea of **commutative justice**.

Thirdly, elements of **distributive justice** may occasionally become relevant in this context as well. Assessment of the fairness of the contractual obligation is then not primarily related to the balance between the parties. Rather, it is focused on enhancing the position of the weaker groups of citizens in comparison with other groups. A good example of such contractual social protection is the principle of **social force majeure** that has been used in the Nordic countries.⁶ According to this principle, the legal consequences of delays in payment and other performance may be mitigated if the ultimate reasons for the delay are unfavourable changes in the health, work, housing, or family situation of the debtor.

Fourthly, fairness rules in contract law may be used to **support other societal policies**. A typical example is regulation concerning racism and gender equality: contracts not in compliance with such regulation may

⁵ C. R. Sunstein, R. H. Thaler. Libertarian Paternalism is Not an Oxymoron. – The University of Chicago Law Review 2003, pp. 1159–1202.

⁶ See my paper “Social Force Majeure” — A New Concept in Nordic Consumer Law. – Journal of Consumer Policy 1990, pp. 1–14.

be considered unfair for this reason.^{*7} Environmental concerns and human rights issues may influence the assessment of fairness as well.

In other words, fairness rules rest on a complex web of purposes and conceptions of justice. Most national and international solutions contain both procedural and substantive elements. Obviously, up-to-date legislation on fairness and standard-form contracting needs both elements. Depending on where the emphasis is put, there are different approaches to the issue in different countries.

3. Four models for approaching the issue

Differing assessments of the need for regulating unfair contract terms and standard-form contracts connected with various understandings of the purposes and conceptions of justice of such regulation, as outlined above, have led to different approaches to the issue in different countries. Acknowledging that there are many variations on the regulatory themes that surface in this context, one may perhaps group the ways of dealing with the issue into a couple of larger categories or models. Four models are distinguished here: **the ‘no particular problem’ model**, **the standard-form contract model**, **the consumer protection model**, and **the general fairness model**.

As the purposes mentioned usually are intertwined in practice, the models cannot directly be tied to the particular conceptions of justice analysed in the previous section, even though there are some obvious connections. I will note some such connections below. In most models one can find at least traces of all the conceptions of justice mentioned, but some conceptions come more to the fore in some models than in others.

The **‘no particular problem’ model** is based on the belief that the general rules on making contracts — based on certain safeguards of free will and consent of both parties, perhaps with additional rules related to the need to adjust the contract in the event of changed circumstances — basically produce just results. What the parties have agreed on, without fraud or force, has to be considered just precisely because they have agreed on it, and the law should recognise their agreement. Interference against unfair contract terms is warranted only in particular cases for particular reasons.

Prior to the Unfair Contract Terms Act 1977, the law of the United Kingdom could be viewed as an expression of such a model, as common law did not regulate unfair terms in any systematic way. Even though said act had a general clause on ‘reasonableness’ that covered both standard and individual terms in consumer contracts as well as standard terms in business contracts, one could even claim that the ‘no particular problem’ model continued to apply also after the adoption of this act, as it did not apply to terms imposing obligations and liabilities, but only covered exemption clauses. This situation continued until the implementation of the Unfair Contract Terms Directive, which required UK law to properly regulate terms imposing obligations and liabilities in consumer contracts. Today the domestic approach in the UK might be moving in the direction of an even broader fairness model, as the Law Commissions have proposed an extension of the scope of the general fairness control to cover both business-to-business relationships and individually negotiated terms in consumer contracts.^{*8}

The **standard-form contract model** is a more fully developed version of the general contract law approach, based on the assumption of rationally acting parties. In this model, the reality of contractual consent in relation to standard-form contracts is problematised. Therefore, problems of unfairness appear that cannot be remedied with the help of general contract law rules alone. Particular regulation of standard-form contracts is required.

The most well-known example of national regulation focusing on standard-form conditions is the German Act on General Conditions from 1976.^{*9} This act, which dealt both with the problem of incorporation and interpretation and with the fairness problem, only applied to standard-form conditions (general contract conditions). It did not relate to consumer protection in particular but was based on the recognition of a partial market failure occurring when standard terms are used. It controlled standard terms in both consumer and commercial contracts.^{*10} Later, in the German *Schuldrechtsreform*, these provisions were included in the Civil Code (*Bürgerliches Gesetzbuch*) in a specific chapter on general contract conditions.^{*11} Provisions on general conditions (*algemene voorwaarden*) have been included in a specific part of the modern Dutch Civil Code as well.^{*12}

⁷ See, e.g., D. Schiek. *Differenzierte Gerechtigkeit*. Baden-Baden: Nomos 2000.

⁸ See the joint Report by the English and Scottish Law Commissions (2005).

⁹ Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen.

¹⁰ See, e.g., R. Zimmermann. *Consumer Contract Law and General Contract Law: The German Experience*. – *Current Legal Problems* 2005, pp. 415–489.

¹¹ Gesetz zur Modernisierung des Schuldrechts, BGB, articles 305–310.

¹² See the Dutch Civil Code, articles 6:231–247.

The German act has had a strong influence on the content of the EC Unfair Contract Terms Directive. The preparation of this directive proceeded from the assumption that all consumer contracts, both standard-form contracts and individually negotiated contracts, should be covered.^{*13} However, this was criticised, especially in the German doctrine: the fairness control of individually negotiated contracts was said to be in conflict with private autonomy and the functioning of the market economy.^{*14} This criticism led to the scope of application of the directive as adopted being restricted to contracts that have “not been individually negotiated”.^{*15}

Obviously, the standard-form contract model, like the ‘no particular problem’ model, emphasises the importance of procedural justice. The use of standard terms is seen as bringing in an element of one-sidedness to the contracting procedure that has to be alleviated with the help of fairness rules. Possible other forms of justice only come into play at a second stage, when the applicability of the fairness rules, related to the use of standard terms, has already been determined.

By contrast, the **consumer protection model** looks at the typical imbalance between the parties in the consumer market. The basic ethos of such a model is consumer protection. The starting point is not the perceived conflict between contractual will and superimposed standard terms but, rather, the typical strength of the bargaining power possessed by businesses as compared to that of the consumers. The delimiting criterion for protective measures in this model is the consumer–business relationship rather than the way in which the contract was made (individually drafted or based on standard terms).

Admittedly, in practice it is not always easy to distinguish the models, and they can be combined. Such a combination has expressly been used in the EC Unfair Contract Terms Directive, as its scope is delimited by reference both to standard terms (more specifically, terms not individually negotiated) and to consumer relationships. However, as the directive was prepared solely with consumer relationships as its object of regulation, the content of the directive appears to be a good example of the consumer protection model.

The French approach has followed the consumer protection model even more clearly. It applies the control over unfair terms only to consumer contracts but includes individually negotiated (i.e., non-standard) terms within this control.^{*16}

The consumer protection model is often preoccupied with achieving commutative justice, even though it, of course, also contains strong elements of procedural justice, and sometimes traces of distributive justice.

Finally, the **general fairness model** is the most far-reaching, including both consumer relationships and business-to-business relationships within the scope of fairness rules, and extending those rules to cover not only standard terms but also individually negotiated terms. Such a model recognises that the contract mechanisms can lead to unfair results in all kinds of relationships and with regard to all kind of terms, and it underscores that the enforcement machinery of the state should not be made available to put into effect contracts that are considerably unfair. The principle of fairness therefore is not a principle limited to consumer relations or standard-form contracting; rather, it should permeate the whole of contract law.

A well-known example of legislation that is based on the general fairness model is that found in Nordic contract law. Probably the most (internationally) well-known provision in Nordic contract law is the general clause in § 36 of the almost identical Nordic Contract Acts^{*17}, according to which a court may set aside or adjust a term of a contract if its application leads to unfair results. As the general clause focuses on the consequences of the application of a term, the courts can make use of it both when a term was unfair already when the contract was made and when a change of circumstances has led to unfairness. Of course, even though the general clause is generally applicable, a considerable portion of the case law concerns consumer contracts. However, many interesting decisions concerning business-to-business contracts have been made as well.

The Nordic general fairness model eclectically includes all of the above-mentioned forms of justice and is based to some extent on a general understanding that courts should not be used to produce substantive injustice.

¹³ See the 1990 proposal OJ C 243, 28.09.1990, p. 2.

¹⁴ H. E. Brandner, P. Ulmer. The Community directive on unfair terms in consumer contracts: some critical remarks on the proposal submitted by the EC Commission. – *Common Market Law Review* 1991, pp. 652 ff.

¹⁵ Article 3.

¹⁶ Loi Scrivener 1978 and now Code de la Consommation, articles L 132.1–L 132.5.

¹⁷ In Sweden: Lag om avtal och andra rättshandlingar på förmögenhetsrättens område (1915:218), the general clause added by Act 1976:185, in Finland: Laki varallisuus oikeudellisista oikeustoimista (228/1929), the general clause added by Act 956/82, in Norway: Avtaleloven (1918/4), the general clause added by Act 1983/160, and in Denmark: Lov om aftaler og andre retshandlinger på formuerettens område (1986/600).

4. Four questions related to our understanding of human beings and society

It is not only our understanding of justice that determines how we approach the issue of contractual fairness. Our attitude is also deeply embedded in our interpretation and visions of the society in other respects. The design of the fairness rules relates to some extent to how we perceive typical human behaviour and how we picture a good society. Our perception of human beings, the economy, societal relations, and the functions of law may all contribute to the place fairness is given in the structure of contract law.

As to the understanding of **human beings**, the need for contractual fairness rules obviously depends on the strength of the rationality assumption that contract law is based on — i.e., **how rationally parties are presumed to act when making contracts**.

Traditional contract law, emphasising the autonomy of the parties, is based on a strong assumption of rationality. The idea of contracts having binding force and the related respect for freedom of contract are seen as justified not only because private autonomy is a value in itself but also because it is instrumentally just. As the parties are presumed to be the ones who best can take care of their own interests, their voluntary agreement must be seen as the most just compromise between their aspirations. However, this kind of reasoning presupposes that the parties are guided by a free and rational will and that this can have an impact on the contract in an equitable bargaining process.

Clearly, the ‘no particular problem’ model in regulating fairness, being the ‘traditional’ contract law model, is based on such a perception of the typical role of the parties. However, also models that accept a broader role for fairness thinking may be based on a strong rationality assumption. The more one emphasises procedural justice in the assessment of fairness, the more rationally one usually presumes individuals to act. Various kinds of pre-contractual information duties are typical examples of regulation that believes in the rationality of those who are supposed to use the information. Also the standard-form contract model builds on a rationality assumption at least as far as individual terms are concerned.

However, well-known behavioural research shows quite clearly that people in many situations act much less rationally than expected. Fairness problems in contracting are not only related to information imbalances. Even in cases where information is available, people often do not act on this information. For various psychological reasons, information may not be taken into account in contractual decision-making processes.^{*18}

The recognition of this fact obviously must give rise to a certain guard against purely procedural versions of fairness. Even relatively transparent procedures in contracting can lead to unfair results because of psychological factors. Only more general substantively focused fairness models — models that are not limited to standard-form contracting alone — can deal with such unfairness.

However, there is, of course, no necessary link between empirical facts and normative conclusions. Even though one recognises that a full-blown rationality assumption is empirically false, one may still want to stick to the assumption in a normative sense. One may still normatively assume that people have to act rationally — if they do not, they will have to bear the consequences. This is a tenable position, but, given the facts, some would consider it rather cold and unjust.

A second assumption on which the conception of justice of traditional contract law is based relates to the **economy** and its competitive structures. The mechanism of competition is understood to promote just outcomes of contracting in the marketplace. Market forces tend to guarantee a just balance between the rights and obligations of the parties. Therefore, if contracts become unfair, this is seen as a result of market failure. A relevant question with regard to the content of fairness rules therefore is the following: **To what extent does one believe that competition really leads to fair and balanced contracts?**

With regard to certain issues, it is obvious that such an effect is not achieved. It is common knowledge that the market mechanism primarily works with regard to the price and perhaps some other central features of contracts, such as guarantee periods. With regard to other parts of contracts, particularly of standardised contracts, there is little incentive for businesses to compete. As a result, even competition law to some extent accepts co-operation between businesses in this area.^{*19} The market mechanism often fails to have an impact on standard terms, which is an important explanation for the fact that fairness rules concerning standard-form contracts are common in most jurisdictions.

As to the more central parts of a contract, competition law recognises the possibility of unfairness caused by market failure in this area as well. One of the purposes of the prohibition of abuse of dominant position is to protect those contracting with a business in a dominant position against unfairness caused by the imbalance

¹⁸ See the very illuminating analysis by G. Howells. The Potential and Limits of Consumer Empowerment by Information. – Journal of Law and Society 2005, pp. 349–370.

¹⁹ See more closely my paper “Cooperation and Competition Regarding Standard Contract Terms in Consumer Contracts”. – European Business Law Review 2006, pp. 49–72.

created by this position.^{*20} However, the competition law approach to this issue is of an on/off nature. Either the business is regarded as in a dominant position and the competition law safeguards come into play or it does not have such a position and no safeguards are available. This seems to imply that competition works sufficiently well to guarantee fairness in the latter situation — of course, provided that there is no forbidden collaboration between the players in the marketplace.

It is, of course, possible to adopt such a position in contract law as well. For the price and other central parts of the contract (or, as in the Unfair Contract Terms Directive, the main subject matter of the contract^{*21}) competition is understood to adequately achieve just outcomes, and the relatively rare cases of abuse of dominant position are left for competition law to deal with. This kind of thinking obviously lies behind the restrictive attitude toward applying the fairness test to the price and to other central parts of the contracts in many jurisdictions.

Again, however, this is only one possible position. Rather than adopting a black-and-white attitude toward competition — it either functions or it does not — one may view the issue as much more complex. Perhaps one could see the impact of competition as varying along a continuum rather than being either full-blown or non-existent. The economic structure may be more or less competitive, depending on the line of business, on prevailing conditions, etc. This understanding of economy makes it easier to defend the need for contractual fairness rules with a broader scope than the competition law rules that are interested only in one end of the scale, the abuse of dominant position.

Thirdly, other visions concerning **society** than those related directly to the level of competition in the economy are relevant in this context as well. One may describe the issue in various terms; the concept of trust offers a good expression of what I am referring to. Obviously, in a society where people are generally used to trusting other members of the society and are expected to do so, the approach to the regulation of contractual fairness must differ from the attitude toward the issue in a society that is built on an attitude of suspicion. The more parties trust each other in the society and the marketplace, the less need there is to analyse contract terms in detail. Thus, our third question will be this: **How well do members of the society trust each other, and how much should they trust each other when contracting?**

For example, English business and contractual practices are said to be of a more adversarial nature when compared with the more co-operative features of Continental and Nordic market processes.^{*22} This is reflected in law as well: in English law and business practice, a party has a relatively limited obligation to inform the other party about negative circumstances when a contract is concluded.^{*23} Therefore, parties in this environment should take adequate precautions when contracts are concluded. As there is less room for trust both in the other party and in legal safeguards against potential actions of the other party, business parties are expected to look after their own interests. It is no wonder, therefore, that English law traditionally has been reluctant to give courts broad powers to interfere in contracts, and that it has adhered rather more to the ‘no particular problem’ model of regulation.

In the same way, also consumer decision-making can be assumed to relate to the level of trust that consumers have with regard to the other players in the marketplace. This relates to the level of trust in the overall honesty of the marketplace, including the system of consumer protection, as well as to the trust in the relative moral integrity of the business sector, or at least of the businesses the consumer is dealing with. The more trustful consumers are, the less they will feel a need to be on guard against unfair contract practices. A higher level of trust therefore implies a need for or a reliance on more efficient consumer protection. Consumers behave differently in a marketplace that they regard as well regulated and supervised than in one where they feel more unsafe. In relation to regulation of unfair contract terms, a high level of trust implies a broad reliance on the mechanisms through which courts can interfere in unfair terms, as the existence of such terms means betrayal of the trust upon which the contracting was done.

Again, the empirically ascertained level of trust does not necessarily determine our normative visions of society. One may very well normatively argue for the adoption of principles along the lines of *caveat emptor*. One may also claim that certain distrust may be economically efficient — in particular, in contractual relationships in the marketplace. However, as a counter-argument one could refer to economic studies that mention a high level of trust both in other members of society and in the legal mechanisms of society as an important factor explaining the success of particular economies.

In addition, if one looks at transaction costs in the contractual setting, it is not necessarily the paradigm of distrust that is the more efficient, even though one might think that its relatively negative stance towards fair-

²⁰ EC Treaty article 82 (2) (a): “Such abuse may, in particular, consist in [...] directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions.”

²¹ Article 4 (2).

²² Those differences between the English and German markets are also used as explanation in the well-known paper by G. Teubner. Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences. — *Modern Law Review* 1998, pp. 11–32.

²³ See, e.g., the overview by J. H. M. van Erp. The Pre-contractual Stage. — A. Hartkamp, M. Hesselink, E. Hondius, C. Joutstra, E. du Perron, M. Veldman (eds.). *Towards a European Civil Code*. 3rd ed. Nijmegen: Ars Aequi Libri & Kluwer Law International 2004, pp. 375–377; P. Legrand. Pre-contractual Disclosure and Information: English and French Law Compared. — *Oxford Journal of Legal Studies* 1986, pp. 322–352.

ness rules should make it foreseeable and therefore legally less expensive. A comparison between common-law contract rules and Continental contract law illustrates this paradox. English contract law traditionally²⁴ considers itself to offer a high degree of legal foreseeability, because its starting point has been a strict adherence to a literal interpretation of the contract.²⁵ For a party to a contract to be able to foresee (in this legal environment) how the contractual relationship is going to function legally in various situations in the future, the terms of the contract have to cover all possible scenarios in detail and from various angles — and this has led to the well-known detailed and expensive Anglo-American contracting practice. If a party does not engage in writing detailed and comprehensive contract terms, the risk of the contract becoming unreasonable as the situation progresses grows. By contrast, the Continental system with its broader access to fairness might offer the parties a certain trust that courts may intervene if the contract becomes too unfair. In a system like this, the transaction costs related to contract-making are probably not as high as in a legal environment that forces the parties to make detailed and extensive contracts.

Irrespective of such more instrumental arguments, however, the basic issue remains: Do we want to promote a society that believes in and builds on trust or distrust? Such societal visions are not irrelevant in discussion of the scope and content of contractual fairness rules.

Finally, also our visions concerning the **functions of law** obviously affect our attitudes toward fairness rules in contracting. The basic legal tension, traditionally expressed in the maxim '*summum ius summa iniuria*', between formal equality and foreseeability on the one hand and concrete justice on the other is at the core of the discussion concerning fairness rules in contract law. The basic question here is this: **What level of concrete injustice is the legal system prepared to accept as a tribute to the acknowledgement of the basic principle of *pacta sunt servanda*?**

Clearly, all legal systems have some threshold above which injustice stemming from contracts is considered to be too apparent to be acceptable. All legal systems also accept that perfect justice in each singular case is an impossible utopia — and that there is not, nor can there be, agreement on what such perfect justice could mean in detail.

The broad approach to fairness rules adopted in the Nordic general fairness model can probably be understood against the background of a vision of the function of law that recognises a greater role for the courts in striving for justice *in concreto*. In such a vision, the contractual fairness principle could be understood as an expression of the principle that parties should not be able to use freedom of contract to require courts to produce injustice.

5. Conclusions

Above I have attempted to paint, with a very broad brush, the complex picture of the philosophies behind the various approaches to contractual fairness rules. In a comparative perspective, one can distinguish several models of fairness regulation. These models are connected with various combinations of different conceptions of justice.

However, the approaches are not only related to different understandings of justice. I have tried to show that they also are affected by different views on how humans act and should act, how the economy functions, how one trusts and should trust fellow members of the society, and how much interest courts should have in concrete justice. In addition, opinions may differ on the normative conclusions regarding fairness regulation that one may legitimately draw from such varying views.

At least in part, all of this relates to the fact that European cultures are different.²⁶ The regulation of unfair contract terms is clearly an issue in relation to which deep cultural cleavages come to the fore. One may therefore ask whether rules of this kind can be harmonised in Europe without unnecessarily sacrificing culturally bound variations in the understanding of the nature of humans, the economy, society, and the law. Even though there are many arguments for a legal-technical harmonisation in respect of at least some contract law issues across the European Union, the basic idea of a Europe 'united in its diversity'²⁷ may advise us to move cautiously in sensitive areas such as regulation of unfair terms.²⁸

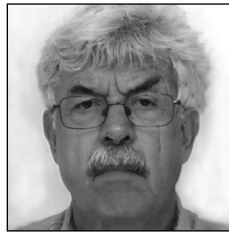
²⁴ English contract law seems to be changing, however, see, e.g., on 'good faith' R. Brownsword, N. J. Hird, G. Howells (eds.). *Good Faith in Contract, Concept and Context*. Aldershot: Ashgate 1999.

²⁵ K. Zweigert, H. Kötz. *Introduction to Comparative Law*. Third Edition. Oxford: Clarendon Press 1998, p. 406.

²⁶ See more closely on the relationship between such differences and private law many of the contributions in Th. Wilhelmsson, E. Paunio, A. Pohjola (eds.). *Private Law and the Many Cultures of Europe*. The Hague: Kluwer Law International 2007.

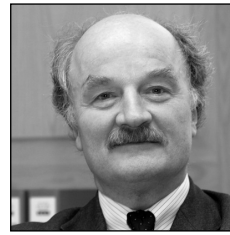
²⁷ Draft Treaty Establishing a Constitution for Europe, adopted by consensus by the European Convention on 13 June and 10 July 2003, Preamble.

²⁸ The Unfair Contract Terms Directive was not extended to individual contract terms precisely because there was no agreement on the issue, see Th. Wilhelmsson. *Social Contract Law and European Integration*. Aldershot: Dartmouth 1995, p. 137.



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Unfair Terms in the Draft Common Frame of Reference

(Comments on the Occasion of the Tartu Conference
on Recent Development in European Private Law)

1. The starting point: Mandatory rules on unfair terms based on directive 93/13/EEC

1.1. Some remarks on directive 93/13

Common EU rules on unfair terms will always be based on the well-known directive 93/13/EEC, which will not be analysed in detail in the present limited context.^{*1} The directive contains a mandatory, minimum, internationally applicable instrument of ‘horizontal’ consumer protection, which must be implemented in due form and applied consistently by the Member States and their courts of law in respecting this protective ambit, as interpreted by the ECJ.^{*2}

As will be remembered, this directive, which was a compromise between German and French concepts^{*3}, is currently subject to the review of the consumer *acquis* by the European Commission.^{*4} Several questions have been put to the stakeholders, which have given different answers.^{*5} The questions to be reviewed are many, more than in the European Commission paper. Among them are the following:

¹ OJ L 95, 21.04.1993, pp. 29–34.

² ECJ case C-144/99 (Commission v. Netherlands). – ECR 2001, I-3541.

³ H.-W. Micklitz, N. Reich, P. Rott. Understanding European Consumer Law. Intersentia Antwerp 2008, paragraphs 3.2–3.4.

⁴ Green Paper on the Review of the Consumer *Acquis* COM(2006) 744 final of 8.02.2007; see the critical evaluation by H.-W. Micklitz, N. Reich. Europäisches Verbraucherrecht – Quo vadis? (Überlegungen zum Grünbuch der Kommission zur Überprüfung des gemeinschaftlichen Besitzstandes im Verbraucherschutz v. 8.02.2007). – Verbraucher und Recht (VuR) 2007, p. 121; Chr. Twigg-Flesner. No Sense of Purpose or Direction? The Modernisation of European Consumer Law. – European Review of Contract Law (ERCL) 2007, p. 198.

⁵ Undated and unpublished Commission Staff Working Paper: Report on the Outcome of the Public Consultation on the Green Paper on the Review of the Consumer *Acquis*; see for a full analysis of the responses M. B. M. Loos. Review of the European Consumer *Acquis*. Sellier 2008, p. 40.

- Should an amended and ‘modernised’ version of the directive be limited to consumer transactions or be extended to ‘mixed contracts’, to contracts with (non-professional) legal persons⁶, to transactions with small and medium undertakings (SMU) or perhaps to all B-to-B and C-to-C contracts? It should be remembered that new Member States have used their discretion in this field very extensively.⁷
- What is the decisive yardstick for control, always respecting the principle of freedom of contract, as seen with German law’s concept of *Allgemeine Geschäftsbedingungen* (AGB) — standard business terms imposed on the other party — or the unbalanced contract negotiation via *contrats d’adhésion* between the *non-professionnel* and the *professionnel* as in French law⁸, which would include also ‘terms not individually negotiated’, as in directive 93/13 but limited to specific persons in need of protection, like consumers? The EU consultation paper on the review of the consumer *acquis* even asks whether the “discipline of unfair contract terms should also cover individually negotiated terms”⁹.
- How could AGB respectively terms not individually negotiated become part of a contract? This concerns the question of controlling the inclusion (*Einbeziehungskontrolle*) covered by directive 93/13 only indirectly in clause 1 lit. i of the annex of the ‘indicative list’ whereby terms “irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract” may be regarded as unfair?
- What is the content of the principle of good faith in article 3? Should a procedural understanding as in UK law¹⁰ or a substantive approach as applied in Germany¹¹ be preferred? What is the (limited!) harmonising role of the ECJ¹²?
- What exceptions should be made to the substantive scope of application?
- What is the importance of (lack of) transparency of AGB or terms not individually negotiated?¹³
- Will there be a ‘grey list’ or blacklist setting forth terms that should normally be regarded as unfair? As will be remembered, article 3 (3) contains an annex with what is called an indicative, non-exhaustive list of terms that “may be regarded as unfair”; Member States do not have a formal obligation of implementation.¹⁴
- What is the impact of an unfair term on an individual contract? Is a national court under a duty to raise questions of unfairness on its own initiative, despite the procedural autonomy of Member States?¹⁵ Is this limited only to B-to-C situations, which is the starting point of the existing case law of the ECJ, or can it be extended to any type of contracting, including those involving a business? What about abstract proceedings?¹⁶
- What about different standards of interpretation with regard to the use of terms not individually negotiated or AGB in individual and collective proceedings, as addressed by article 5’s sentences 2 and 3, and as confirmed by the ECJ?¹⁷ Is the distinction justified?¹⁸
- Finally, more generally, what shall be the role of collective proceedings? Is it possible and feasible to separate enforcement by way of injunctive relief from the material law? Directive 93/13/EC combines the two and has considerably enhanced the level of consumer protection by obliging Member States to establish public agencies and/or to grant consumer organisations standing to file an action for injunction.

⁶ ECJ case C-541/99 (*Cape Snc. v. Idealservice*). – ECR 2001, I-9049. It takes a narrow interpretation of the consumer concept by excluding legal person, even if working on a non-profit basis.

⁷ H. Schulte-Nölke (ed.). *Consumer Law Compendium*. Munich: Sellier 2007, p. 677 ff.; N. Reich. *Unfair Terms in the Contract Law of New EU Member Countries — The Example of the Baltic States, Hungary and Poland*, *Contemporary Issues of Law* 2006, 1, based on a preceding study on “Transformation of Contract Law and Civil Justice in the New EU Member Countries”. – F. Cafaggi (ed.). *The Institutional Framework of European Private Law, Collected Courses of the Academy of European Law*. Oxford University Press 2006, pp. 271–302.

⁸ J. Calais-Auloy, F. Steinmetz. *Droit de la Consommation*. 7ème edition. Dalloz 2006, pp. 195–213.

⁹ *Supra* Note 5 at p. 18.

¹⁰ *Director General of Fair Trading v. First National Bank* [2002] 1 Appeal cases (AC) 481; see H.-W. Micklitz. *The Politics of Judicial Cooperation*. Cambridge University Press 2005, p. 418.

¹¹ H.-W. Micklitz, N. Reich, P. Rott (Note 3), p. 3.1.

¹² ECJ case C-237/02 (*Freiburger Kommunalbauten v. Hofstetter*). – ECR 2004, I-3403. See the opinion of AG Geelhoed.

¹³ H.-W. Micklitz, N. Reich, P. Rott (Note 3), paragraphs 3.16–3.18.

¹⁴ ECJ case C-478/99 (*Commission v. Sweden*). – ECR 2002, I-4147; see EC Commission paper *supra* Note 4 at p. 18.

¹⁵ ECJ case C-168/05 (*Elisa Maria Mostaza Claro v. Centro Movil Milenium SL*). – ECR 2006, I-10421; see N. Reich. *More clarity after Claro?* – ERCL 2007, p. 41.

¹⁶ ECJ case C-473/00 (*Cofidis v. Jean Louis Fredout*). – ECR 2002, I-10875.

¹⁷ ECJ case C-144/79 (*Commission v. Netherlands*). – ECR 2001, I-3541, p. 20.

¹⁸ H.-W. Micklitz § 13.23. – N. Reich, H.-W. Micklitz. *Europäisches Verbraucherrecht*. Nomos Baden-Baden 2003.

1.2. Proposals of the Acquis Group

Some of these questions had been on the agenda of the Acquis Group.^{*19} It decided to mostly reproduce the wording and structure of the directive as basically a consumer protection instrument as interpreted by the ECJ, with some interesting modifications:

- The concept of the consumer is extended in article 1:201 to “any natural person who is **mainly** [emphasis added — N.R.] acting for purposes that are outside this person’s business activity”, thus partially avoiding the problems of ‘mixed contracts’ that the ECJ created in Gruber by its narrow reading of the concept of consumer contracts according to article 13 of the Brussels Convention.^{*20}
- Chapter 6, on ‘Non-negotiated Terms’, contains general rules on both the terms not individually negotiated and AGB, also including B-to-B transactions, with special rules pertaining to consumer contracts.
- Article 6:201 contains a rule on ‘inclusion of terms’ (with the ‘attention-drawing’ principle, including special provisions according to which consumers must have a “real opportunity to become acquainted before the conclusion of the contract”), based on different sources of secondary law and comparative law material.^{*21}
- Article 6:301 (1) includes the unfairness principle known from article 3 (1) of directive 93/13 without reference to the consumer standard. Paragraph 2 provides for a special rule on unfairness in B-to-B transactions “only if using this term amounts to a gross deviation from good commercial practice”^{*22}. However, it is questionable whether there is enough evidence in the *acquis* to extend the control of unfair terms to B-to-B transactions also, and whether the yardstick used is appropriate and practical.^{*23}
- Article 6:304 blacklists clauses on exclusive jurisdiction of the business domicile in B-to-C contracts, thus following the precedent of the Océano case of the ECJ.^{*24}
- Article 6:305 repeats the ‘indicative list’ of directive 93/13 without amending it or changing its legal content, with the exception of clause (1) (i) of the annex. The comment suggests that the “list as such is ‘grey’”^{*25}, although this is not clear from the wording.
- Article 6:203 reiterates the *contra proferentem* rule of directive 93/13, thereby relying on the use and usefulness of a different interpretation of terms in dependence on the type of the proceedings. The comment refers to the ECJ case law^{*26}, but without taking into account trends in Member States’ courts to set this distinction aside.^{*27}

The *acquis* principles do not challenge the distinction between individually negotiated terms and standard terms, even though this creates uncertainty in the daily enforcement practice. This might be because the *acquis* principles do not deal with enforcement and because, instead, they separate — contrary to the EC directives — substantive law from rights, remedies, and procedures. It must equally be regretted that the *acquis* principles do not make any suggestions on extending both the scope and the legal nature of the indicative list of directive 93/13 by proposing either a “grey” or a “black” list of terms which should not be used in pre-formulated contract terms. The *acquis* principles substantially go behind existing Member State law, which has not been used as a reference point. This is justified in the comment in allegation that “[g]iven the differences in Member States’ law, establishing a blacklist could be seen as an undue interference”.^{*28} This, of course, restricts the ambit of the *acquis* principles substantially and falls behind the goals established in the European Commission proposal of 1992.

¹⁹ Comments by T. Pfeiffer, M. Ebers. — Research Group on the Existing EC Private Law (Acquis Group, ed.), Principles of the Acquis Group. Sellier 2007, pp. 213–254 (in the following comment).

²⁰ ECJ case C-46401 (Johann Gruber v. BayWa). — ECR 2005, I-439. Express critique by Ebers, *supra* Note 19, comment to article 1:201 paragraph 6.

²¹ T. Pfeiffer, M. Ebers (Note 19), pp. 222–228.

²² *Ibid.*, pp. 234–237, referring to the Late Payment Directive 2000/35/EC. — OJ L 200, 8.08.2000, pp. 35–38 (for an interpretation with regard to retention of title see case C-302/05 Commission v. Italy (ECR 2006, I-10597) and to comparative law).

²³ Critique by N. Jansen, R. Zimmermann. Grundregeln des bestehenden Gemeinschaftsprivatrechts? — Juristenzeitung 2007, pp. 1116, 1120.

²⁴ ECJ case C-240 et al./98 (Océano Gr v. Quintero et al.). — ECR 2000, I-4941. Concerning arbitration clauses see Th. Pfeiffer, M. Ebers (Note 19), p. 246 (referring to the Claro case C-168/05 *supra* Note 15).

²⁵ T. Pfeiffer, M. Ebers (Note 19), p. 250.

²⁶ *Ibid.*, p. 230 with reference to ECJ 9.09.2004, case C-70/03 (Commission v. Spain). — ECR 2004, I-7999.

²⁷ See H.-W. Micklitz. — Münchener Kommentar zum BGB. 4th ed. 2000, § 13 AGBG Rdn. 49 ff.

²⁸ Comment *supra* Note 19 at p. 246.

1.3. Proposals in the DCFR

The proposals of the Acquis Group have to some extent been brought over into the Draft Common Frame of Reference as presented at the end of 2007²⁹, but this action also shows an attempt to develop them further into a general EU law on unfair terms, used in whatever type of transaction is involved, whether B-to-B, B-to-C, or C-to-C. However, they are not placed in a coherent structure. Article II.–4:209 contains rules on conflicting terms, serving as part of the chapter on the formation of contracts; article II.–8:104 insists on preference for negotiated terms, which is part of the rules on interpretation.

The question of inclusion of terms is regulated in article II.–9:103 (‘Terms Not Individually Negotiated’), thus:

- (1) Terms supplied by one party and not individually negotiated may be invoked against the other party only if the other party was aware of them, or if the party supplying the terms took reasonable steps to draw the other party’s attention to them, before or when the contract was concluded.
- (2) If a contract is to be concluded by electronic means, the party supplying any terms that have not been individually negotiated may invoke them against the other party only if they are made available to the other party in textual form.
- (3) For the purposes of this article:
 - (a) ‘not individually negotiated’ has the meaning set forth by II.–9:403 (on the meaning of ‘not individually negotiated’) and
 - (b) terms are not sufficiently brought to the other party’s attention by a mere reference to them in a contract document, even if that party signs the document.

Section 4 of Chapter 9 contains a ‘General EU Law of Unfair Terms’. It is an attempt to set general standards while differentiating in several respects between B-to-C and B-to-B (eventually C-to-C) transactions, which makes their understanding rather complex. Its most important provisions are as follows:

- Article II.–9:401, which insists on the “mandatory nature of the following provisions”, namely that
The parties may not exclude the application of the provisions in this section or derogate from or vary their effects.
- Article II.–9:402 (‘Duty of Transparency in Terms Not Individually Negotiated’), stating:
 - (1) Terms that have not been individually negotiated must be drafted and communicated in plain, intelligible language.
 - (2) In a contract between a business and a consumer, a term that has been supplied by the business in breach of the duty of transparency imposed by paragraph 1 may on that basis alone be considered unfair.
- Article II.–9:403 (‘Meaning of “Not Individually Negotiated”’), which states:
 - (1) A term supplied by one party is not individually negotiated if the other party has not been able to influence its content, in particular because it has been drafted in advance, whether or not as part of standard terms.
 - (2) If one party supplies a selection of terms to the other party, a term will not be regarded as individually negotiated merely because the other party chooses that term from that selection.
 - (3) The party supplying a standard term bears the burden of proving that it has been individually negotiated.
 - (4) In a contract between a business and a consumer, the business bears the burden of proving that a term supplied by the business, whether or not as part of standard terms, has been individually negotiated.
 - (5) In contracts between a business and a consumer, terms drafted by a third party are considered to have been supplied by the business, unless the consumer introduced them to the contract.
- Article II.–9:404 (‘Meaning of “Unfair” in Contracts between a Business and a Consumer’), which sets forth:

²⁹ For a detailed first evaluation see R. Schulze (ed.). *Common Frame of Reference and Existing EC Contract Law*. Munich: Sellier 2008, pp. 3–24 (an introductory paper by R. Schulze). See comment to the section on ‘Non-negotiated Terms’ by T. Pfeiffer at pp. 177–185 in Schulze’s. For a review see N. Reich. – *Journal of Consumer Policy* (JCP) 2008, p. 369.

In a contract between a business and a consumer, a term [that has not been individually negotiated] is unfair for the purposes of this section if it is supplied by the business and if it significantly disadvantages the consumer, contrary to good faith and fair dealing.

- Article II.–9:405 (‘Meaning of “Unfair” in Contracts between Non-business Parties’), stating:

In a contract between parties neither of whom is a business, a term is unfair for the purposes of this section only if it is a term forming part of standard terms supplied by one party and significantly disadvantages the other party, contrary to good faith and fair dealing.

- Article II.–9:406 (‘Meaning of “Unfair” in Contracts between Businesses’), specifying:

A term in a contract between businesses is unfair for the purposes of this section only if it is a term forming part of standard terms supplied by one party and of such a nature that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing.

Article II.–8:103 is in line with the *acquis* principles but does not draw a distinction between the interpretation of terms in individual and collective proceedings. Article II.–9:410 bans exclusive jurisdiction clauses. Article II.–9:411 contains a list of “terms that are presumed to be unfair in contracts between a business and a consumer”, thus repeating material from the annex of directive 93/13 but at the same time ‘upgrading’ the items into a grey list. We will comment on the structure and contents of the DCFR and their relation to the *acquis* principles in section 2.2.

2. The need for a ‘federal approach’ in the EU

2.1. ‘Federalism’ in EU contract law

An analysis of the DCFR can start from different perspectives, one concerned with contents, another with its relationship to existing EU and Member State law, and a third based upon a critical evaluation of the *acquis* and proposals for its reform. The present commentary will take another direction. It will position the DCFR in a federal, multilevel system of governance, which is characteristic of EU legislation on contract law matters.³⁰ As a starting point, the EU has only a limited jurisdiction over contract law. After the well-known Tobacco judgment of the ECJ of 5 October 2000³¹, it is without doubt that the internal market clause of EC article 95 does not allow for general competence of the EU in all cases of divergence of laws in the Member States, but also the measure envisaged by the EU legislator must show a genuine contribution to establishing the internal market — for example, by removing existing or foreseeable barriers to free trade, or by safeguarding undistorted competition, such as through improving health and safety standards, eliminating transaction costs, and improving consumer confidence.³² Since most contract law is based on so-called ‘default rules’, the parties at least in B-to-B (and to some extent also in C-to-C) transactions will be able to choose freely the applicable contract law; there is usually no need of harmonisation here, unless a specific relationship to the functioning of the internal market can be shown, as in the Late Payment Directive, 2000/35.³³ Conflict rules, themselves based on freedom of choice of applicable law under article 3 of the Rome Convention (to be superseded by the Rome I Regulation³⁴), will usually give the parties sufficient freedom to find the optimal legal regime for their transaction themselves.

Such a starting point with regard to freedom of contract and party autonomy does not exist with regard to mandatory provisions like those on unfair terms, the subject matter of this paper. As experience shows, they can have a double impact on the internal market:

- They may enhance the confidence of ‘passive partners’ to a transaction, particularly consumers, for entering into a business relationship, particularly with a supplier or provider from another EU

³⁰ See H.-W. Micklitz, N. Reich, P. Rott (Note 3), pp. 1.21–1.22; S. Weatherill. *EU Consumer Law and Policy*. Elgar Pub. Cheltenham UK, 2005, p. 157.

³¹ ECJ case C-376/98 (Germany v. EP and Council). – ECR 2000, I–8919.

³² ECJ joined cases C-453/03 et al. (ABNA et al. v. Secretary of State for Health). – ECR 2005, I–10423 paragraph 108; case C-380/03 (Germany v. EP and Council (tobacco II)). – ECR 2006, I–11573 paragraphs 37–40; AG Trstenjak opinion of 15.11.2007 in case C-404/06 (Quelle v. VZBV) paragraph 44 (not yet published).

³³ *Supra* Note 22. This principle is usually based on ECJ case C-339/89 (Alsthom Atlantique v. Compagnie de construction Sulzer). – ECR 1991, I–107 paragraph 15; N. Reich. *Understanding EU Law*. 2nd ed. Intersentia Antwerp 2005, p. 269.

³⁴ Proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I) of 15 December 2005, COM(2005) 650 final; but see final compromise amendments by the Legal Committee of the EP of 14.11.2007 which became part of regulation (EC) No. 593/2008 of the EP and the Council of 17 June 2008 on the law applicable to contractual obligations (“Rome I”). – OJ L 176, 4.07.2008, pp. 6–16.

member country, including electronic commerce contracting with partners whose identity may not be known but who still must respect certain mandatory standards.

- On the other hand, overly restrictive mandatory rules may impose an indirect impediment to cross-border trade by creating additional transaction and search costs, particularly for SMU providers.

The EU legislator has to find a balance between these two contradicting objectives, which so far have found support with the ECJ; nothing in the case law suggests that directive 93/13 and the necessary amendments could not be based on EC article 95, including the technique of minimum harmonisation.^{*35} According to article 8:

Member States may adopt or retain the most stringent provisions compatible with the treaty in the area covered by this directive, to ensure a maximum degree of protection for the consumer.

This idea seems to be in contrast with ‘modern’ concepts of EU institutions to do with ‘complete harmonisation’ as used in the recent ‘Unfair Commercial Practices Directive’ document, 2005/29/EC.^{*36} It should, however, be remembered that consumer contract law is not fit for ‘full’ or ‘complete’ harmonisation, because the unfairness concept itself refers to (non-harmonised) national contract law, as the ECJ has recognised in its *Freiburger Kommunalbauten* judgment.^{*37}

Any EU regulation on unfair terms, whatever its scope of application and basic concepts, will always have to keep in mind the underlying national rules on AGB or terms not individually negotiated, thus presupposing diversity and not unity. We hope that both the proposals of the Acquis Group and the DCFR insisting on their mandatory character do not cast into doubt the basic concept of ‘minimum harmonisation’ but only are efforts to improve the present unsatisfactory state of EC law on unfair terms by proposing a (very limited) number of amendments, which will have to be put on the Community statute books under the corresponding legislative procedures. We will make some suggestions later in this paper as to how this can be done. If they take the form of directives similar to the Recast Directive on the non-discrimination *acquis*, 2006/54/EC^{*38}, Member State law would have to be implemented accordingly wherever necessary. Also, without formal adoption as a directive, these proposals could be used by Member States to review their national law if it shows certain deficits because of having transposed only the minimal rules of directive 93/13, or by traders drawing up and implementing self-regulatory codes of conduct as encouraged by recent EU initiatives.^{*39}

However, it would have been necessary to use more comparative law material, particularly in the field of blacklisted and grey-listed clauses; this should allow for more conformity of standards aimed at combating unfair terms within the EU. But it seems that neither the *acquis* principles nor the DCFR provisions have entailed much comparative study, at least insofar as specific provisions on unfair terms are concerned. In particular, the CLAB database, which allows some information about incriminated contract clauses in the EU to be visible, has not been consulted.^{*40} Finally, it should at least be discussed whether the example of the Unfair Commercial Practices Directive, 2005/29/EC, which blacklists a whopping 31 misleading or aggressive practices^{*41}, could be used as a model to be followed also for unfair terms. The problem is, of course, related to the extent of ‘full harmonisation’ of the directive that is now before the ECJ.^{*42}

2.2. Some critical remarks on the DCFR

In our opinion, the basic flaw of the proposals in the DCFR is their ‘double-headed’ approach to unfair terms — namely, that they use at the same time the AGB and the terms not individually negotiated concepts but apply them differently to B-to-C, B-to-B, and C-to-C transactions. Thomas Pfeiffer, himself a member of the Acquis Group, writes:

³⁵ ECJ cases 382/87 (*Buet et al. v. Min. Public*). – ECR 1989, 1235; C-361/89 (*Criminal proceedings against di Pinto*). – ECR 1991, I-1189; C-183/00 (*Gonzales Sanchez v. Medicina Asturiana*). – ECR 2002, I-3901 paragraph 27; C-71/02 (*Karner/Troostwijk*). – ECR 2004, I-3025 paragraph 33.

³⁶ OJ L 149, 11.06.2005, pp. 22–39. For a critical evaluation see G. Howells, H.-W. Micklitz, Th. Wilhelmsson. *European Fair Trading Law*. Ashgate Publishing 2006, pp. 27–48, 244; review by N. Reich. – JCP 2007, p. 39.

³⁷ *Supra* Note 11. Similar Th. Wilhelmsson. *Full Harmonisation of Consumer Contract Law?* – *Zeitschrift für Europäisches Privatrecht (ZEuP)* 2008, p. 225.

³⁸ OJ L 204, 26.07.2006, pp. 23–36; for a comment N. Burrows, M. Robinson. *An Assessment of the Recast Community Equality Directive*. – *European Law Journal (ELJ)* 2007, p. 186.

³⁹ For an assessment see G. Howells, etc. (Note 36), pp. 195–216; F. Cafaggi. *Self-regulation in European Contract Law*. – *European Journal of Legal Studies* 2007/1.

⁴⁰ Its limited reliability has been discussed by H.-W. Micklitz, M. Radeideh. *The European Database on Unfair Terms in Consumer Contracts*. – JCP 2005, p. 325.

⁴¹ H.-W. Micklitz, N. Reich, P. Rott (Note 3), pp. 2.43–2.46.

⁴² Case C-261/07 (*VTB-VAB v. Total Belgium*) — not yet decided.

To this extent, the existence of three different definitions of fairness might give rise to the conclusion that there are different ideas of fairness behind these provisions. This, however, is not the case. Judicial control of non-negotiated terms is justified because, in the particular situation of the formation of the contract, there was no free consent to the terms by one side.^{*43}

The *acquis* principles are somewhat more transparent in this context because they proceed from directive 93/13 as such and its concept of terms not individually negotiated; the reference to standard terms serves only for clarification purposes in article 6:101, without attachment of legal importance to it.

The DCFR accords much more relevance to this distinction. According to the definition in Annex I, “‘standard terms’ are terms that have been formulated in advance for several transactions involving different parties, and that have not been individually negotiated by the parties”. This will include terms formulated by third parties, but it must always be meant for multiple, not individual, use — an element sometimes hard to prove, especially in notarised contracts.^{*44} A definition of ‘individual negotiations’ is included in article II.–9:403 (1), similar to that in directive 93/13, with some further specifications and rules on proof relating to standard terms.

The unfairness test in article II.–9:404–406 is divided into three different levels, thereby combining the more substantial concept of good faith with the more procedural concept of fair dealing, which can be demonstrated by using the following matrix.

Form/scope	B-to-C	B-to-B	C-to-C
Terms not individually negotiated	(left open?) + significant disadvantage – good faith / fair dealing	–	–
Standard terms	+	+ gross deviation from good commercial practice – good faith and fair dealing	+ significant disadvantage – good faith and fair dealing

Instead of applying a single criterion for controlling unfairness and leaving discretion to national law or national judges on how to apply it to the relevant categories of transactions (the federal dimension), the DCFR artificially divides substantive protection against unfair terms into classes according to differentiated layers of formal requirements, like ‘terms not individually negotiated’ and ‘standard terms’, on the one hand, and different concepts of ‘unfairness’, on the other, as shown in the matrix above. It is obvious that such a scheme will make the formal and substantive elements in its scope of application decisive, without really being able to provide for any clarification of the concepts used. As a legal commonplace it may be true that consumers in B-to-C contracts are in the most need of protection, and that businesses in B-to-B situations should be protected only in extreme situations. Finally, C-to-C transactions seem to range in the middle: there is some need of protection, but this should apply only to ‘standard terms’, not to terms not individually negotiated.

The matrix, based as it is on the proposals of the DCFR, tries to put a rigid borderline between different types of transactions — indeed it takes its starting point from different market relations that in practice are not so easily distinguishable. It should be remembered that the concept of the consumer has been, according to the definition portion of the DCFR, extended to persons acting ‘primarily’ outside their business capacity; ‘mixed contracts’ may therefore be regarded as B-to-C transactions enjoying a higher degree of protection than transactions in cases where the business element is dominant — a distinction that is hard to verify in practice. The concept of C-to-C transactions is completely new in EC law, and it is not clear how they have to be qualified if a ‘non-business party’ uses an agent, such as in the not infrequent case of the sale of a used car by a private person via a commercial agent. The European Commission in its review paper on the consumer *acquis* ponders whether “contracts between private persons [should] be considered consumer contracts when one of the parties acts through a professional”.^{*45} This problem has not even been mentioned by the DCFR! The idea of combining the principles of good faith and fair dealing appears elegant; however, it does not overcome the substantial differences behind these concepts, which make it even more necessary to grant Member States’ courts a certain margin for interpretation. To put it bluntly, for the years to come there will be substantial differences in the degree to which control is exercised, with regard to the type of term, the modes of interpretation, the substance of control, and enforcement via courts and/or public agencies.

⁴³ *Supra* Note 19 at p. 179.

⁴⁴ See the list of exclusions in article I.–1:101 (2).

⁴⁵ *Supra* Note 4 at p. 16.

2.3. The first proposals on ‘implementing’ the DCFR and the *acquis* principles in EU law

2.3.1. The DCFR as an ‘optional instrument’?

The legal nature of the DCFR is still unclear, and the European Commission so far has taken a low profile in clarifying its character. It has, however, put forward the idea of an ‘optional code’ or a 26th resp. 28th instrument — that is, an instrument that the parties to a contract, whether B-to-B, B-to-C, or C-to-C, could freely choose and thus avoid being subject to different Member State law determined on the basis of the Rome Convention resp. the coming Rome I Regulation.^{*46} The attractiveness for business would be that only the mandatory provisions of the optional instrument would set limits to contractual autonomy, not the diverging Member States’ consumer protection provisions under the principle of minimum harmonisation. If such an instrument is to be made attractive, consumers must be confident that, by being subject only to EU law, they still are guaranteed a high level of protection.^{*47}

This approach has been criticised as a ‘clandestine attempt’ to circumvent the minimum protection rule of the existing consumer *acquis* and to achieve the preferred European Commission objective of ‘full harmonisation’ through the back door.^{*48} This critique depends, obviously, on the level of harmonisation and protection that can be achieved through the DCFR. The paper of Hugh Beale^{*49} delivered at the Tartu Conference is quite explicit on this point:

I believe that an optional instrument would also be valuable for consumer transactions. This is not because I think that consumers are particularly worried about their rights under whatever law they contract under (even though this argument has been used to justify many of the directives). Consumers do not think there is much risk that they personally will get into a dispute with the seller in the conditions of which it will matter what the governing law is. I think the optional instrument would be more for the benefit of businesses that are seeking to sell to consumers from other Member States. For the business, a large number of hoped-for transactions may in the aggregate impose significant legal risk. The business may therefore be reluctant to advertise and sell to consumers in other jurisdictions. Again the concern is particularly strong for SMEs. Larger firms will probably set up a subsidiary in each Member State, and that subsidiary will know and use the local law. An SME is much less likely to be able to afford that. Instead it may wish to export by direct marketing, but it may well be put off by differences between the underlying systems of law. These may be of two kinds. First, there is the risk that the Member State that is the destination of the SME’s potential sales will have given consumers more than the minimum rights required by the various directives. Secondly, there may well be significant differences in areas of law that are outside the field of application of any directive. For example, in a consumer sale, the buyer’s rights to damages and the measure of those damages are governed entirely by national law.

The rules of article 6 of the proposed Rome I Regulation^{*50}, entitling consumers to the protection of the mandatory rules of their ‘home’ law in a wide set of circumstances, have the potential to create particularly serious barriers to trade of this kind. This will be the case particularly if the ‘home law’ rule is to be applicable to a consumer who buys on the Internet from a seller in another Member State, on the basis that the Internet seller is targeting consumers in other EU countries. In effect, the Internet seller would be required to be familiar with the law of every Member State. This would be highly problematic, particularly for SMEs, and may well lead to them refusing to accept orders from other Member States.

Short of unification of contract and sales law across Europe, I think the best solution lies in the optional instrument. The seller should be permitted to offer to sell to the consumer **either** on terms giving the consumer the minimum protection of the law of the consumer’s home country **or** under the optional instrument, which would be a European contract and sales law. The optional instrument would contain all consumer protection required by the directives, plus general rules of contract law (which together would solve 99% of the cases likely to arise). If the parties choose the optional instrument to govern their contract, they (especially the seller) would be bound by all of the rules of the optional instrument — individual rules would not be optional, save as the instrument has provided.

The consumer could be asked which is his or her home state. If the seller were prepared to contract on terms reflecting the requirements of that law, it could simply accept the consumer’s order. If it is not

⁴⁶ S. Grundmann. The Optional European Code on the Basis of the *Acquis*. – European Law Review (ELRev) 2004, p. 698.

⁴⁷ See D. Staudenmayer. Ein optionelles Instrument im Europäischen Vertragsrecht? – ZEuP 2003, pp. 829, 839 ff.

⁴⁸ N. Reich. Der Common Frame of Reference und Sonderprivatrechte im Europäischen Vertragsrecht. – ZEuP 2007, p. 177.

⁴⁹ In this volume at pp. 10–17.

⁵⁰ Proposal for a Regulation of the European Parliament and the Council on the law applicable to contractual obligations (Rome I): Outcome of the European Parliament’s first reading (Brussels, 28–29 November 2007) (3 December 2007).

prepared to sell on those terms because (following my argument) it does not know what the law of the consumer's home state demands, it should have the right to refuse the order unless the consumer agrees that the sale should be governed by the optional instrument. The consumer could exercise this choice by pressing a 'Blue Button' on the screen, showing his or her acceptance of the optional European law. Such a Blue Button could be designed in the style of the European blue flag with the 12 stars, possibly with an inscription such as 'Sale under EU Law'. It would make the benefits of European law visible to all businesses and consumers wishing to make use of the internal market.

This kind of opt-in instrument would be a form of legislation, and settling its terms would entail the same kind of political choices — of the kind of rules, the degree of consumer protection, etc. — involved in drawing up any contract code. This is not altered by the fact that it would be 'optional'. Parties would frequently opt in without knowing exactly, or even approximately, what rules would then apply to their transaction and the degree of protection that they would be afforded, and businesses might not have the bargaining power to avoid the optional instrument or something even less favourable. The rules of the optional instrument would not be a purely technical matter; legislative choices would have to be made.

The draft CFR does not purport to be a definitive proposal for an optional instrument. Rather, it is just a first draft that might be used to prepare a detailed proposal. Then some means of ensuring both a reasonable degree of social justice in the provisions of the instrument and a modicum of democratic input would be essential.

This is certainly a proposal worth considering, one that could even be based on the new article 81 (1) of the Draft Reform Lisbon Treaty on the Functioning of the European Union, which reads:

The Union shall develop judicial co-operation in civil matters having cross-border implications, based on the principle of mutual recognition of judgments and decisions in extrajudicial cases. Such co-operation may include the adoption of measures for the approximation of the laws and regulations of the Member States.

The adequate measure here would certainly be a regulation to which the parties could opt in by choosing the Blue Button on their PC, as suggested by Hugh Beale for e-commerce.⁵¹ It may, however, be subject to some doubt whether the 'regulation' could be called a 'measure' of the approximation, because it will be an instrument independent from Member State law but still based on it. As an autonomous instrument of EU law, it would set aside conflicting Member State law and its mandatory provisions would take direct effect in the relations between the parties.

Another possibility for the adoption of an optional instrument in the form of a regulation would be the use of EC article 308 (as eventually amended by the reformed treaty), which had been confirmed by the ECJ justifying the use of a regulation for the creation of a *Societas Europaea Cooperativa*⁵²:

In those circumstances, the contested regulation, which leaves unchanged the different national laws already in existence, cannot be regarded as aiming to approximate the laws of the Member States applicable to co-operative societies but has as its purpose the creation of a new form of co-operative society in addition to the national forms.

The use of a regulation as an optional instrument in the sense proposed by Hugh Beale would, in our opinion, require that the protective ambit of the proposed provisions of the DCFR on unfair terms be considerably upgraded and increased, in particular with regard to the blacklisting or grey-listing of certain clauses; otherwise, consumers risk accepting a much lower standard of protection than is usually guaranteed by their national law, going beyond directive 93/13. The same is true for persons who are not covered by the narrow concept of the consumer.

Even if an optimal level of EU protection against unfair terms not individually negotiated or AGB could be attained, it would be impossible to completely exclude a reference to (the highly different and diverging) Member State law. As the *Freiburger Kommunalbauten* case itself shows, the standard of unfairness in a specific contract term can usually be determined only by measuring it against applicable national law. Good faith and fair dealing stand side by side! In litigation this will be determined by the court with competence according to the jurisdiction rules of regulation 44/2001. The mandatory rules on consumer protection in articles 15–17 will always be applicable in cases of disputes and provoke a 're-nationalisation' of the conflict even if the parties have chosen the 'optional instrument' to govern their transaction. A national court eventually seized in this context will probably apply that Member State's own law of unfair terms to the conflict if the provisions are as unclear and incomplete as those in the DCFR.

⁵¹ In a similar direction H. Schulte-Nölke. EC Law on the Formation of Contracts — from Common Frame of Reference to the "Blue Button". — ERCL 2007, p. 332.

⁵² Case C-436/03 (*Parliament v. Council*). — ECR 2006, I-3733 paragraph 46.

2.3.2. The *acquis* principles as a ‘European consumer contract law regulation’

The *acquis* principles are intended to restate and extend the existing EU consumer law in a coherent form. They come close to what the European Commission in its review paper^{*53} has called a horizontal instrument. Traditionally, the consumer law directives had been based on EC article 95 as a measure of internal market policy. The limits of this approach have been debated extensively in the wake of the Tobacco advertising judgment, even though the court has not yet cast any doubt on the legal basis of the consumer contract directives on the basis of minimum harmonisation. However, AG Trstenjak in her opinion of 17.07.2008 in the Gysbrechts case^{*54} has challenged the Belgian legislation forbidding prepayment clauses in distance contracts under the minimum protection clause of article 14 of directive 97/7/EC^{*55} as creating an obstacle to exports against EC article 29. The judgment of the ECJ is awaited by the end of 2008.

In a different context, suggestion was made to use the specific consumer law provision of article 153 (3) (b) EC for the adoption of a ‘European consumer contract law regulation’ (ECCLR) based on the principle of minimum harmonisation as set forth in paragraph 5 of article 153:^{*56}

The ECCLR as such would be a “measure to support [...] the policy pursued by Member States”. Since all Member States now have — either on their own or implementing EU directives — their national consumer contract law, the general principles of an overall EU approach to consumer protection based on information and fairness before entry into and within transactions, and specific rules on ‘cooling-off’ periods in direct and distance marketing, on unfair terms, and on legitimate quality expectations as rather well-developed areas of EU consumer contract law, could easily be elaborated and ‘codified’. This would be a ‘measure’ of legislative character as is expressly recognised in the (somewhat scant) practice under article 153 (3) b).^{*57} In its directive 98/8/EC on unit pricing^{*58}, the EU has used article 153 (3) b) for a truly legislative measure. There seem to be no reasons not to continue this approach and avoid the intricacies of the internal market competence issues. The transformation of existing directives into directly applicable regulations meets the requirement of effectiveness, which the European Commission itself put forward as a criterion for reviewing existing European consumer protection directives. It has often been said that directives are in harmony with the subsidiarity principle as set forth in the protocol on subsidiarity, attached to the Amsterdam Treaty. But practice with implementing directives has shown long delays, different methods of implementation, and additional distortions of competition. Several Member States had to be taken to court before finally implementing a long-adopted directive. In the case of minimal harmonisation directives, the differences in the level of protection among Member States were indeed considerable, sometimes even greater than before ‘harmonisation’ — a fact deplored by the European Commission. The use of directives as an instrument for consumer protection has, unfortunately, not been a success story.

The ECCLR would apply in parallel with existing Member State law. It would remove the existing contradictions of EU directives and provide for a common level of consumer protection in the EU that would be directly applicable. The usually applicable Member State law would determine which consumer protection provisions are mandatory. The ECCLR would apply only in a subsidiary manner. It would set aside conflicting Member State law only in cases where said law does not guarantee the necessary minimal protection.

2.3.3. Combination of an optional instrument and an ECCLR?

In an ideal world of ‘federal’ law-making and implementation in the EU, combination of the two instruments with existing international conventions like the CISG might be able to solve the fundamental dilemma of EC contract law: to allow parties optimal freedom of choice of ‘their’ contract regime while at the same time guaranteeing a sufficiently high level of consumer protection, namely:

- ‘Internal transactions’, whether B-to-B, B-to-C, or C-to-C, would be governed by applicable Member State law, supplemented by the ECCLR, guaranteeing minimum standards in consumer transactions wherever they take place in the EU.

⁵³ *Supra* Note 4 at p. 9.

⁵⁴ Case C-205/07 not yet published; for a critique see N. Reich, H. W. Micklitz. Volle Harmonisierung durch die Hintertür? – VuR 2008 (forthcoming).

⁵⁵ Directive 97/7/EC of the EP and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts. – OJ L 14, 4.06.1997, p. 19.

⁵⁶ N. Reich. A European Contract Law, or an EU Contract Law Regulation for Consumers? – JCP 2005, p. 383.

⁵⁷ H.-W. Micklitz, N. Reich, P. Rott (Note 3), paragraph 1.23; G. Howells, St. Weatherill. Consumer Protection Law. Ashgate Aldershot 2005, p. 128.

⁵⁸ Directive 98/6/EC of the European Parliament and of the Council of 16 February 1998 on consumer protection in the indication of the prices of products offered to consumers. – OJ L 80, 18.03.1998, pp. 27–31.

- ‘Cross-border transactions’ follow either conflict rules under Rome I or the ‘optional instrument’ of the DCFR, either by including B-to-C transactions if the level of protection can be regarded as sufficient, or at least as equivalent to national law, or with reference to the ECCLR, which makes reference to national laws superfluous.
- ‘International’ B-to-B sales transactions may apply the CISG rules or ‘soft law instruments’ like the UNIDROIT principles⁵⁹ under their respective provisions and be supplemented by the optional instrument.

The second alternative of this combination may be particularly useful if the optional instrument should become a real ‘option’ in cross-border B-to-C transactions, especially in e-commerce: the ECCLR would guarantee the consumer a European standard of consumer protection that is shielded by the optional instrument, itself a directly applicable regulation, against differing Member State rules. The optional instrument need not in itself contain consumer protection provisions (such as the above-mentioned grey lists and blacklists of unfair clauses) as is the case now with the somewhat unsatisfactory DCFR. Instead, it could simply refer to the ECCLR, which then would include the common EU rules on consumer protection without the need to refer to Member State law. Such a technique would, of course, require that the level of consumer protection be sufficiently high to allow for setting aside Member State law on the basis of the principle of minimum harmonisation. This so far is not the case. However, it could provide for an incentive in this direction to make the optional instrument attractive also for application to B-to-C transactions.

⁵⁹ This was originally foreseen by article 3 of the draft Rome I Regulation, see *supra* Note 34. Article 3 of regulation 593/2008 has not expressly taken up this possibility, but mentions it in recital 13.



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Unfair Terms in the *Acquis* Principles and Draft Common Frame of Reference:

A Study of the Differences between the Two Closest Members of One Family

1. The *acquis* principles and Draft Common Frame of Reference — a question of relationship

The first volume of the Principles of the Existing EC Contract Law was published last summer.^{*1} It contains the first results of the work conducted by the *Acquis* Group, whose purpose is to restate the content of the *acquis communautaire* and to form it into one coherent system of law. The *Acquis* Group is trying to provide a proof that the fragmented sources of the European private law express legal ideas that in many cases can be generalised and then can serve as the basis for a more profound and wider harmonisation of private law in Europe. The work of the *Acquis* Group should be treated as a sort of intellectual experiment concerning the possibility of creation of coherent contract law in Europe.^{*2}

The day of publication of the Draft Common Frame of Reference (DCFR) is also forthcoming.^{*3} This draft has been prepared by the Compilation and Redaction Team — a small group of researchers representing two large research networks, namely the Study Group on a European Civil Code and the *Acquis* Group on Existing EC Contract Law. The majority of the DCFR consists of results of the work conducted by the Study Group, which in the intellectual sense continues the work initiated by the Commission on European Contract Law (the so-called Lando Commission).^{*4} However, certain parts of the DCFR have been entirely reserved for rules

¹ Research Group on the Existing EC Private Law (*Acquis* Group). Principles of the Existing EC Contract Law (*Acquis* Principles). Contract I. Pre-contractual Obligations. Conclusion of Contract. Unfair Terms. Sellier 2007 (hereinafter *acquis* principles).

² On the Function of the *acquis* principles see G. Ajani, H. Schulte-Nölke. – *Acquis* principles (Note 1), pp. IX–X; R. Schulze. Die *Acquis* – Grundregeln und der Gemeinsame Referenzrahmen. – *Zeitschrift für Europäisches Privatrecht* (ZEuP) 2007/3, pp. 731–734.

³ C. von Bar, E. Clive, H. Schulze-Nölke, H. Beal, J. Herre, J. Huet, P. Schlechtriem, M. Storme, S. Swann, A. Veneziano, P. Varul, F. Zoll. – Principles, Definitions and Model Rules on European Private Law. Draft Common Frame of Reference. Sellier 2008 (hereinafter DCFR).

⁴ C. von Bar, H. Beal, E. Clive, H. Schulte-Nölke. – DCFR (Note 3), pp. 24–26; C. von Bar. Working Together Toward a Common Frame of Reference. – *Juridica International* 2005 (X), p. 18.

developed by the *Acquis* Group.⁵ These are the parts with respect to which the existing *acquis communautaire* has reached a high level of development. The problem of unfair terms is one issue that has been widely elaborated on at the Community level. The Unfair Terms Directive accelerated the private law harmonisation process for the core of contract law.⁶

Although the Compilation and Redaction Team consists of members of both the *Acquis* Group and the Study Group and continues its work on the basis of the texts elaborated by the respective groups, it maintains at least a partial autonomy in the process of incorporation of texts prepared by the groups into the one coherent set of rules in the Draft CFR. Therefore, the texts issued under the auspices of the Study Group or *Acquis* Group are not identical in their text to what is to be finally provided by the Compilation and Redaction Team.⁷ In this context, the difference in the methodology applied by the Study Group and *Acquis* Group needs to be emphasised.⁸

In the course of its work, the Study Group is generally continuing the approach adopted by the Lando Commission. Thus, it is trying to formulate the rules on the basis of results obtained in the process of comparative research. Since the individual solutions adopted by the European countries (as well as other legal systems or acts considered during the working process) are quite diverse, the Study Group maintains a lot of freedom in developing the rules and principles. In practice, the Study Group formulates the proposals for the 'best rules', taking into account different legal traditions.⁹ The methodology adopted by the *Acquis* Group is more formalised, because for the adoption of every so-called 'black-letter rule' it requires finding sufficient legitimisation in the existing formal sources of the *acquis communautaire* and in the case law of the European Community.¹⁰ That does not mean, however, that the content of the rule expressed in the *acquis* principles remains the same as in the Community law. In fact, quite often it is the contrary. The generalisation and placement of the rule in a different context necessarily modify the content of the rule itself. It has to be emphasised, however, that the respective rule of the *acquis communautaire* expresses a legal concept or idea that can be applied in a broader scope. In specifying its methodology, the *Acquis* Group has, however, reserved a right to improve the Community law whenever such an initiative does not change the ideology behind the rule.¹¹

Even if the Compilation and Redaction Team preparing the final text of the DCFR adopts the rules formulated by the *Acquis* Group, it is not bound by the methodology adopted in the process of creation of the *acquis* principles. Consequently, the Compilation and Redaction Team is free to adjust these rules and harmonise them with the whole system of the DCFR, which can be achieved either by the formulation of a 'better rule' than the one provided by the existing *acquis communautaire* or by the 'correction' of the results obtained by the *Acquis* Group in the process of comprehension of European Community law. Thus, the rules taken over from the *acquis* principles and then incorporated into the text of the DCFR may differ slightly from the original text.

Both the Study Group and the *Acquis* Group maintain some sort of control over their own texts and those of their counterpart, as well as over the whole process of incorporation of those texts into the DCFR. The coordinators of these two groups may object to some formulations and propose an alternative solution.

In the case of unfair terms, the original text of the *acquis* principles has been modified in the process of incorporation into the DCFR. The question of the rules governing unfair terms has been the subject of vigorous debate within the Compilation and Redaction Team. Therefore, it is possible that the problems concerning the issue of unfair terms will lead to the presentation of alternative drafts of rules, at least with respect to one central point of the criterion of 'non-negotiation' as a condition for the unfairness test with regard to consumer contracts.

By applying the methodology of the *Acquis* Group, I would like to analyse in the following part of this paper the differences in the texts of the *acquis* principles and the DCFR. By doing so, I will strive to answer the question of which of the two texts more closely reflects the state of the existing *acquis communautaire*. Moreover, I will try to decide which of the two formulations would better fit into the text of the DCFR — the original text of the *acquis* principles or its version filtered by the DCFR. The same analysis will be applied to the two possible formulations proposed by the DCFR.

⁵ G. Ajani, H. Schulte-Nölke. – *Acquis* principles (Note 1), p. X; C. von Bar, H. Beal, E. Clive, H. Schulte-Nölke. – DCFR (Note 3), p. 28.

⁶ See S. A. Smith. *Atiyah's Introduction to the Law of Contract*. Oxford: Clarendon Press 2005, p. 25.

⁷ The text of the *acquis* principles is "one of the sources from which the Compilation and Redaction Team has drawn". See C. von Bar, H. Beale, E. Clive, H. Schulte-Nölke. – DCFR (Note 3), p. 28.

⁸ G. Dannemann. – *Acquis* principles (Note 1), p. XXIV.

⁹ *Ibid.*

¹⁰ On the methodology of the *Acquis* Group see G. Dannemann. – *Acquis* principles (Note 1), p. XXVIII.

¹¹ On the critique of the methodology of the *Acquis* Group see N. Jansen, R. Zimmermann. *Grundregeln des bestehenden Gemeinschaftsprivatrechts?* – *Juristen Zeitung* 2007/23, p. 1113 ff. My response to this critique will soon be published in *Zeitschrift für Gemeinschaftsprivatrecht* (GPR).

2. The Unfair Terms Directive as a major source of formulation of the *acquis* principles on non-negotiated terms

By the adoption of Directive 93/13 on Unfair Terms in Consumer Contracts, the European Community harmonised one of the most controversial areas in the field of contract law. It is not my intention to repeat here the well-known discussion preceding the adoption of the final version of this directive.^{*12} It is, however, important to stress some of the critical arguments made during this debate, which resulted from the differences in European legal traditions. Two main concepts were competing with each other in the origins of the directive. The German tradition was focused on the control of standard terms. The law involved an attempt to determine the limits of the quasi-legislative activity of a business.^{*13} The law on standard terms was not covered in consumer law, and B-to-B transactions were also covered by the fairness test, with only a relaxed level of its control. The French model, in turn, was based on a very different assumption. The starting point in the French system was the idea of protection of the weaker party (labelled as the consumer or non-professional). In this model, it did not matter whether the consumer was able to influence the content of the contract, and the requirement of ‘standardisation’ of the terms (in the sense that they are intended to apply in several transactions) has not been formulated.^{*14}

The proposals to be adopted in the directive more closely resembled the French model. Consumer contracts were supposed to be subject to the control regardless of whether the business used standard terms, and despite the issue of whether the consumer could influence the content of the contract.^{*15} The Unfair Terms Directive of 1993 is the result of a compromise without coherent ideological underpinnings. The directive comprises a sort of mixture, based on both the German and French solutions.^{*16} The core of the German legal notion of standard terms is not entirely meaningless under the directive, but its practical relevance is greatly reduced, because its meaning is reduced to a starting point for the establishment of a presumption that the terms have not been negotiated (article 3 (2), item 3). The directive emphasises also that unfairness is more likely to appear in cases of standard terms (article 3 (1)).

Individual terms drafted with the intention of narrow application to a particular contract are also subjected to the fairness test (article 3 (1)). However, the terms that have been negotiated are excluded from the control procedure. The Unfair Terms Directive forms a part of consumer law. The other parties may not invoke the fairness test on the basis of the directive.^{*17}

3. The fairness test in B-to-B transactions according to the *acquis communautaire*

The idea of also applying the fairness test to B-to-B transactions is inherent in European Community law, although it finds a quite limited scope of application. According to article 3 (3) of the Late Payment Directive, certain agreements derogating the rules on the consequences of delayed payment should not be invoked or should entitle the creditor to damages if under consideration of all circumstances of the case and good commercial practices they are ‘grossly unfair’ to the creditor. This test does not depend on the use of standard terms or ‘non-negotiation’ of the terms. The directive proves, however, that Community law does not hesitate to also apply the fairness test to pure commercial transactions.^{*18}

¹² See, for example, T. Wilhelmsson. *Standard Form Conditions*. – A. S. Hartkamp et al. *Towards a European Civil Code*. Kluwer International 2004, p. 434.

¹³ See F. Ranieri. *Europäisches Obligationenrecht*. Springer 2003, pp. 168–170; H.-W. Micklitz. *Verbraucherschutz in den Grundregeln des Europäischen Vertragsrechts*. – *Die Zeitschrift für Vergleichende Rechtswissenschaft (ZVglRWiss)* 2004/103, p. 98; H.-W. Micklitz. *The Principles of European Contract Law and the Protection of the Weaker Party*. – *Journal of Consumer Policy* 2004/27, p. 349.

¹⁴ J. Calais-Auloy, F. Steinmetz. *Droit de la consommation*. Dalloz 2006, p. 204; F. Ranieri (Note 13), pp. 171–172.

¹⁵ T. Wilhelmsson (Note 12), p. 434.

¹⁶ F. Ranieri (Note 13), p. 183. *Cf.* T. Wilhelmsson (Note 12), p. 434.

¹⁷ See also K. Riesenhuber. *System und Prinzipien des Europäischen Vertragsrechts*. Berlin: De Gruyter Recht 2003, pp. 427–428.

¹⁸ T. Pfeiffer, M. Ebers. – *Acquis principles* (Note 1), p. 234, article 6:301, No. 1.

4. Unfair terms in the *acquis* principles

The structure of the *acquis* principles on unfair terms is at variance with the structure of the Unfair Terms Directive. It resembles more closely the original concept of the German *AGB Gesetz* (currently incorporated into the German Civil Code) than the structure of the directive. Thus, the *acquis* principles provide for the three traditional tools of incidental control of the terms: inclusion in the contract (article 6:201), interpretation of the concept of *contra proferentem* (article 6:203), and the fairness test (articles 6:301–6:306). The directive does not contain distinct provisions on incorporation (inclusion) of the terms in the contract.^{*19} The body of the directive contains some provisions on the transparency of the terms, and the annex to the directive sets forth some provisions related to the consumer's possibility of being acquainted with the content of the terms. The general requirement of transparency is regulated with the aid of the interpretation rule of the directive (article 5), and the provision governing the consequences of the lack of possibility to learn about the terms in No. 1, Lit. 'j' of the annex.^{*20} The later provision shows the tendency of the European lawmaker to treat the question of the possibility of acquaintance with the content of terms on the level of the fairness test and not on the level of the formation of contract or incorporation of the standard terms. The *acquis* principles put the question of the consumer being acquainted with the terms on the level of incorporation into a contract.^{*21} The set of contract terms that should be regarded as unfair is implicit in article 6:305, and it does not contain any equivalent to No. 1, Lit. 'i' of the directive's annex. However, article 6:302 of Chapter 6, section 3 of the *acquis* principles — also the section regulating the validity of terms (which means mostly the regulation of the fairness test) — requires the communication of not individually negotiated terms in 'plain, intelligible' language.

The *acquis* principles follow more closely the German model in the area of the personal scope of application of the contract term test. The 'inclusion' part goes even further by applying incorporation control despite the personal qualification of the user and the client (article 6:201). Thus, in German law, professional clients are at least *de jure* deprived of the privilege of this test.^{*22}

Generally, where the fairness test is used, all groups of possible users and clients are included in the system.^{*23} However, the different groups of contracting parties have to be distinguished. A general clause establishing the conditions for determining the unfairness of the conditions (article 6:301) applies for C-to-C and B-to-C transactions. For B-to-B transactions it applies only through the standard of article 6:301, which sets forth an additional criterion, that of 'gross deviation' from good commercial practice. The two lists of forbidden clauses (the blacklist — with only one position — of article 6:304 and the grey list of article 6:305) constitute an exemplification and concretisation of the general clause, but only with respect to B-to-C transactions.

The *acquis* principles follow the solution of the directive quite closely with regard to the subject matter of the control procedure. The inclusion and fairness tests apply only in cases of non-negotiated terms.^{*24} The meaning of the notion of standard terms is reduced as it is in the directive. It is only of relevance for the burden of proof of the negotiation of terms (article 6:101 (4)) as well as in relation to the 'battle of the forms' governed by the 'grey-letter rule' of article 6:204.

5. Unfair terms in DCFR

The rules on non-negotiated or unfair terms in the DCFR do, in fact, have a different structure. In the *acquis* principles, these rules are gathered in one chapter (Chapter 6), whereas in the DCFR they are spread throughout the different parts of Book II (Contracts and Other Juridical Acts). The rule on battle of forms is included in the chapter on formation of a contract (Chapter 4) in its article II.–4:209; the rule on interpretation of non-negotiated terms is situated in Chapter 8, which is devoted to the interpretation of a contract (article II.–8:103) and priority of negotiated terms (article II.–8:104); and rules on the incorporation of the standard terms into a contract are presented in Chapter 9, on the content and effects of the contract (article II.–9:103). The latter chapter also provides rules concerning the fairness test (the whole of section 4).

The major differences between the *acquis* principles and the DCFR centre on the three aspects of the fairness test. The first central issue is the criterion of 'non-negotiation'. Article 9:403 includes a long and elaborate

¹⁹ *Ibid.*, p. 222, article 6:201, No. 4.

²⁰ T. Wilhelmsson (Note 12), p. 437.

²¹ ACQP article 6:201 (1). T. Pfeiffer, M. Ebers. – *Acquis* principles (Note 1), p. 223, No. 10.

²² H. Schulze-Nölke. – R. Schulze. Bürgerliches Gesetzbuch. Handkommentar. Nomos 2007, p. 363, § 305, No. 11. See § 310 (1) of the German Civil Code.

²³ N. Jansen, R. Zimmermann (Note 11), p. 1116.

²⁴ Supportive for this approach N. Jansen, R. Zimmermann (Note 11), p. 1116.

definition of the expression ‘not individually negotiated’. This definition is designed to make it more difficult for users who are attempting to circumvent the fairness test through presentation of the terms as negotiated when, in fact, the client was not really able to influence the clauses. Nevertheless, one of the alternatives presented in article II.–9:404 abandons the criterion of non-negotiation as a condition in the fairness test in consumer contracts entirely.

There is also a difference in the treatment of various personal configurations between the *acquis* principles and DCFR. The DCFR provides for three different standards for the fairness test, to be applied for different configurations of the parties — article II.–9:404 defines the meaning of unfairness in B-to-C contracts; article II.–9:405 in C-to-C contracts; and article II.–9:406 in B-to-B contracts. Above all, it is a difference in the drafting style that probably makes the text of the DCFR more readily comprehensible. However, the differences in drafting style at the same time hide the essential differences in substance that pertain to both C-to-C and B-to-B contracts. In such cases, the fairness test of the DCFR encompasses only the standard terms. The individual terms are not subjected to the fairness test, even if they are ‘non-negotiated’. Article II.–9:405 and 9:406 surprisingly do not formulate the requirement of non-negotiation, although the use of standard terms does not exclude the fact of ‘negotiation’ with the client.

The third main difference relates to the issue of evaluation of the non-acquaintance of the client with the terms. However, the DCFR previews also the test of effective incorporation, which requires the user at least to undertake reasonable steps aimed at drawing the other party’s attention to them, before or when the contract is concluded (article II.–9:103 (1)). A party in violation of this requirement is subject to sanctions in the event of lack of clear, effective inclusion of the terms in the contract. In the consumer law of the DCFR, this situation is differently regulated, however. In the case of B-to-C contracts, the question of the lack of the consumer’s real opportunity to be aware of the terms’ content has to be evaluated as one of the factors that must be considered in the process of assessing the unfairness of these terms (article 9:408). This means that lack of the possibility of being acquainted with the terms on the part of the consumer does not lead inevitably to the invalidity of the terms or to lack of their incorporation. This is definitely one of the factors that can be decisive in cases of ambiguity concerning the fairness of the terms in question. The judge may assess as fair terms that the consumer could not have been aware of, but only if other circumstances of the case so allow.

6. The question of the different structure of rules on unfair terms in the *acquis* principles and DCFR

The question of structure can be reduced to a pure drafting issue. However, it can also be explained by the differences in the entire concept between the *acquis* principles and DCFR. Book II of the DCFR encompasses the whole matter of contract law, whereas the scope of the *acquis* principles is limited by the content of the *acquis communautaire* — therefore, the *acquis* principles do not build a comprehensive system of contract law. To some extent, the *acquis* principles mirror also the structure of Community law, which tends to be more problem-oriented, rather than following the traditional ‘pandectic’ structure. Therefore, unfair terms are seen as posing one coherent problem, which can be presented as a unified whole in any of various ways. The DCFR follows the more traditional construction of contract law, and, in consequence, the different fragments of the unfair terms matter have been allocated to the respective areas of various matters of contract law, like formation, interpretation, or content of a contract. The different manner of presentation may also be seen as not purely confined to the drafting issue. The *acquis* principles by presenting the problem of non-negotiated terms as a separate issue emphasise the exceptionality and autonomy of the legal problem arising from the phenomenon of the contract concluded in the situation of imbalance of bargaining power. It shows the relationship with the phenomenon of standard terms as a separate legal category and a distinct legal concept. In such a system, the ‘non-negotiation’ of the terms (in the meaning of lack of real possibility of such negotiation on the part of the weaker party) constitutes ideological justification of the special interest devoted to this category by the legislator. In the style of presentation applied in the DCFR, the meaning of the legal category for non-negotiated terms is hardly reduced. If the proposal of giving up the requirement of non-negotiation in consumer contracts as a condition for the fairness test were to be maintained, it would be difficult to find a common name for the issue under discussion. The notion of unfair terms covers the problem with the different, non-homogenous categories. The concept of abuse of power by the user of standard terms (in the majority of cases) would be reduced to the question of protection of one party in the ‘normal’ world of contractual relationships.

7. The problem of standard terms and the requirement of ‘non-negotiation’

As was already mentioned above, the structure of the *acquis* principles emphasises more strongly the peculiarity of the problem with ‘non-negotiated terms’ than does the DCFR. To some extent, however, the idea of standard terms as a special legal category is preserved more fully in the text of the DCFR, since in B-to-B and C-to-C transactions a term may be unfair only if it is a standard term. In both cases, the ambiguity of the *acquis communautaire* in relation to the ideological underpinnings of the unfair terms law is further perpetuated in the *acquis* principles and DCFR. The *acquis* principles are an attempt to unify as far as possible the system of control of unfair terms. There is a conceptual gap between the conception of limiting the user’s freedom of creation of standard terms and the conception of protection of the weaker party. The idea of limiting the freedom of the user of standard terms does not require taking into account the status of the other party. The control of standard terms finds its justification in the possibility of abuse of the fact that the client is prevented from being acquainted with the standard terms on account of the irrational increase in the transaction costs that he or she might be forced to bear. However, in the majority of transactions, nothing ‘wrong’ happens — the obligations are performed according to the contract. The client usually behaves rationally, without even undertaking an effort to become acquainted with the standard terms, even if they are delivered to him or her in sufficient time before conclusion of the contract. The economic argument concerning high transaction costs to be borne by the client is valid despite the client’s qualification as a consumer or as a professional.^{*25} It can justify a system that is not focused only on consumer protection. The *acquis communautaire* does not, however, follow this path. For the Unfair Terms Directive the notion of ‘standard terms’ plays a less significant role, and it has been largely replaced with the notion of non-negotiated terms. The ideology behind the material on ‘non-negotiated terms’ obviously cannot be the same as that behind the language on ‘standard terms’. In cases of ‘non-negotiated’ terms, the problem of high transaction costs for one party is not present as in the case of standard terms. In cases involving non-negotiated terms, which are standard terms, the argument concerning transaction costs applies, whereas it does not matter at all in cases of individual contracts, where the transaction costs are usually higher for the proponent of the terms, who does not benefit from the number of contracts concluded that use these terms. Therefore, there is not merely one justification for the system of control adopted in the Unfair Terms Directive. It is a mix of the two concepts — those of abuse of standard terms and of the weaker party’s protection. The idea of the protection of the weaker party, specified in the case of the Unfair Terms Directive as the consumer, justifies the system of control in consideration of the typical features of the weaker party — in the most typical case, this party is intellectually and economically of fewer resources than the other party.^{*26} In such a case, the typical instrument assumed in the mechanism of freedom of contract — according to which each party is potentially able to secure and enforce its reasonable interests and any lack of this happening is due to this party’s negligence or application of the wrong strategy — cannot work. Accordingly, this is an area of said party’s self-responsibility. The criterion of non-negotiation seems to be in line with this assumption. If the ‘weaker party’ is not able to negotiate with its counterpart, it cannot be ‘self-responsible’. The other party must take care of the ‘reasonable interests’ of its counterpart. If a contract term has been ‘negotiated’ by the parties, in such a case the ‘weaker party’ has to prove the ability to enforce its own interests, which should result in its own ‘self-responsibility’. In such cases, the mechanism of exclusion of control is fully justified.^{*27}

The use of standard terms does not exclude *ex definitione* an assumption that the terms have been ‘negotiated’. It is, rather, an exceptional case in which the client could have a real opportunity to influence the content of the terms.^{*28}

The system adopted in the *acquis* principles follows the ‘mixed’ ideology of the Unfair Terms Directive. This ‘mixed’ ideology has, however, been extended also to C-to-C and B-to-B transactions. For C-to-C and B-to-B transactions, the DCFR is also following this path. There is, however, one significant difference between the two texts. As I have already mentioned, the DCFR confined the control in these two cases to applying only if the proponent uses standard terms. There is strong justification for the approach adopted in the *acquis* principles. Article 3 (3) of the Late Payment Directive does not require the substantively limited fairness test, according to which the clause in question is part of the standard terms. This argument applies, however, in both ways. The Late Payment Directive does not require **also** that the term in question have been negotiated. In the text of the *acquis* principles, the B-to-B and C-to-C fairness test requires non-negotiation. The DCFR, by contrast, does not express in the cases of C-to-C and B-to-B contracts a requirement of non-negotiation. Therefore, it creates an impression that not every piece of the puzzle has found its proper place.

²⁵ H. Kötz, H.-B. Schäfer. *Iudex oeconomicus*. Mohr Siebeck 2003, p. 193.

²⁶ See H. Kötz, H.-B. Schäfer (Note 25), pp. 191–192.

²⁷ See M. Wolf. *Rechtsgeschäftliche Entscheidungsfreiheit und vertraglicher Interessenausgleich*. Tübingen: J.C.B. Mohr (Paul Siebeck) 1970, p. 62.

²⁸ For German law see H. Schulte-Nölke. – R. Schulze (Note 22), p. 362, § 305 No. 8.

The concept of the DCFR with regard to the treatment of standard terms seems to be more consistent. For B-to-B and C-to-C transactions, it follows the idea of the limitation of the freedom of standard terms' use. The use of standard terms is sufficient to justify legislative intervention to prevent abuse, whose possibility of occurrence has increased as a consequence of the structure of the transaction costs. It is probably a weakness of the DCFR not to add the requirement of non-negotiation to article II.–9:405 and 406. This could be easily corrected by means of interpretation work, however.

The problem of carrying such a solution over into the text of the *acquis* principles is, nonetheless, connected with the lack of sufficient justification in the existing *acquis communautaire*. The basis for expanding the system of control into the B-to-B area (and probably with a sort of *a fortiori* argument into the C-to-C area) is not very strong, but perhaps it is sufficient according to the self-imposed methodology of the Acquis Group.^{*29} The mentioned article 3 (3) of the Late Payment Directive has a narrow scope of application. However, it provides proof that the idea of the fairness control has been accepted in Community law also with reference to B-to-B transactions. Furthermore, article 3 (3) of the Late Payment Directive lays down the criteria for judging unfairness of terms. For this reason, both the *acquis* principles and the DCFR use in their respective provisions the criterion of deviation from good commercial practices.^{*30} The test of article 3 (3) finds its application also to negotiated terms. The Acquis Group was concerned that preservation of the consistency of its own draft will also require application of the non-negotiation test to B-to-B transactions. It would be entirely not inconsistent to have the requirement of non-negotiation apply for B-to-C contracts but not for B-to-B transactions. The key question that might arise in this respect is whether it would not be reasonable to abandon the requirement of non-negotiation entirely. The answer is rather negative in tone, because in B-to-B transactions this would mean an unjustified limitation of freedom of contract. Probably the Acquis Group should apply the fairness test in B-to-B and C-to-C transactions only to standard terms. This solution would, however, require an argument that article 3 (3) of the Late Payment Directive justifies the concept of the fairness test in B-to-B transactions, but its broadening requires confinement of the scope of its application to standard terms only.

The central battleground concerns the conditions surrounding 'non-negotiation' in consumer contracts. The *acquis* principles follow the Unfair Terms Directive. The Compilation and Redaction Team have, in this respect, received very different instructions from the Study Group and Acquis Group. The Study Group would like to give up this requirement entirely, whereas the Acquis Group wish to maintain it in the text of the DCFR.

Above I have discussed the initial French and German position that served as the basis for the Unfair Terms Directive. However, also the results of the work of the English Law Commission on the unfair terms law are of special importance for the future development of unfair terms law. The existing requirement of non-negotiation has been called into question.^{*31} The reasons for this are probably more sophisticated than simple desire for expansion of the weaker party's protection. Probably two from among these multiple and diverse reasons are of extreme relevance for the future debate on the 'best' approach to unfair terms. One of the reasons for abandoning the requirement of non-negotiation is a very practical one — namely, there is very limited possibility to prove that negotiations were carried out and the consumer was not deprived of influence on the content of the contract. The application of this criterion does not, however, change much in practice, since there is a presumption of the non-negotiated nature of the terms (in the case of the directive, only for standard terms). In cases of individual contracts, the burden of proof usually rests with the consumer.^{*32} This proof is very hard to establish, since it is highly difficult to determine what kind of circumstances should be proved. This increases the level of legal uncertainty. What only appears to be negotiation can also be used by the business to mislead the consumer about his or her rights with regard to a challenge of the assumed unfairness of the terms. It may also happen that the representative of the business is authorised to undertake some negotiations with the client while the actual scope allowed for such negotiations cannot lead to results that do not violate the interests of the consumer in an unfair way. The second reason may have a theoretical background deep in English common law. The idea of reviewing contractual terms is strictly related to the level of acceptance of certain terms by the relevant party. The level of the client's awareness concerning the content of the contract directly influences its fairness. The influence that the client has exercised on the content of the clause concerned is considered to be part of the fairness test.^{*33} The waiving of the requirement of non-

²⁹ See T. Pfeiffer, M. Ebers. – *Acquis* principles (Note 1), pp. 234–235. Article 6:301, No. 2–3; Cf. N. Jansen, R. Zimmermann (Note 11), p. 1116.

³⁰ T. Pfeiffer, M. Ebers. – *Acquis* principles (Note 1), p. 234. Article 6:301, No. 2. Critique on the criterion of the "deviation from the good commercial practices in the context of the non-negotiated terms": N. Jansen, R. Zimmermann (Note 11), p. 1120.

³¹ The Law Commission and the Scottish Law Commission (Law Com No. 292) (Scot Law Com No. 199). Unfair Terms in Contracts. 2005, pp. 31–32.

³² Article 3 (2) first sentence of the Unfair Terms Directive.

³³ See the Law Commission and the Scottish Law Commission (Law Com No. 292) (Scot Law Com No. 199). Unfair Terms in Contracts. 2005, p. 31 (impact of the negotiation on the reasonableness test), p. 32 (impact of the advice on the fairness test). See also R. Brownsword. Contract Law. Themes for the Twenty-First Century. Oxford University Press 2006, p. 91; M. H. Whincup. Contract Law and Practice. Kluwer International 2006, p. 214, No. 7.4. See, however, S. A. Smith (Note 6), pp. 308–313.

negotiation as is possible under English law would be in line with the traditional system of that country.^{*34} However, the motivation behind such a proposition is probably different from what is seen in the French law. In the latter system, the question of negotiation does not matter so much, although it would probably also be considered to some extent in the frame of the 'good faith' test. By contrast, here the fairness test is focused on the substantive content of the contract.

In the already existing *acquis communautaire* there are some traces allowing one to state that the fairness test encompasses not only the substantive content of the contract but also procedural elements concerning the formation of a contract. The most significant examples are provided in article 4 (2) of the Unfair Terms Directive as well as in the already mentioned No. 1, Lit. 'i' of the annex to that directive. The first of these provisions specifies that the terms concerning the main objects of contracts may be subjected to the fairness test only if the term in question is non-transparent. The above-mentioned No. 1, Lit. 'i' of the annex to the directive seeks to ban those terms of which the consumer could not learn prior to the conclusion of the contract. As regards the terms governing the main objects of the contract, there is lack of clarity as to whether the lack of transparency equates to unfairness of these terms, or whether it simply allows or opens the possibility for application of the fairness test. Furthermore, there is still a possibility that the lack of transparency needs to be assessed as just one of the factors influencing fairness, among many other 'substantive' factors.

It is possible to trace a somehow circular development. In the first phase of the development of the 'law of unfair terms', the problem was seen mostly at the level of the formation of the contract and the validity of the client's consent. The extended use of the *in dubio contra proferentem* rule was a bridge from the 'formation of contract' approach to the 'substantive test' approach. The substantive test approach was focused on the fairness of the contract. This test was independent from the problem of the client's awareness and consent. There are some signs that the circle may have closed — proceeding from the substantive test to the formation test approach.

It is highly possible that between the French approach and the new English (or English Law Commission's) approach exists a fundamental difference. The French approach, encompassing also negotiated consumer contracts, is focused on the content of the contract and its substantive fairness. The English approach, presenting the analogical formulation, applies a liberal assumption. The fairness test consisting in taking into account the real possibility of the client's influence on the content of the contract is an attempt to verify the 'quality' of the consumer's consent to the contractual terms. If the 'quality' of the consent is high, then even substantively 'unfair' term should not be declared as such.

The decision the Compilation and Redaction Team of the academic DCFR is going to take does not reflect the old struggle between the French and German approaches that has influenced the Unfair Terms Directive. This was the debate between the different concepts of the substantive fairness test, although with a different understanding of the freedom of contract. Now the debate that is going to be initiated concerns the development of Continental unfair terms law as a whole and will definitely concern the issue of whether the idea of the substantive test should be maintained in the unfair terms law or whether the right time has come for a renaissance of the formation test idea. Moreover, it is also possible that inclusion of negotiated contracts under the fairness test would lead to very different developments: in England (and probably even in other European common-law countries) of the formation test, as distinct from the rest of Europe's substantive test.

8. The next step?

Both the *acquis* principles and the DCFR are not fully comprehensive with regard to the matter of unfair terms. Furthermore, both texts reflect the existing ambiguity of Community law. This ambiguity, which is probably clear to every member of each of the research groups participating in the creation of the DCFR, also reflects, however, the difficulties in obtaining progress. The Unfair Terms Directive has probably harmonised the laws of the Member States only on the surface of their respective contract laws. The real differences, extending quite deeply into the basic understanding of the function of contract law, remain, however, and in consequence cause further difficulties that cannot be easily removed. This is not a flaw of both texts, though, since they do not constitute the codes but only the systems of reference. In the areas regulated by Community private law, both the *acquis* principles and the DCFR have proposed a more coherent set of rules than that existing under the current law. Yet neither can we ignore completely the different legal traditions that exist in Europe, which are reflected, in turn, in the national laws on standard terms. The apparently similar laws of the different countries conceal the quite far-reaching differences that do, in fact, exist. Therefore, there is still a place for improvements in this respect.

³⁴ See, however, Unfair Contract Terms Act from 1977 and Unfair Terms in Consumer Contracts Regulation from 1994, restated 1999 – M. H. Whincup (Note 33), pp. 219 *ff.*

The *Acquis* Group once again needs to pose the question of article 3 (3) of the Late Payment Directive. Is it due to the lack of coherence of the Community law-maker that the fairness test of this provision does not require ‘non-negotiation’ (and does not confine the fairness test to standard terms)? Would it make any sense that the B-to-C test be confined to non-negotiated terms and in B-to-B transactions it be open for negotiated clauses as well? At first sight, such a solution appears completely absurd. However, in reality it may not be as absurd as one might suppose. This solution could have some sense if the fairness test applicable to negotiated terms were understood in the ‘English’ and not in the ‘French’ way. If the test used were to concern mostly ‘formation of the contract’ (combining the ability to negotiate the terms as well as the allowed level of fairness — procedural fairness) and not involve a substantive fairness test, the system may become consistent. Therefore, the corresponding language should be drafted differently in order to avoid the impression of a badly reversed hierarchy of values that could lead to the impression that terms in B-to-B transaction are subjected to more intense judicial control than those in consumer cases. Subjecting B-to-B transactions to consideration of negotiated terms and not allowing this for B-to-C transactions would be a result not of lack of consistency but of the very different theories underpinning the systems of control. This would remove the axiological conflict between the Unfair Terms Directive and Late Payment Directive. The DCFR, whose final version is nearly ready, should not try to go this new and risky route; instead, it should follow the latest version of the *acquis* principles, because at some point it may be reasonable to undertake innovative experiments that very probably are, in fact, well justified by the state of the existing *acquis communautaire*, which in this respect may even prove to be the right one. However, it will be extremely difficult to draft the rules in a way that will clearly show the readers and users of the *acquis* principles the difference in approach as discussed above.



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The Structure of the Law on Multiparty Situations in the Draft Common Frame of Reference

The purpose of this contribution is to provide a comparative analysis of the treatment of multiparty situations in the Draft Common Frame of Reference (DCFR).^{*2} Because such situations are more complex than simple bipartite relationships, their study reveals a lot about the structure and underlying way of thinking of a legal system.

A very important element in this respect is that the DCFR clearly distinguishes the contract as a juridical act from the obligational relationship between the parties resulting from a (valid) contract — the contractual relationship. This distinction is also expressed in the division between Book II (on contracts and other juridical acts) and Book III (addressing contractual and non-contractual obligations). This distinction is especially important for avoiding misconceptions concerning multiparty relationships or situations. In multiparty operations, there often is a contractual relationship between parties other than those having made the contract. But in nearly all legal systems, the law of obligations was developed first for two-party-relationships and only later for more complex situations. The discipline of multiparty operations is in many national systems covered with rules that are still determined proceeding from the idea that a ‘real’ contractual relationship only can exist between the parties who made the contract. Some of them may have been useful as transitional in the development described but have since lost their utility. Some were originally in line with the general rules for bipartite relationships in their time but are no longer so because they have missed out on the developments of general contract law.^{*3}

This approach of the DCFR allows a more or less coherent treatment of the different multiparty situations. I will deal in this article with situations wherein three parties are involved, as they are sufficient to demonstrate the questions and proposed solutions. The main questions in this respect involve the relation among the different relationships — i.e., to what extent one of the bipartite relationships is dependent upon one or more of

¹ This article originated as a lecture at the Congress VIII. Forum on the Civil Code, Univerzita Karlova, Prague, 4 December 2007.

² All references are, unless otherwise stated, to the interim version of the DCFR as published on 1 January 2008: Principles, Definitions and Model Rules of European Private Law — Draft Common Frame of Reference, Interim Outline Edition edited by C. von Bar, E. Clive, H. Schulte-Nölke, H. Beale, J. Herre, J. Huet, P. Schlechtriem†, M. Storme, S. Swann, P. Varul, A. Veneziano, F. Zoll. Also available at <http://www.storme.be/DCFRInterim.html>.

³ Cf., on a partly different but from a legal theory perspective related topic, R. Dekkers. Les méfaits de la stipulation. — *Mélanges Fernand de Visscher* 1950 (III), p. 361 ff., explaining how the specific rules of the *stipulatio* as a form of contract remained influential even when a stipulation was no longer required for an innominate contract because of the acceptance of the general notion of contract.

the other bipartite relationships. The rules of the DCFR are, as in most national jurisdictions, the expression of a balancing of general principles, especially the principles of autonomy and of reliance.⁴

I will start the analysis with the rules on (direct) representation, continue by addressing operations that can be seen as giving rise to a new creditor, and finally discuss operations giving rise to a new debtor.

1. Direct representation

In the rules on representation, the balancing of the different principles, especially the autonomy principle and the reliance principle, has applied a technique of ‘separation’, which is used to some extent (but less clear) in the rules on other institutions discussed below.

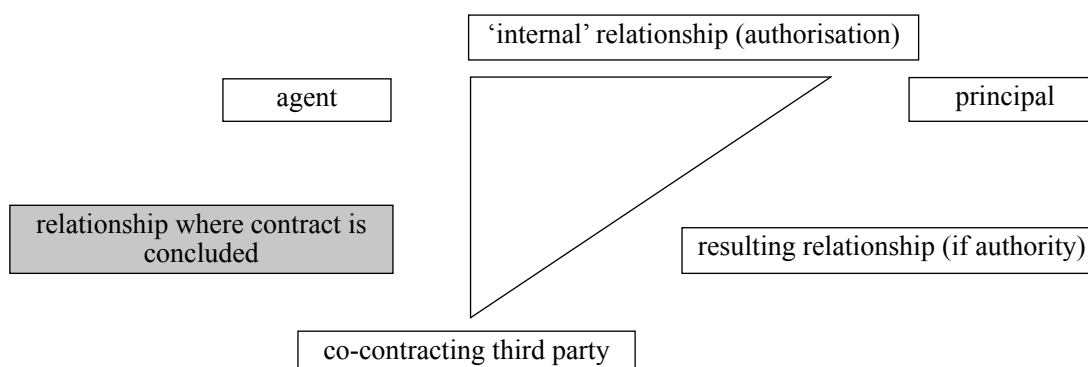
1.1. The separation between the authority and the authorisation/mandate

The rules on (direct) representation start from the distinction and separation between the ‘external relationship’ and the ‘internal relationship’. The rules on representation in Book II, Chapter 6 deal only with the external relationship — i.e., the relationships between (a) the principal and the third party and (b) the representative and the third party (article II.–6:101 (1) — whereas the internal relationship will be governed by its own rules, depending on the nature of that relationship (article II.–6:101 (3) *a contrario*); the latter relationship will often be one stemming from a contract of mandate, and the rules for such relationships as set forth in Book IV.D will apply, but a different type of contractual relationship or even a non-contractual relationship could be involved.

The external relationship centres on the notion of authority, to be distinguished from the (act of) authorisation and the directions that are elements of the internal relationship. It is the old distinction between ‘*quod potest*’ and ‘*quod licet*’. Thus:

- Articles II.–6:102 (2) and IV.D.–1:102 (b) define the ‘authority’ of a representative as “the power to affect the principal’s legal position” (especially to bind the principal by acts by which the principal will be bound as if he had carried out the act itself).
- Article II.–6:102 (3) defines the ‘authorisation’ of the representative as “the granting or maintaining of the authority” (usually by the principal itself in a contract or other juridical act with the representative). Equally, article IV.D.–1:102 (a) *juncto* IVD.–1:101 (1) (a) defines a ‘mandate’ of a representative as “the authorisation and instruction given by the principal to conclude a contract or otherwise affect the legal position of the principal in relation to a third party”.

Given this approach⁵, the question of whether the act of ‘authorisation’ is separated from the (rest of the) contractual relationship itself between the principal and the representative (as it is constructed in, for example, German law) has lost most of its importance.



⁴ Some authors have criticised the DCFR for not being enough ‘principled’. I have tried to respond to this criticism in my article “Une question de principe(s)? Réponse à quelques critiques à l’égard du projet provisoire de Cadre commun de référence”. – ERA Forum 2008/1.

⁵ Which is also known in international private law: the conflict of law rule for the internal relationship is found in the Rome Convention, which explicitly excludes from its scope (article 1, 2f) the question whether an agent can bind its principal in relation to a third party. The conflict of law rule for that question is found in the Hague Convention on the law applicable to representation, esp. articles 11 to 15.

1.2. The form and features of this separation

The exact nature of the separation can be seen more clearly when one analyses the rules on the coming into existence of authority and its ending.

1.2.1. Coming into existence

The authority of a representative may be (a) granted by the principal (II.–6:103 (1)); (b) granted by the law (II.–6:103 (1)), this grant also being called authorisation; or based upon appearance: If a person causes a third party reasonably and in good faith to believe that he has authorised a representative to perform certain acts, the person is treated as a principal who has so authorised the apparent representative (II.–6:103 (3)). In the latter case, the authorisation is only ‘apparent’ but the authority is ‘real’: the agent has authority and not merely apparent authority.^{*6} The rule is an expression of the principle of reliance, which in the circumstances described receives priority over the pure autonomy principle.

The same applies for the scope or extent of the authority. The rules of II.–6:103 and IV.D.–1:102 (a) imply that directions given by the principal to the representative but not known to the third party do not limit the authority of the representative.^{*7}

1.2.2. Ending of authority

The same separation between authorisation (in the internal relationship) and authority (in the external relationship) is found in the rules concerning the ending of the one and the other.

The rules on the ending of authorisation are found in the general rules of contract law, especially in Book III, supplemented by the specific rules on mandate contracts in Book IV.D., which provide that a mandate can, moreover, be revoked at any time by the principal (article IV.D.–1:104), except in specific cases of irrevocability where revocation is restricted to the grounds of termination as in general contract law and some additional situations (see article IV.D.–1:105).

The rules on the ending of authority, on the other hand, are found in Book II — specifically, in II.–6:112. Again, the basic rule (paragraph 1) cites the apparent internal relationship as the criterion for the continuation or ending of the authority: “The authority of a representative continues in relation to a third party who knew of the authority notwithstanding the ending or restriction of the representative’s authorisation until the third party knows or can reasonably be expected to know of the ending or restriction.”^{*8} This also implies that authority does not end retrospectively.

The terms in paragraph 2 apply when the ‘third party’ is not really a third party; that is, “[w]here the principal is under an obligation to the third party not to end or restrict the representative’s authorisation, the authority of a representative continues notwithstanding an ending or restriction of the authorisation even if the third party knows of the ending or restriction”. This also means, *a contrario*, if there is no obligation toward the third party, authority is ended in the external relationship when the third party is notified or knows about the ending, even if the ending is not allowed in the internal relationship between principal and representative; whether the revocation is valid or not is for the third party *a res inter alios acta*.

1.3. Effect on the resulting relationship

The mechanism of representation in the DCFR implies, in conformity with the tradition, that the relationship between the principal and third party is the relationship as concluded between the representative and the third party. Both parties are in relation to each other as well bound by that relationship as able to invoke it.

Thus, the relevant elements for interpretation of the concluded contract are to be found in the acts and minds of the representative and the third party (not of the principal). However, as the principal is considered to be a party to the relationship from the beginning (and not only at a later stage, as in the case of acquisition by assignment for example), the mind and behaviour of the principal may be relevant for the application of certain

⁶ This is basically a question of good drafting: An appearance can be a fact which is relevant at law, but it makes no sense to draft legal rules which spell out apparent legal effects.

⁷ The Draft of the Czech CC provides the same in article 405, requiring moreover that the directions are contained in the document of authorisation. The Draft has on the other hand no explicit rule for an authority based on appearance, apart from the case of a tacit ratification when the principal remains silent after becoming aware of the act made by the agent in its name (see article 407 (1)).

⁸ Cf. article 405 of the Draft Czech CC. In article PECL 3:209, the grounds of ending were listed in the article itself; as the DCFR contains a Book on Mandate Contracts, they are now discussed there, as we mentioned.

rules relating to the formation and validity of the contract (e.g., bad faith of the principal).⁹ It would lead us too far to discuss the details here.

2. New creditors

There are many situations wherein a person not being a party to a contract becomes a party to the contractual relationship. In this article, we analyse only the situations that can be seen as introducing a second creditor.

2.1. Stipulation in favour of the third party

A first example is the stipulation in favour of a third party.¹⁰ I take it as the first example for consideration here because it bears some resemblance to representation, in that from the beginning it is intended that another party than the parties making the contract will become a creditor in the contractual relationship. In the stipulation in favour of a third party, there is no authority of the promisee/stipulating party to bind the third-party beneficiary, and neither is the stipulation made in the name of the third-party beneficiary. But in other respects there is some analogy, even if the analogy is much closer to ‘indirect representation’ (see *infra*): the third party acquires a right against the promisor by virtue of a contract between the stipulator and the promisor. The analogy is obscured additionally because ‘third party’ and ‘internal relationship’ are traditionally used here in the opposite sense from that applied in the case of representation.

2.1.1. Rules on binding character and revocability in conformity with general contract law

It is interesting that the DCFR has, differing from many national legal systems, applied the general rules of contract law to these stipulations in favour of a third party in a coherent manner.

First of all, the **creation** of a right of the third-party beneficiary does not, as a matter of principle, depend on acceptance by the third party. According to article II.–9:302 (a), “in the absence of a provision to the contrary in the contract, the third party has the same rights [...] as if the contracting party was bound to render the performance under a binding unilateral promise in favour of the third party”. It would indeed have been inconsistent to accept the binding force of unilateral promises (following from article DCFR II.–1:103 (2)) but not under the same conditions the binding character in relation to a beneficiary of a contract in favour of the beneficiary as long as the beneficiary has not accepted it. The beneficiary thus acquires the right or benefit as soon as the notice reaches the beneficiary (compare II.–1:106, ‘Notice’). Evidently, the parties may make the acceptance a precondition for the right of the beneficiary. And, where acceptance is not required, the beneficiary may, in conformity with general contract law, waive its right (see article II.–9: 303 (1), which states that “[t]he third party may reject the right or benefit by notice to either of the contracting parties”, the sole specific rule being that, upon such rejection without undue delay, the right or benefit is treated as never having accrued to the beneficiary).

Evidently, acceptance by the beneficiary (or authority of the stipulator to bind the beneficiary) is required where the beneficiary has to engage in some obligation itself. But in such a case, there simply is a normal contact with the beneficiary, although its rights and obligations can still be made dependent upon the fate of another contract, such as an underlying contract between the stipulator and the promisor.

Fully coherent with the basic approach, the revocability or irrevocability of the right or benefit of the beneficiary depends upon the terms of the basic contract (between the stipulator and the promisor); see article II.–9:301 (2) (“The nature of the third party’s right or benefit is determined by the contract”) and more explicitly article II.–9:303 (2) (“The contract determines whether and by whom and in what circumstances the right or benefit can be revoked or modified after that time”), as corrected by the reliance principle (in article II.–9:303 (3)). I understand this in such a way that, if desired, any intended revocability after the time the beneficiary was notified has to be stipulated.

⁹ Cf. article 406 III of the Draft Czech CC.

¹⁰ In the Draft Czech CC articles 1507 and 1508.

2.1.2. Effects in the resulting relationship (promisor — beneficiary) and defences

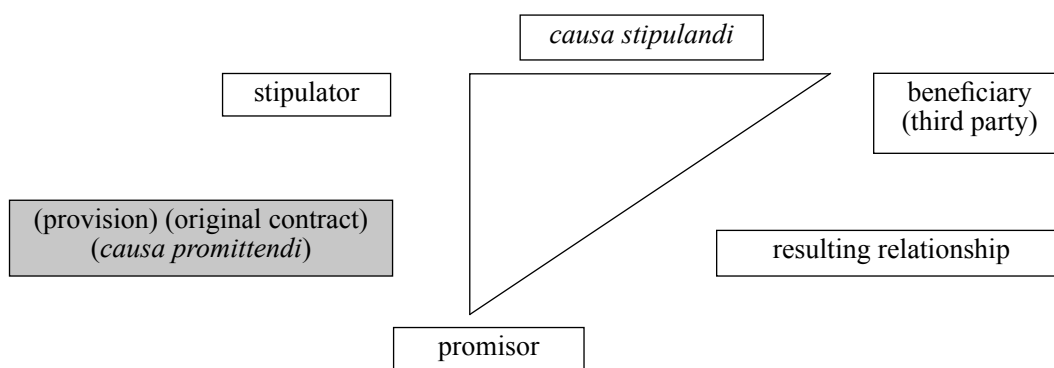
As is expressed in article II.–9:301, paragraph II, the modalities of the resulting relationship — i.e., the obligation of the promisor toward the beneficiary — is fully dependent upon the contract and relationship between the stipulator and the promisor; otherwise, said obligation is not abstracted from it: “The nature and content of the third party’s right or benefit are determined by the contract and are subject to any conditions or other limitations under the contract.”^{*11} Article II.–9:302 repeats the same idea by providing the following:

(Where one of the contracting parties is bound to render a performance to the third party under the contract, then, in the absence of provision to the contrary in the contract):

- (a) the third party has the same rights to performance and remedies for non-performance as if the contracting party was bound to render the performance under a binding unilateral promise in favour of the third party; and
- (b) the contracting party may assert against the third party all defences which the contracting party could assert against the other party to the contract.^{*12}

On the other hand, the relationship between the stipulator and the beneficiary is in principle not relevant for the relationship between promisor and beneficiary (in the rest of this article, I will call the latter relationship the ‘valuta relationship’ and the former the ‘provision relationship’, following the terminology well known in the law on bills of exchange and generalised by doctrine in some national jurisdictions^{*13}).

These rules are consistent with the general idea that the institution bears some analogy to an assignment of rights by the stipulator (the beneficiary can be compared to an assignee as new creditor) and not to an additional debtor of a possible obligation of the stipulator towards the beneficiary. This distinguishes the *stipulatio alteri* from a *delegatio (solvendi)*.



There are some differences from assignment, which can be explained when one keeps in mind that the right of the third-party beneficiary is not, as in assignment, transferred to the beneficiary at a later stage but is at the beginning created as a right of the beneficiary. Thus, there is no transfer of property in an existing right.

Given the idea that a stipulation in favour of a third party is in a sense halfway between representation and assignment, the question arises of whether the beneficiary can in some circumstances have rights superior to what the stipulator has or would have (this question also arises in assignment). The DCFR deals only with the case of a revocable right where the beneficiary believes it to be irrevocable: where the parties have led the beneficiary to believe this and the third party has acted in reliance on this, it is protected (article II.–9:303, paragraph III). But the same should probably apply in regard to other elements of the obligation than revocability or irrevocability.

¹¹ The same idea is found in article 1507 II of the Draft Czech CC.

¹² This corresponds to article 1507 III of the Draft Czech CC.

¹³ The provision relationship is always the relationship where lies the reason why the debtor of the resulting relationship engaged itself. In case of a new creditor, it is the relationship to which there is a new creditor, in case of a new debtor, it is precisely not the original relationship to which there is a new debtor.

2.2. Assignment

In the DCFR, the assignment of a right to performance is first of all a transfer of property based upon the relationship between the assignor and the assignee: “An ‘assignment’ of a right is the transfer of the right from one person (the ‘assignor’) to another person (the ‘assignee’)”, according to article III.–5:102, paragraph I. This is a clear difference from representation and stipulation in favour of a third party, where no transfer of an existing asset takes place.

As a transfer of property, this would have been more logically a subject to be dealt with in Book VIII, on transfer of property, with regulation in Book III covering only the effect (or absence of effects) of this transfer in relation to the *debitor cessus* (the ‘internal relationship’). That is the approach taken in some of the most modern codes, such as the Dutch civil code of 1992.¹⁴

I would have preferred the Dutch approach, which is more consistent with the rules themselves and would have clarified a pattern that is now a bit hidden in the rules and which can usefully be compared to the pattern of separation we have found in the case of representation.

2.2.1. Structure of the relationships

Where there is no abstraction of the transfer of property from the underlying relationship between assignor and assignee¹⁵, there is at the same time in several respects a separation between the property situation (the effect of a transfer from the assignor to the assignee based upon their underlying relationship) and the ‘internal’ obligational relationship with the *debitor cessus*. On the other hand, the resulting relationship between the assignee and the debtor is basically dependent upon the original relationship between assignor and assignee; in other words, it is not a new relationship but the original relationship wherein another creditor is substituted for the original creditor.

The main aspects of this separation and dependency are the following:

1. The transfer cannot give, in principle, the assignee a right with a different content¹⁶ from the right the assignor had against the debtor. But it can give rise to a substitution of the creditor without the consent of the debtor.¹⁷ There is neither a need for prior modification of the internal relationship (consent of the debtor) nor the effect of a modification of the internal relationship other than the substitution of the creditor. That substitution is the consequence of the transfer rather than a prerequisite.
2. There is an additional¹⁸ element of separation in the rule of article III.–5:108, which provides that “[a] contractual prohibition of, or restriction on, the assignment of a right does **not** affect the assignability of the right” (i.e. does not prevent the transfer of property) (III.–5:108 (1)), but does on the other hand not deprive the debtor of:
 - (a) its right to perform in favour of the assignor and be discharged by so doing; and
 - (b) all rights of set-off against the assignor as if the right had not been assigned (III.–5:108 (2))”, unless the debtor has consented or created reliance (III.–5:108 (4) (a and b)).¹⁹

¹⁴ The assignment as transfer of property is dealt with in Book III (esp. 3:94), the internal relationship in Book VI Tit. 2, article 6:142 *ff*.

¹⁵ In the published interim version, this was not very clear. Article III.–5:103 (1) has since been modified to clarify this and now reads (in 3 paragraphs):

“(1) The requirements for an assignment of a right to performance are that:

(a) the right exists;

(b) the right is assignable;

(c) the person purporting to assign the right has the right or authority to transfer it.

(d) the assignee is entitled as against the assignor to the transfer by virtue of a contract or other juridical act, a court order or a rule of law; and

(e) there is a valid act of assignment of the right.

(2) The entitlement referred to in paragraph (1)(d) need not precede the act of assignment.

(3) The same contract or other juridical act may operate as the conferment of entitlement for the purposes of paragraph (1)(d) and as the act of assignment for the purposes of paragraph (1)(e). Unless it provides otherwise a contract or other juridical act containing an undertaking to assign is regarded as being itself an act of assignment.

(4) [...]”

Thus, the requirements for a transfer of property in a right to performance are parallel to those for the transfer of a corporeal movable: he DCFR chooses a causal and not an abstract system of transfer.

¹⁶ This does not exclude partial assignment of a right, see article III.–5:107 on assignability in part.

¹⁷ Article III.–5:104, paragraph II in the interim version, now III.–5:104, paragraph IV.

¹⁸ At least conceptually, the DCFR diverges here from most national jurisdictions, which provide that in case of a valid contractual prohibition, the right is in effect not assignable. In the traditional sense also article 1559 I of the Draft Czech CC.

¹⁹ An additional exception is made (III.–5:108 (4) (c)) for “rights to payment for the provision of goods or services” (i.e., receivables), as a matter of economic public policy.

In other words, the property passes, but, in relation to the debtor, the creditor is only substituted for insofar as the debtor agrees or has caused reliance. That property passes also implies a priority for the assignee in relation to other creditors of the assignor (expressly in article III.–5:108 (3)).^{*20}

On the other hand, the substitution of creditor in the internal relationship does not fully coincide with the transfer of property. By substitution of creditor, I mean the effect that the debtor can be discharged by paying to someone different from the original creditor and can no longer be discharged by paying the original creditor, and its counterpart that a different person can (in its own right) claim payment and the original creditor can no longer claim payment (in its own right). Apart from the situation mentioned *supra* where a right is assigned in breach of a contractual restriction, there are other situations of divergence between transfer of property and substitution of creditor. One has to distinguish between cases where this follows from property law itself (not related to the rules on assignment) and cases in which it follows from the rules of the law of obligations connected with the reliance principle and addressed in a more specific form in the rules concerned with assignment. The first type of case concerns the divergence between the ownership of the right and the authority to dispose of the right (also called entitlement to receive performance in III.–5:119 (5:118 in the interim version of the DCFR), which means entitled in the internal assignor/assignee relationship) (such entitlement may follow from rules of property law but also from a mandate for indirect representation). The second type of cases relates mainly to those addressed by article III.–5:119 (5:118 in the interim edition):

- on the one hand, according to paragraph 1, “the debtor is discharged by performing to the assignor so long as the debtor has not received a notice of assignment from either the assignor or the assignee and does not know that the assignor is no longer entitled to receive performance”^{*21};
- on the other hand, according to paragraphs 2 and 3^{*22}, the debtor is discharged by performing in good faith to the person identified as the assignee in a notice of assignment from the assignor, *c.g.*, if the creditor has caused the debtor reasonably and in good faith to believe that the right has been assigned to a person who identifies himself as assignee in a notice of assignment, to that person.

The debtor will also be protected if the assignment was void or retroactively avoided but this was not yet reported to the debtor at the time of performance.

In these cases, the same principle applies as in the case of an authority to represent based on appearance: performance to the apparent creditor discharges the debtor; the apparent creditor has authority to receive the performance, although he is not authorised (not entitled in accordance with his relationship with the owner of the right). The main criterion for this appearance is the notice given to the debtor.

As mentioned, I would have preferred to use here the same technique as applied with representation and mandate, where we dealt with both aspects in different places. However, in English, ‘assignment’ means both and is a well-established word, which made it difficult to convince the group to change this single term into two different words and speak, for example, of ‘transfer of property in the right’ on the one hand and ‘substitution of creditor’ on the other.

2.2.2. Effect in the resulting relationship and defences

1) Defences out of the provision relationship

In cases of assignment, the debtor has never promised anything to the assignee. Nevertheless, after assignment there will be a relationship between debtor and assignee of the same nature as the relationship that existed between debtor and assignor. If the assigned right is a contractual right, the contractual relationship continues to be of a contractual nature between the assignee and the debtor. It follows that this relationship is indeed dependent upon the original relationship (provision relationship); even more, it is the same relationship in which at some point in time the creditor is substituted.

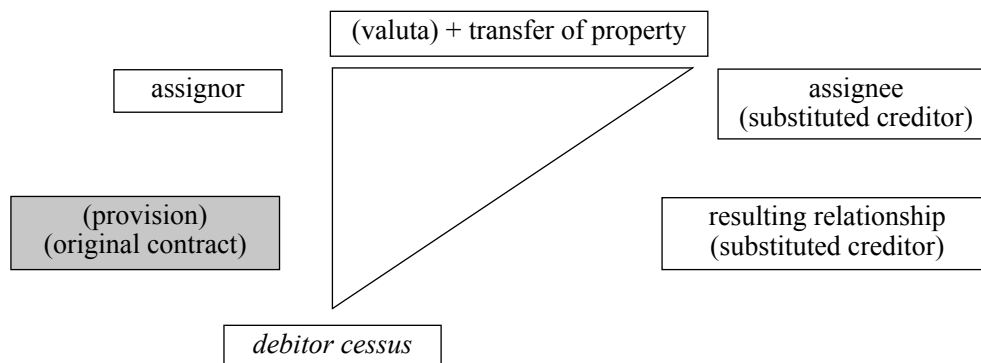
The basic principle thus can only be that “[t]he debtor may invoke against the assignee all substantive and procedural defences to a claim based on the assigned right which the debtor could have invoked against the assignor” (article III.–5:116, paragraph I).^{*23} In principle, the defences of the debtor cannot be modified without the consent of the debtor.

²⁰ “(3) Where the debtor is discharged under paragraph (2) by performing in favour of the assignor, the assignee’s claim against the assignor for the proceeds has priority over the right of a competing claimant so long as the proceeds are held by the assignor and are reasonably identifiable from the other assets of the assignor.”

²¹ This is slightly more precise than article 1560 of the Draft Czech CC, which provides that the debtor may pay the old creditor until he receives notice.

²² A modification compared to the interim edition.

²³ Cf. article 1562 I of the Draft Czech CC.



There are some exceptions to this rule, which are consequence of the general idea that rights are, in principle, transferable (expressed in III.–5:105):

- unless there is a valid contractual prohibition of assignment^{*24}, the debtor can be obliged — by being given sufficient notice^{*25} — to pay to a different creditor (*ex* III.–5:113);
- where the obligation is an obligation to pay money, the debtor can also be obliged to pay it in a different place within the European Union, under deduction of the costs incurred by reason of this change in the place of performance (article III.–5:117, paragraph I); and
- the debtor loses the possibility to invoke against the assignee a set-off with a right against the assignor that did not yet exist at the time of notice and is not closely connected with the assigned right (see article III.–5:117, paragraph 3).^{*26}

Apart from these specific changes, the debtor retains all defences unless he has waived a defence or caused the assignee to believe there was no such defence (article III.–5:116 (2) (a)) (correction of the autonomy principle by the reliance principle, this time in favour of the assignor).^{*27}

Finally, one has to take into account that, after assignment and the notification thereof, the relationship only exists between the debtor and the assignee, and all causes of extinction (not only payment) must relate to the assignee and no longer to the assignor in order for the debtor to be discharged (the set-off rule of article III.–5:117(3) proceeds from this idea).

2) Defences out of the valuta relationship

The internal relationship between the assignor and the assignee is, in principle, a *res inter alios acta* for the debtor. He cannot invoke defences that the assignor may have against the assignee (e.g., that the assignee has not yet paid the price), unless their effect is that there is no assignment or that it has already been retroactively avoided.

2.3. Appropriation of a right to performance by the principal in cases of indirect representation

The Principles of European Contract Law (PECL) contained some provisions on indirect representation (article 3:301 *ff.*), which were absent from the interim edition of the DCFR because they were still under discussion. In the final DCFR, the so-called direct action of the principal against the third party in cases of insolvency of the intermediary will be maintained, basically along the lines of article 3:302 PECL.

In that case, the principal has the right to take over the rights of the intermediary by notice to the third party. He will thus exercise against the third party the rights acquired on the principal's behalf by the intermediary, subject to any defences that the third party may invoke against the intermediary. The DCFR rule will make the analogy with assignment clearer by providing that the third party has the same forms of protection against the principal as a *debtor cessus* against the assignee.

One can indeed see the exercise of the so-called direct action by the principal as a form of assignment based upon a unilateral act of the principal, which he is entitled by law to perform.

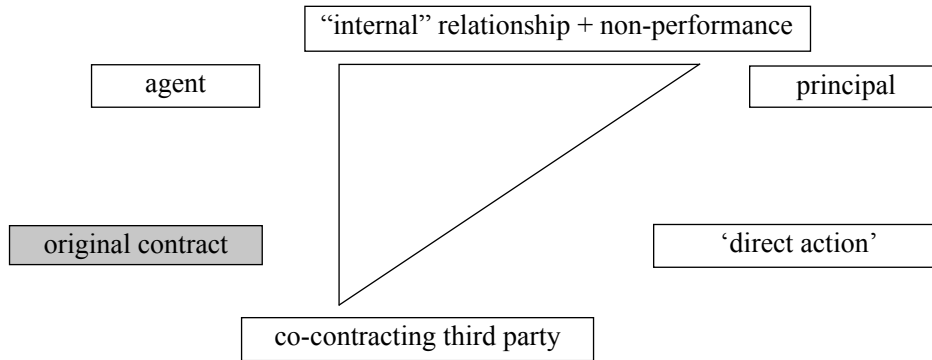
The position of the principal after such notice is thus in principle the same as the position of an assignee after provision of notice.

²⁴ And with the exception of receivables, see *supra*.

²⁵ See III.–5:120 (in the interim edition III.–5:119) on Adequate Proof of Assignment.

²⁶ Cf., although slightly different, article 1562 II, second sentence of the Draft Czech CC.

²⁷ Cf. article 1562 II of the Draft Czech CC.



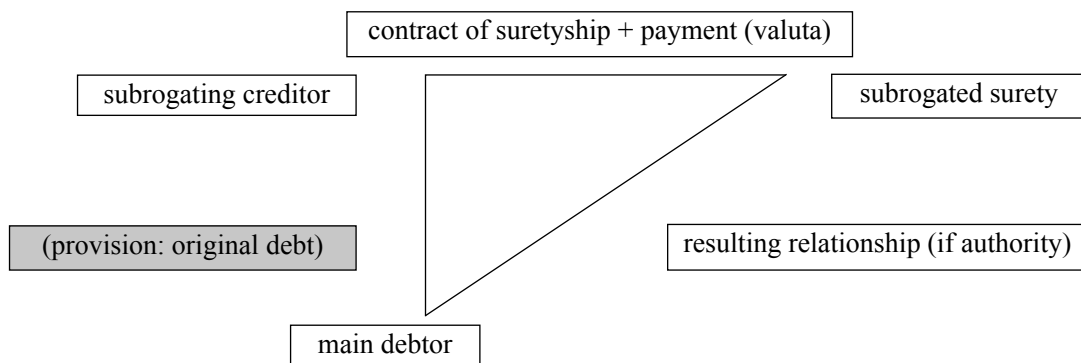
2.4. Subrogation

The rules on personal subrogation (or assignment *ex lege*) are still underdeveloped in the DCFR. On the one hand, only some of the possible cases of subrogation are explicitly mentioned. On the other hand, the consequences of subrogation are not fully explored. Nevertheless, it is possible to indicate the basic features of subrogation as they emerge from the rules found in the DCFR.

The DCFR does indeed spell out details of the most important cases of personal subrogation, in the chapter on plurality of debtors and in the book on personal security:

- According to article III.–4:107 (2), a solidary debtor who has performed more than that debtor’s share may, subject to any prior right and interest of the creditor, exercise the rights and actions of the creditor, including any supporting security rights, to recover the excess from any of the other debtors to the extent of each debtor’s unperformed share. Apart from this subrogation, the solidary debtor who has performed also has a right of recourse (article III.–4:107 (1)).
- According to article IV.G.–2:113, second sentence, the security provider^{*28} is subrogated, in so far as he has performed the secured obligation, to the creditor’s rights against the debtor. Here also, the right acquired by way of subrogation is concurrent with the right to reimbursement or recourse. Paragraph 2 also provides that in cases of partial performance the creditor’s remaining rights have priority over the rights to which the security provider has been subrogated.
- Article IV.G.–1:108 and IV.G.–1:109 contain rules on subrogation for the situation of a plurality of security providers.
- For the case of payment by a third party who is not also a solidary debtor, article III.–2:107 (2) mentions the possibility of subrogation — without spelling out, however, the requirements that may obtain.

As in the case of assignment, personal subrogation entails as well a transmission of property in a right as a change in the relationship with the debtor. The rules of the DCFR do not yet really distinguish these two elements or spell out the associated specific rules. In my opinion, this means that the rules on assignment must be applied with appropriate adaptations.



²⁸ Article IV.G.–2:113 applies as such only to dependent personal security, but according to article IV.G.–3:109 also with appropriate adaptations to independent personal security.

Thus, it is clear that the debtor against whom a right is exercised after subrogation may invoke against the subrogated party, in principle, all defences that he could have invoked against the original creditor, with similar exceptions. As for the relationship between the subrogating creditor and the subrogated creditor, the debtor can, in principle, only invoke it in order to limit the subrogation to the amount of performance by the subrogating party. Equally, the debtor should be discharged by performing for the subrogated creditor as long as he does not know that that person is no longer entitled to receive performance (compare article III.–5:119 (1) DCFR (formerly III.–5:118(1))).

2.5. Real subrogation

The rules on real subrogation are even more underdeveloped in the interim version of the DCFR. This is partly caused by the fact that this institution is mainly an institution of property law and should find its main place in the books on acquisition of property (Book VIII) and proprietary security (Book IX). Thus far, the provisional drafts do not, however, cover the main cases of real subrogation found in national legal systems.

There is one case of real subrogation described in Book III, in article III.–5:108 (3): where a right is assigned in breach of a contractual prohibition or restriction and the debtor performs in favour of the assignor (as he is entitled to do), the assignee's claim against the assignor for the proceeds has priority over the right of a competing claimant so long as the proceeds are held by the assignor and are reasonably distinguishable from the other assets of the assignor. Although the term 'real subrogation' is not used, that is what this rule amounts to. The traditional requirements for real subrogation are spelled out: the assignee's property in the right to performance is extinguished²⁹ but at the same time maintained because there is an identifiable *ersatz* object and there is a causal link between the loss of the original object of the property right and the presence of the *ersatz*.

On the other hand, there is no similar rule in article III.–4:206 for the event of a solidary creditor having received more than its share (it would be consistent to have similar priority here).

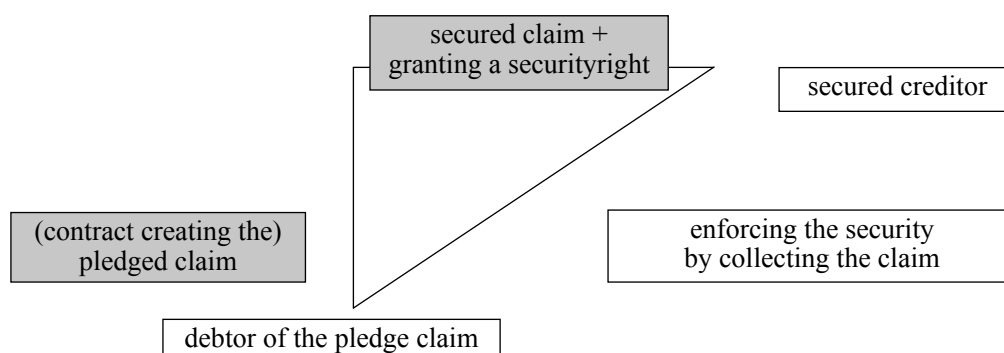
In the working group's discussions of proprietary security, there were also clearly diverging opinions on the possibility for maintaining the priority of a transferor under reservation of title in assets replacing the transferred assets (e.g., the right to payment of the price when the buyer under reservation of title sells the unpaid-for goods to a third party).

2.6. Granting of a security interest in a right to performance

It will be interesting to see how the DCFR will deal with the situation in which a security interest is granted in a right to performance. Such granting can be seen as a negative element of assignment rather than something totally different: the acquirer acquires not ownership in the claim but a limited property right, a security right.

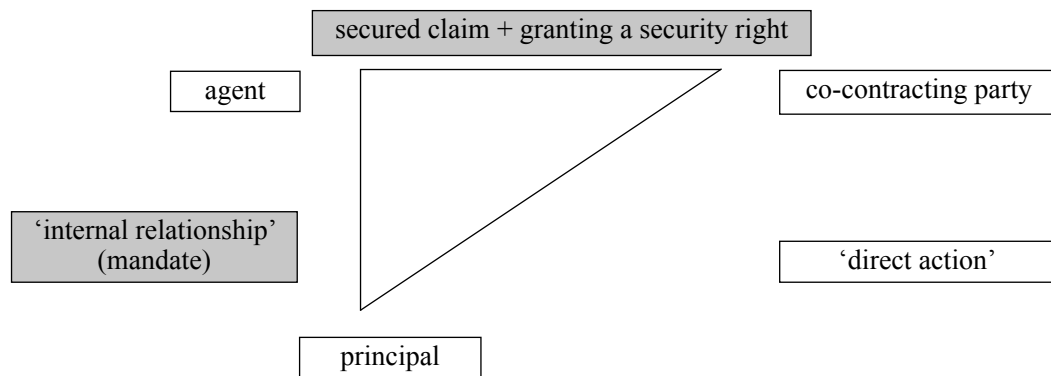
A series of associated matters can be seen to be basically the same as in the case of assignment: the requirements for the creation of the security right, the relationship between the creation of the right, and the relationship with the *debitor cessus*.

There is one important difference: the limited character of the security right implies first of all in the system chosen by the DCFR that the security right is accessory or dependent upon the creditor's right to performance. For the matter of the defences, this must have the concomitant effect that the debtor cannot only invoke all defences from the relationship with its creditor (the security-giver); it also has to invoke all defences the main debtor (the security-giver) has against its secured creditor. In other words, the exercise of the security right is "subject to any defences which the security giver may set up against the secured creditor and those which the debtor of the encumbered right may set up against the security giver", to paraphrase PECL article 3:303.



²⁹ Because the debtor is discharged by performing to the assignor, see *supra*.

The latter rule is the PECL rule on the *actio contraria* of the third party against the principal of his contractor in cases of indirect representation. That rule will only in a minor form be maintained in the DCFR. But the rule on defences shows that the nature of such an *actio contraria* is that of a security right in a claim.

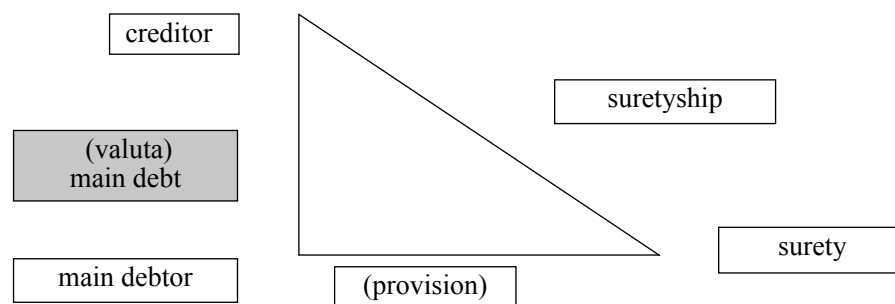


2.7. New creditors – conclusion

The analysis I have undertaken is an attempt to show that there is a sufficient degree of coherence in the rules concerning different multiparty situations that have in common their addition or substitution of a creditor to a relationship, in one way or another. Certainly, the coherence could be made even clearer, but one cannot expect too much — the result thus far is already rather innovative in this domain.

3. New debtors

A similar analysis could be conducted of the rules concerning different multiparty situations that can be seen as the addition or substitution of a debtor: the substitution of debtor in the strict sense (article III.–5:201) and transfer of contractual position (III.–5:301), the additional debtor (rules not yet present in the interim edition but to be included in the final DCFR), the dependent personal security (IV.G., section 2), the different forms of *delegatio solvendi* (not regulated as such in the DCFR) and its specific forms such as the independent personal security (IV.G, section 3), money transfer and the different payment instruments, etc. In these situations, too, it is very helpful to analyse the different relationships separately, taking into account for each to what extent each relationship is dependent upon or independent from one or more of the other relationships. I hope to do this in another article, but by way of example I shall draft the triangle for dependent personal security.





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A Secured Transactions' Regime for Europe: Treatment of Acquisition Finance Devices and Creditor's Enforcement Rights

1. The scope of a secured transactions regime: Introduction

In the preceding contribution, by Hugh Beale, the issue of what kinds of devices should be covered by the rules on secured transactions was intentionally left open. It will be addressed here, together with the suggested treatment of another area that is key for the creation of an effective secured transactions regime — the creditor's enforcement rights outside insolvency. It must be noted at the outset that both of these topics are still under discussion in the working group on security in movable property led by Ulrich Drobnig within the Study Group on a European Civil Code. The considerations here expressed are not intended to reflect a common position reached within said group. Furthermore, they relate mainly to commercial security, leaving aside issues of consumer protection, unless specifically stated otherwise.*¹

The scope of the scheme is arguably one of the most debatable questions as regards a possible future European regime for secured transactions. We can try to put the problem in the simplest way possible: should it matter whether the transaction formally creates a limited real right in favour of the creditor or whether one party retains 'title' to the collateral but does so to secure a monetary claim toward the other party (i.e., retention of title in a sales contract, financial lease)?

This is often referred to in the context of a contrast between a 'functional' and a 'formal' approach to personal property security devices. I wish to argue that the mentioned contrast of approaches is less radical than one might think at first and that at least some 'formalistic' legal systems in this respect have shown a tendency to apply a functional reasoning. This having been said, it is still quite a difficult area to tackle at a European level, and the possible solutions, as we will see, may largely depend on how we shape the secured transactions regime as regards other key issues, such as publicity, priorities, and enforcement rights.

Before entry into discussion of the subject matter at hand, a word should be spent on the *acquis communautaire* in the area of retention of title devices. As is well known, there is very little of this, and what there is proves not particularly helpful. I am referring to article 4 of the Directive on Late Payments in Commercial Transac-

¹ The rules drafted by the Working Group, being meant to be part of the Academic Common Frame of Reference, do purport to cover consumer contracts as well and will probably contain specific rules on consumer protection issues.

tions^{*2}, which contains a short and quite obscure rule on simple clauses on retention of title in sales contracts (that is, when the seller retains title only to the sold goods until full payment of their price). Apart from the obscurity of the text, a recent decision of the European Court of Justice stated that the formal requirements set forth in this directive apply only to the *inter partes* effects of the retention of title clause. non-performance of an obligation gives the injured party reasonable reason to believe that the party cannot rely on the other party's future performance^{*3} The conclusion is that the directive is of little relevance as far as we are concerned.

2. The case for a functional approach to retention of title devices

The question I would like to address is how a future European secured transactions law should treat retention of title devices.

One possible approach is, of course, to exempt them altogether from a general secured transactions regime, in view of their different formal structure. Both seller and lessor are 'true owners' of the assets and deserve to be considered as such. The opposite solution may appear to be excessively influenced by the modern secured transactions regimes modelled on article 9 of the Uniform Commercial Code, that is the Personal Property Security Acts of the various Canadian provinces and the more recent New Zealand legislation, and not tailored to the basic characteristics of most European property law systems.

I would like to argue against the formalistic approach. It is true that most European legal systems still accord importance to whether one party is formally vested with 'title' — i.e., 'ownership' — of the goods. Thus, in retention of title devices the creditor is considered the 'owner' of the assets and may act as such and not just as if entitled to a limited right. Retention of title devices are usually governed by general and specific contract law and are not subject to special publicity requirements.^{*4} Furthermore, they are mostly dealt with, from a systematic point of view, in quite different parts of the relevant legislation (be it the relevant civil code or *ad hoc* statutes). When we look at the individual legal systems, however, these statements are qualified by a number of exceptions. Moreover, the rules are not always the same for the different types of retention of title devices — sale with reservation of ownership and financial lease.

2.1. European national laws

In considering the legislation of individual countries, first of all one should note that some European jurisdictions do require certain formalities and even registration in the case of sale with retention of title, though it must be admitted that the manner and the effects of such formalities vary considerably and are not always crystal clear.^{*5} Registration is also exceptionally required for leases, in order to render the lessor's right opposable to third parties'.^{*6}

More importantly, the nature of the retention of title where security is concerned is given practical recognition in many legal systems. Even putting aside the example of Germany (where retention of title clauses extended to future receivables deriving from the resale of the original assets and to future products manufactured with the original assets are treated as security rights in the buyer's insolvency)^{*7}, several countries have taken the

² Directive 2000/35. — OJ L 200, 8.08.2000, pp. 35–38.

³ ECJ case C-302/05, Commission v. Italy, 26 October 2006. — OJ C 326, 30.12.2006, pp. 16–17. The same interpretation was put forward in legal scholarship, see in particular E.-M. Kieninger. *Der Eigentumsvorbehalt in der Verzugsrichtlinie – Chronik einer verpassten Chance.* — J. Basedow et al. (eds.). *Aufbruch nach Europa.* Tübingen: Mohr Siebeck 2001, p. 160 ff.

⁴ See for all the general report by E.-M. Kieninger. — E.-M. Kieninger (ed.). *Security Rights in Movable Property in European Private Law.* Cambridge Univ. Press 2004, p. 54 ff. For the treatment of retention of title in Eastern Europe see J.-H. Röver. *Secured Lending in Eastern Europe.* Oxford University Press 2007, esp. p. 172 ff.

⁵ Italian law, for instance, requires a written document with prior ascertained date proving the title retention clause in order for it to be opposable to other competing creditors and in the debtor's insolvency, while registration is an added requirement as against subsequent purchasers for retention of title clauses on certain items. For details see A. Veneziano. *Italy.* — H. C. Sigman, E.-M. Kieninger (eds.). *Cross-Border Insolvency over Tangibles.* Sellier 2007, p. 167 ff. Another interesting example is Spanish law, where the effects of the law No. 28/1998 on the registration of retention of title clauses are still debated: for a thorough discussion with references to case law see A. Carrasco. *Los derechos de garantía en la Ley Concursal.* Madrid: Aranzadi 2004, p. 160.

⁶ For instance, the *crédit-bail* is subject to filing in a specialised register in France: Décr. 4 juillet 1972, article 8. A registered *crédit-bail* is opposable to third parties. The lessor may nevertheless prove its title as against other creditors by other means, though actual knowledge of each individual creditor in insolvency should be established. L. Aynés, P. Crocq. *Les sûretés. La publicité foncière.* II ed. Paris 2006, p. 347.

⁷ *Absonderungsrecht* under § 52 InsO. The simple retention of title, on the other hand, still enjoys a full *Aussonderungsrecht*: § 47 InsO. See for all K. Reinicke, D. Tiedtke. *Kreditsicherung.* V ed. 2006, p. 289 ff.

security function of such devices into account. The recent French reform of secured transactions law, for instance, has integrated the *clause de réserve de la propriété*, thereby openly recognising its character as a security. This characterisation entails, among other things, the debtor's right to receive any difference between the value of the assets and the outstanding debt: 2371 (3) c.c.*⁸

2.2. Recent international instruments

When we turn to international instruments dealing with secured transactions, we find that two important texts have appeared in recent years: the 2001 Cape Town Convention on International Interests in Mobile Equipment and its protocols (the 2001 Aircraft Protocol and 2007 Railway-Rolling-Stock Protocol)*⁹ and the draft UNCITRAL Legislative Guide on Secured Transactions.*¹⁰ They both choose a 'functional' approach and, in particular, include retention of title devices in the general regulatory framework for secured transactions.

Certainly, they do so in somewhat different ways. The UNCITRAL Legislative Guide shows a marked preference for what it calls a 'unitary approach' to acquisition financing devices (defined so as to encompass both traditional security devices enabling a person to acquire assets and title retention arrangements with the same purpose). The unitary approach means that acquisition finance devices — in particular, title retention devices — are included within the general definition of security rights.*¹¹ The lively debate on this issue during the preparatory work, however, has prompted the elaboration of an alternative text, applying a so-called non-uniform approach to acquisition finance devices. In practice, one of the versions of the latter option — called alternative A — enables countries to pursue the aim of functional equivalence by retaining their own settled terminology and legal concepts relating to retention of title agreements.*¹² A further option, alternative B, taking stock of the opposition from the representatives of some European countries, treats assets under acquisition security devices as third-party-owned.*¹³

Irrespective of the model followed by each state, however, the most important message of the draft UNCITRAL Legislative Guide on this point is that states should not simply rely on traditional classifications. They should clearly spell out the policy decisions underlying their choices and the economic results of these decisions. Moreover, all devices pursuing the same function of enabling acquisition of assets on credit by the debtor should be treated alike, whatever their structure or form.

The Cape Town Convention provides a list of interests in mobile goods to which it applies, separately mentioning security rights, the rights of the seller under a title retention clause, and rights of a lessor under a finance lease agreement. The English-language version of the title itself, moreover, does not even contain the term 'security' (while the French does refer to *garanties* — though not to *sûretés*). When we look at the applicable provisions, however, it is easy to discern that there is much less difference than one might imagine among the rules applicable to the three interests mentioned above (mostly pertaining to enforcement procedures). In practice, the Cape Town Convention and the arguably more convincing option in the UNCITRAL Legislative Guide are similar, in the sense that countries could express the functional equivalence by applying their own terminology and in a manner consistent with their own legal concepts.

Earlier still, the EBRD Model Law on Secured Transactions had tried to find a distinctly European approach to this subject matter, to be used as a model in Central and Eastern European legal systems. It too, however, included retention of title within the scheme, transforming it into an unpaid vendor's charge.*¹⁴

I would like to point out that it is reasonable to look at those international instruments when drafting a new European regime. We need rules that are adapted to the specifications of the European financing market but are at the same time competitive in the wider context of international trade.

⁸ Ordonnance 23 mars 2006, article 2367 ff. c.c. See L. Aynés, P. Crocq (Note 6), p. 344 ff.

⁹ The text of the Convention and of the Aircraft Equipment (the only Protocol entered into force at the present date) are reproduced in R. Goode, Convention on International Interests in Mobile Equipment and Protocol Thereto on Matters Specific to Aircraft Equipment. Official Commentary — Commentaire Officiel. — Uniform Law Review/Revue de droit uniforme 2002, p. 353 ff. The finalised text of the Railway Rolling Stock Protocol, approved 23 February 2007, is available at www.unidroit.org/english/conventions/mobile-equipment/railprotocol.pdf (15.09.2008).

¹⁰ The latest text at my disposal is: Security Interests. Recommendations of the UNCITRAL Draft Legislative Guide on Secured Transactions, Note by the Secretariat, A/CN.9/631 16 March 2007 (courtesy of Prof. Harry Sigman, whom I thank).

¹¹ A/CN.9/631 (Note 10), paragraph 184.

¹² A/CN.9/631 (Note 10), Alternative A paragraph 174: "The insolvency law should provide that, in the case of insolvency proceedings with respect to the debtor, assets subject to an acquisition financing right are treated in the same way as assets subject to security rights generally".

¹³ A/CN.9/631 (Note 10), Alternative B paragraph 174.

¹⁴ Article 9 EBRD Model Law (London: EBRD 1994): the unpaid vendor's charge does not require registration in order to be opposable to third parties (thus, also other secured creditors) if it secures the payment of the price for the original goods and is not stipulated for a period longer than six months. Available at <http://www.ebrd.com/pubs/legal/secured.htm> (15.09.2008).

3. Functional approach and special treatment of acquisition finance devices

The main question, in my opinion, lies not so much in how broadly a security interest is defined but in how all functionally equivalent devices are subsequently treated as concerns publicity, priority, and enforcement.

In other words, the choice of a functional approach does not necessarily mean that **all aspects** of the regulation concerning security rights should be automatically applicable, without further thought, to all devices aimed at securing a creditor by granting satisfaction concerning the value of certain assets of the debtor with priority against competing third parties.

There is a middle way between completely excluding retention of title devices from the general regime for secured transactions and including them without taking their nature into account.

First of all, if a general requirement of registration for all secured transactions is envisaged, one may think of special treatment of simple retention of title clauses in sales contracts (for instance, a total exemption from registration up to a certain amount of time, as suggested for the unpaid vendor's charge in the above-mentioned EBRD model law). More convincingly, a shorter, commercially reasonable 'grace period' for the registration of retention of title may be envisaged. If the buyer's obligation is fulfilled within that time, no need for registration arises. Should what is agreed upon exceed the grace period, the seller must register in order to ensure its priority.

At the same time, one may work on the priority rules. The practical result of applying a formal approach to retention of title is precisely that the seller prevails over a temporally prior perfected floating lien on present and future debtor's assets, by virtue of its being a true 'owner' of the assets. The policy of granting preference to acquisition finance devices, however, may be pursued even if registration is required for both traditional security rights and retention of title, justifying it via efficiency arguments and not on account of the formal structure of the security device. The financier who enables the debtor to acquire assets is granted a super-priority, meaning that it prevails even as against a non-acquisition security right registered earlier.

The most interesting feature of the latter model is that the 'purchase money security interest priority' is extended to **all** devices serving the same acquisition function, whatever their form. Thus, it would apply to a seller with retention of title, to a finance lessor, to a lender whose loan is extended for the specific purpose of acquisition of certain assets, and to other lenders potentially using other formal devices to obtain the same result. The reason is not the structure of the transaction but its economic purpose. Certainly, other issues have to be considered, such as how to determine the relationship between the loan and the purpose of acquisition of an asset, whether special transparency rules are required (specifically concerning notice to prior-in-time lenders), and whether proceeds of the original collateral should enjoy the same priority — or not — as against a prior floating lienor.

Finally, one may envisage a different treatment as regards enforcement measures (as discussed below, in Section 5).

4. Other issues of scope: Sale of receivables, true consignment, and 'true lease'

Finally, a few words must be devoted to other issues of scope. Some transactions may be included in the general scheme as regards specific rules (such as the rules on creation or the publicity and priority requirements), though they do not necessarily serve a security function. One of the reasons to do so may be to foster simplicity and certainty of the legal regime envisaged. In the case of outright sales of receivables, for instance, as opposed to assignment by way of security, there may be difficulties in distinguishing the precise function of the parties' agreement in practice. Taking the economic importance of receivable financing in commercial transactions into account, common rules on creation and publicity may aid in reducing unnecessary litigation related to the characterisation of the parties' agreement. Even stronger is the need for common rules in the case of consignment contracts. Canadian jurisdictions, finally, have extended registration and priority rules to so-called 'true leases' as opposed to leases by way of security, in view of the practical difficulties of establishing the real intent of the parties under the Uniform Commercial Code article 9 model.

Less convincing, to my mind, is the need to protect third parties from the debtor's 'apparent wealth'. This would entail publicity of all transactions separating 'ownership' from 'possession' and also of non-consensual liens limiting the availability of the debtor's assets to creditors. Some jurisdictions have gone in this direction, but it seems to me that the best approach is a practical one. Where difficulties in discerning the purpose of transactions are present, a common publicity regime is useful. A good example is offered by the US practice of optional filing for consignment contracts that do not serve a security function. Most creditors file because they want to achieve greater certainty.

5. Creditor's enforcement rights: How to reconcile the diverging interests

The importance of sound rules on enforcement after default is often underestimated in the case of movable collateral.^{*15} On the contrary, there are many elements present that suggest that a future European secured transactions regime should include a well-developed separate part on enforcement, following the example of recent international instruments such as the Cape Town Convention^{*16} and the draft UNCITRAL Legislative Guide.^{*17}

First of all, some movable goods have a high unit value, and, for these, enforcement proceedings on the part of a creditor may lead to full or at least not negligible satisfaction of that creditor's claims. Secondly, separate enforcement may be exceptionally granted during insolvency proceedings, thereby shielding the creditor from the effects of insolvency. Furthermore, it is important for creditors wishing to extend financing in a particular state to know that there is an efficient system that will treat them fairly when enforcing their rights. This will ensure predictability of results and thus may enhance the availability of cross-border financing. Last but not least, as is well known, extra-judicial means to avoid formal insolvency proceedings through co-operation between (at least some) creditors and the debtor are advantageous, especially in cross-border transactions. The availability of an efficient, speedy, and cost-effective system of recovery will undoubtedly influence the outcome of any 'composition' or 'work-out' agreement after default.

The main obstacle in this area is the close relationship with the efficiency of general procedural law. Even the best enforcement rules can be of no avail if their practical operation is completely left to non-uniform procedural rules. On the other hand, procedural rules are usually linked to public policy concerns, and therefore it is hard to agree on common ground.

Notwithstanding the above-mentioned difficulties, a key principle remains that should be taken into account in determining how to deal with enforcement. Most of all, rules should be clear and simple, in order to ensure predictability of results by the parties.^{*18}

A further point is the need to strike a reasonable balance between ease and speediness of enforcement measures, on one hand, and protection of both the debtor and third parties. It must be stressed that, though the two goals may seem contradictory and tailored to protecting the diverging interests of the parties involved, simple and quick procedures are to the advantage of all participants and not just of the secured creditor.

This is where the question arises of how to bridge the gap between more supple and more restrictive approaches to enforcement in European law.

Traditionally, a contrast is drawn between non-formalistic or less formalistic European legal systems (such as those of England and Germany) and more restrictive legal systems deriving from the French model.^{*19}

The difficulties in reaching a common perspective are shown by the Cape Town Convention, which strongly enhances parties' autonomy but leaves states free to opt out of the general scheme by insisting on the need for court intervention or by limiting or excluding the use of interim measures or of non-traditional specific remedies such as lease of the collateral.^{*20}

¹⁵ For the need of a careful consideration of enforcement measures see U. Drobnig, Die Verwertung von Mobiliarsicherheiten in einigen Ländern der Europäischen Union. – *Rabels Zeitschrift fuer auslaendisches und internationales Privatrecht (RabelsZ)* 1996 (60), p. 40 ff., at 41. An example of legislative inattention to this focal issue is represented by the Italian legislation on the Enterprise Non-possessory Charge in the reformed Banking Law (*privilegio mobiliare ex Art. 46 legge bancaria*). The Banking Law attempted to introduce a modern non-possessory security granted by enterprises in favour of banks, but did not change the cumbersome enforcement proceedings of the Civil Code regarding non-possessory liens, which remain applicable to the new security. See G. Tucci, Towards a Transnational Commercial Law for Secured Transactions: the Preliminary Draft UNIDROIT Convention and Italian Law. – *Uniform Law Review/Revue de droit uniforme* 1999, p. 371 ff.; A. Veneziano (Note 5), p. 159 ff.

¹⁶ Cape Town Conv. (Note 9), Chapter III, articles 8–15.

¹⁷ Draft UNCITRAL Legislative Guide on Secured Transactions, Recommendations, A/CN.9/631 (Note 10) paragraphs 128–172 (Post-default rules).

¹⁸ This is underlined by the Draft UNCITRAL Legislative Guide, see A/CN.9/WG.VI/WP.27/Add.2, 27 April 2006, Default and Enforcement, paragraph 3.

¹⁹ See U. Drobnig (Note 15), p. 40 ff.; a recent, up-to-date overview is provided by E. Dirix, Remedies of Secured Creditors Outside Insolvency. – H. Eidenmüller – E.-M. Kieninger (eds.), *The Future of Secured Credit in Europe*. – *European Company and Financial Law Review*, Special Volume 2, 2008, p. 223 ff.

²⁰ If the contract so provides, the chargee may take possession or control of any collateral, sell it or grant a lease on it, collect or receive any income or profits arising from the management or use of the collateral (article 8), be vested with the property of the collateral (article 9) and exercise interim speedy relief pending final determination (article 13) without the need of any prior court's authorisation. Member States, however, are entitled to opt out and impose leave of court for any of the preceding remedies (article 54 (2)) as well as forbid lease of the collateral in its territory while the charged object is situated within, or controlled from its territory (article 54 (1)) and modify, limit or exclude altogether interim relief measures (article 55): R. Goode (Note 9), p. 454 ff.

On the other hand, in the specialised area of financial instruments, the Financial Collateral Directive^{*21} introduced non-formalistic enforcement measures, which had to be accepted even by stricter legal systems.^{*22} In some cases, the obligation to transpose the European rules tailored to the needs of the financial markets triggered consequences in the area of general secured transactions law.^{*23}

These developments have prompted authoritative scholarship in traditionally formalistic legal systems to detect a tendency in the direction of some convergence, which was unthinkable even in the recent past.^{*24} It goes without saying that if future common rules on enforcement are presented in the form of a suggestion to the national legislators, each of the latter may decide when and how to implement the advised changes. However, even if the European legislator decides to act on the suggestions, the time might be ripe to find reasonable rules commensurate with the needs of the European market and with the multitude of European jurisdictions.

5.1. Ease and speediness of measures

There is much to be said in favour of common enforcement rules based on the principles of simplicity and speedy conclusion. A first step in this direction is to enhance the role of parties' autonomy in the proceedings. The parties should be free to define by agreement the concept of 'default' that leads to enforcement (this may be achieved by applying the general rules on the content of parties' obligations) and in principle be able to determine the consequences of default.

Furthermore, it is true that many legal systems still impose — at least in some cases and especially where non-possessory security is concerned — realisation of the value of the collateral through public officials. It leaps to the eye, however, that such a method is extremely cumbersome and not well suited to cross-border enforcement. It will often mean depreciation of the assets to be sold. Moreover, it may lead to factual discrimination due to the different length and efficiency standard of proceedings in the various European countries. Particularly important, therefore, would be to allow non-judicial sale exercised in an expedited way and directly by the secured creditor, or by the debtor itself if applicable, as well as other means of using the value of the collateral (i.e., lease), if commercially reasonable. Interim remedies, certainly under the debtor's and other parties' right to oppose, could also prove to be of great importance. These rules should be presented as the default ones, though, of course, parties may agree on the need to go to court and take up formal proceedings if they wish to do so.

The point that is bound to raise more concerns is the right of the secured creditor to repossess the collateral after default without asking for judicial authorisation, when the collateral is in the possession of the debtor (in commercial cases, this usually means the debtor's business premises). English law generally allows self-help remedies such as the one mentioned, within the limits of not 'breaching the peace', while other European jurisdictions do not encourage 'private' actions of this kind and instead require judicial authorisation and/or intervention of a public official.^{*25} The latter approach would certainly be more protective of the debtor's rights but may unduly burden the creditor if the proceedings to obtain judicial authorisation or intervention are lengthy and costly. Common European rules should either require (or suggest) the introduction of expedited proceedings or allow for some form of self-help with all necessary safeguards for the debtor.

5.2. Protection of the debtor and of third parties

Traditionally, the protection of the debtor and third parties is left not only to formal judicial proceedings and lengthy public sales of collateral but also to certain 'validity' requirements such as the prohibition *a priori* of agreements allowing the creditor to appropriate the collateral upon default (that is, prohibition of *pactum commissorium*).

²¹ Directive 2002/47. — OJ L 168, 27.06.2002, pp. 43–50.

²² For reference to critical appraisals see E. Dirix (Note 19), p. 224.

²³ See French law, where through the mentioned general reform of secured transactions' law (Ord. 23 March 2006), article 2078 c.c. was substituted by article 2348 c.c., according to which the parties to a pledge or a *nantissement* may agree at any time (thus even before default) that the creditor acquires ownership of the asset upon default of the debtor. The law imposes an evaluation by an expert of the value of the assets at the time of the transfer to the creditor, except for financial assets within a regulated market. The debtor is entitled to the difference between the value of the assets and the amount of the secured debt. See L. Aynés, P. Crocq (Note 6), pp. 222–223.

²⁴ See E. Dirix (Note 19), p. 228 *ff.*, who drives specific attention to the law of mortgages on **immovable** property as well as the law of charges on movable collateral; G. Tucci (Note 15) with particular regard to Italian law.

²⁵ On the common law model (with some differences among jurisdictions) see H. Beale, M. Bridge, L. Gullifer, E. Lomnicka. *The Law of Personal Property Security*. Oxford University Press 2007; see also U. Drobnig. *Vergleichender Generalbericht*. — K. F. Kreuzer (ed.). *Mobilarsicherheiten. Vielfalt oder Einheit?* Baden-Baden: Nomos Verlag 1996, p. 25 *ff.*

The tendency in commercial transactions is to abandon such validity requirements (which are more and more restricted and challenged even in traditional legal systems)^{*26} and to concentrate attention on the control of proper enforcement proceedings. In particular, invalidity is substituted for by the use of evaluation criteria in order to achieve a fair realisation value, by applying standards such as 'good faith' or 'commercial reasonableness' to the creditor's conduct.^{*27} Parties should not be able to contract out of such standards. Waiver of other obligations, on the other hand, should be possible by agreement but only after default.^{*28}

Another mechanism of protection of the debtor and third parties is to avoid any enrichment of the creditor (i.e., if there happen to be any surplus from the sale or alternative use of the value of the collateral, it should return to the debtor). While this principle is well established in the area of traditional security rights such as non-possessory pledges, more resistance is encountered in the case of retention of title devices — in particular, sale with retention of ownership and financial lease. The argument is made that the seller or lessor is the 'real owner' of the assets and thus should be able to exercise full right of ownership.^{*29} Though not referring to the notion of title, also the Cape Town Convention provides that the conditional seller or the lessor may terminate the agreement and take possession or control of the assets without accounting for any surplus.^{*30}

Prohibition of undue enrichment, however, may be important also in the case of retention of title devices — all the more so if a 'floating' retention of title continuing on proceeds is allowed.

Finally, transparency rules may be useful, an example being a duty of the secured creditor to give notice to the debtor and/or other interested parties (i.e., other secured creditors) prior to any extra-judicial disposition of the encumbered assets. On the other hand, the cost-effectiveness of such a requirement depends on the degree of the formalities that are imposed (written form, minimum content of notice, etc.) and it may turn out to be less efficient in the case of other interested third parties than where the debtor is concerned.^{*31}

²⁶ See E. Dirix (Note 19).

²⁷ See Draft UNCITRAL Legislative Guide on Secured Transactions, Recommendations (Note 10), paragraph 128. The Cape Town Convention expressly states that "a remedy shall be deemed to be exercised in a commercially reasonable manner where it is exercised in conformity with a provision of the security agreement except where such a provision is manifestly unreasonable" (Cape Town Conv., article 8 (3)).

²⁸ Draft UNCITRAL Legislative Guide on Secured Transactions, Default and Enforcement (Note 18), paragraphs 10–11.

²⁹ But see the recent different approach taken by French law, article 2371 (3) c.c. (Note 8).

³⁰ Cape Town Conv. (Note 9), article 10. Contracting States may impose a leave of court for the exercise of termination and repossession under article 54 (2).

³¹ On the desirability of a prior notice see Draft UNCITRAL Legislative Guide on Secured Transactions, Default and Enforcement (Note 18), paragraph 16.



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Secured Transactions

In this paper I describe the work that is currently under way, within the Network of Excellence charged with creating a draft Common Frame of Reference, to draft rules on security over moveable assets. After a brief introduction, I deal with two broad questions: (1) the general aims and scope of the scheme for security interests in the traditional sense (such as possessory and non-possessory pledges or mortgages) and (2) registration and other forms of ‘perfection’ (i.e., ensuring that the security interest will be as fully effective as is possible under the applicable law of insolvency). Professor Veneziano’s paper¹ deals with the enforcement of security interests and the very controversial question of whether transactions that are not traditionally classified as security transactions but that serve the same economic function (such as retention-of-title clauses and finance leases) should be brought within the scheme.

1. Introduction

The field of security over moveable property is one in which the laws of the various Member States are so different that the pan-European picture is one of complete disarray. There are wide variations in the extent to which it is possible to create security interests over moveable property: whereas some legal systems allow security to be taken over almost any form of business asset, others are much more restrictive, particularly with respect to non-possessory security over goods. Moreover, there are major differences among both the practical requirements (for example, whether security interests must be registered if they are to be fully effective) and the concepts involved (for example, whether registration is necessary in order for any proprietary right over the moveable to come into existence or whether a failure to register merely means that the security right may not be effective in certain cases, such as that of the debtor’s insolvency). This creates two problems, one a practical one and the other a legal one.

The practical problem is that it may be difficult for a business that is accustomed to employing secured credit to operate in its accustomed way in another jurisdiction, if that jurisdiction does not recognise the relevant type of security right or does not recognise it over the kind of asset available. Indeed, it is strongly arguable that there is a problem here for many Member States themselves. The lack of a comprehensive and efficient system of security over moveable property may mean that credit is less readily available in that jurisdiction, or at least that it will cost more, and this is likely to hinder economic development.

The legal problem arises if assets are moved from one Member State to another. A security interest created over moveable assets in the first Member State may not be recognised by the law of the second Member State. In commonly accepted conflicts of laws practice, the creation of the security right is governed by the law of the *situs* at the relevant time. If the second Member State’s domestic law recognises a similar kind of security right, it will probably treat the asset as if it were subject to that type of right created in the first state. But if the second state’s law simply doesn’t recognise that kind of right (for example, it does not recognise non-possessory security rights over goods), it may not be able to translate the right into its own terms and it

¹ See pp. 89–95.

may simply ignore it. It is strongly arguable that this is incompatible with the freedom of movement of goods guaranteed by the European Treaty.^{*2}

Even if the relevant kind of security right over the assets is recognised in the second Member State, it may be treated as less than fully effective (for example, not effective in the security provider's insolvency) unless it is registered in the second state. This may not be incompatible with the freedoms under treaty, in that requiring registration in the second Member State may be justifiable in order to protect third parties who might buy the asset or take further security over it without having a way of finding out about previous encumbrances. However again practical problems are created for the secured creditor.

There is therefore a strong case for European legislation. This might take the form of harmonisation measures, requiring Member States to recognise security rights created in other Member States (and thus probably to harmonise the kinds of security right that can be created in the different Member States). Alternatively, it may be possible to circumvent the differences in the national laws by creating a form of security right that would have to be recognised and enforced by the laws of all Member States — the so-called European security interest. This would be, in effect, a form of optional instrument but one that allows the parties to create proprietary interests that are not necessarily recognised by their domestic laws.^{*3}

There has been a limited amount of harmonisation already. The Financial Collateral Directive^{*4} requires Member States to recognise security rights (and also functionally equivalent title-transfer arrangements) taken over investment securities, bank accounts, and similar “financial collateral” where both parties are public authorities, central banks, or financial institutions^{*5} and the secured party has “possession or control” over the collateral.^{*6} Formalities such as registration may not be required^{*7}; certain types of enforcement procedures such as the right to appropriate the collateral in the event of default, if provided for in the security agreement, must be permitted^{*8}; and a wide range of rules that might affect the security right in the event of the debtor's insolvency must be dis-applied.^{*9}

However, with other types of moveable collateral, such as goods, receivables, or intellectual property rights, the laws of the Member States remain widely disparate. When the European Commission enquired about barriers to trade within the internal market that are caused by divergences between the laws of the Member States, respondents frequently mentioned differences in the law of security.^{*10} This seems a likely target for future European legislation.

So it is very good news that within the Study Group on a European Civil Code there is a team working on security over moveable property. The team is led by Professor Ulrich Drobnig, former director of the Max Planck Institute for Comparative and International Private Law. It is hoped that the results of their work will form part of the revised DCFR to be submitted to the European Commission by the end of 2008. With Professor Veneziano, I am a member of the group of advisers to the team, and it is largely my ideas for the DCFR book on security over moveable property which I will be discussing. Naturally, what I say is only my personal view, not that of the team or of the Co-ordinating Committee of the Study Group.

At the same time, a working group within UNCITRAL has been busy with the Legislative Guide on Secured Transactions. This is now in almost finished form.^{*11} It contains a great deal of valuable information and discussion, even if in producing model rules for Europe we may not want to follow it to the letter.

The team and the advisers have many other models to look at also. There are the various laws of the Member States, some of which are highly developed. There is the European Bank for Reconstruction and Development Model Law on Secured Transactions. There is article 9 of the US Uniform Commercial Code, now in its ‘Revised’ form. There are the many Canadian Personal Property Security Acts^{*12} (PPSAs) and the variant

² See W.-H. Roth, *Secured Credit and the Internal Market: The Fundamental Freedoms and the EU's Mandate for Legislation*. – H. Eidenmüller, E.-M. Kieninger (eds.), *The Future of Secured Credit in Europe*. – European Company and Financial Law Review, Special Volume 2, 2008, p. 1; J. Rutgers, *Secured Credit and the Internal Market: The Fundamental Freedoms and the EU's Mandate for Legislation*. *Op. cit.* p. 76.

³ See H. Beale, *The Future of Secured Credit in Europe: concluding remarks*. – H. Eidenmüller, E.-M. Kieninger (eds.), *The Future of Secured Credit in Europe*. – European Company and Financial Law Review, Special Volume 2, 2008, p. 376, 379–381.

⁴ Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements. – OJ L 168, 27.06.2002, pp. 43–50.

⁵ Article 1 (2). The Directive applies also where one party is not within those groups provided it is a non-natural person; but article 1 (3) allows Member States to exclude such cases from its operation. In the UK, the implementing legislation applies the same rule where both parties are non-natural persons: *Financial Collateral Arrangements (No. 2) Regulations 2003*, SI 2003/3226.

⁶ See article 2.

⁷ Article 3.

⁸ Article 4.

⁹ Article 8.

¹⁰ See Action Plan on A More Coherent European Contract Law, COM(2003) 68 final (OJ C 63, 15.03.2003), paragraph 41.

¹¹ I have used the version of 16 March 2007, A/CN.9/631.

¹² E.g., Ontario Personal Property Security Act 1967 and (representing a more modern version) Saskatchewan Personal Property Security Act 1993.

of those acts adopted in New Zealand.^{*13} Lastly, there are consultation papers and a report issued by the Law Commission for England and Wales.^{*14} The Law Commission recommended extensive reforms, though these have not been implemented by the national government.

2. General aims and scope

The general aims of the scheme can be set forth quite concisely:

1. The scheme for security rights should be flexible and simple, and taking of effective security rights should be quick and inexpensive.
2. There should be effective means of enforcing the security rights. This obviously benefits secured creditors but also, in the same way as other aims of the system, will benefit debtors also: the more effective the security rights are, the lower will be the costs of enforcement and therefore the cost of credit.
3. There should be adequate warning to other potential secured parties, to unsecured creditors, and to persons who may wish to buy or lease the debtor's property when it is or may be subject to a security right.
4. The scheme may need to provide some protection for the debtor, particularly when security is taken over property that is not used by the debtor for business purposes (i.e., the debtor is acting as a consumer). It may also need to protect some classes of creditor, such as employees who have not been paid their wages.
5. There may need to be safeguards against fraud, for example, to prevent fraudulent claims that a security right was created in favour of a particular creditor at some time in the past.

These objectives are stated here in my own words, but they seem to be fully compatible with the 'Key Objectives' listed in the UNCITRAL guide.^{*15}

Let me explore some of these points in a little more detail.

2.1. Flexibility as to the secured obligations

The scheme should be flexible in three ways. First, there should be flexibility as to the obligations secured. It should be possible to take security over moveable property in order to secure any kind of obligation. Most secured obligations will be monetary — obligations to repay money lent or to pay for goods or services received — but it should be possible to secure any form of obligation. It should be possible to secure not only the debtor's current obligations but also obligations not yet incurred — future advances under fluctuating accounts or loans to be made in the future — without the need for a fresh security agreement. It should be possible to secure all of the obligations a debtor may have to the creditor.

Thus the draft scheme^{*16} provides as follows in article 2:104, 'Secured Obligation':

- (1) The secured obligation
 - (i) may be present or future; conditional or unconditional; and specific or fluctuating;
 - (ii) may also comprise all obligations of the debtor [or a third party] towards the creditor;
 - (iii) may be for money or any other performance which has a monetary value.
- (2) The security right covers, up to a maximum amount, if any, apart from the principal, also the debtor's ancillary obligations towards the creditor, especially:
 - (a) contractual and default interest;
 - (b) damages, a penalty or an agreed payment for non-performance by the debtor of the secured obligation;
 - (c) reasonable costs of extra-judicial recovery of those items;
 - (d) and the reasonable cost for legal proceedings and enforcement proceedings against the debtor and the security provider, if a person other than the debtor.

¹³ Personal Property Security Act 1999. There have been a number of subsequent amendments.

¹⁴ Company Security Interests: a consultative report (LC CP No. 176, 2004); Report on Company Security Interests (LC No. 296, 2005).

¹⁵ UNCITRAL Guide, p. 3.

¹⁶ References are to the draft available in November 2007. Obviously the final version will differ.

2.2. Flexibility as to the kinds of collateral that may be taken as security

Secondly, there should be flexibility as to the types of property that may be used as ‘collateral’. It should be possible to take security rights over any form of collateral, at least so far as business debtors are concerned. It should not matter whether the property is tangible or intangible. Thus, it should be possible to take security over goods, over investment securities, over monetary claims — whether in the form of bank accounts or that of receivables — and over intellectual property rights. It should also be possible to take it over ‘documentary intangibles’ such as negotiable instruments.

It should not matter whether the property can be surrendered into the creditors’ possession or whether the debtor needs to retain possession so that he can use the property — in other words, non-possessory security should be possible over any kind of property. This is very different from what is stated in the law of some states.

More contentiously, perhaps, it should be possible to take security over not just property that the debtor owns at the time but (at least for business debtors) property that the debtor may acquire in the future, again without the need for a fresh security agreement or other form of transfer. This should be possible even if the parties cannot identify precisely what the collateral will be, provided that they can give a generic description, such as ‘all the debtor’s future receivables or future inventory’, that will make it possible to say whether or not an asset falls within the security right’s scope. The possibility to cover future property also means that a security right can attach to the proceeds of disposition of the original collateral — whether rightful or wrongful — without any fresh transaction between the parties. Article 1:102 provides that

(3) If the security provider purports to encumber rights in future, generic or untransferable assets, the security right arises only if and when the assets come into existence, are specified or become transferable.

It should be possible to take a ‘global’ security over all of a business’s assets (the so-called ‘enterprise charge’). Not only does this allow the debtor to offer the widest form of collateral to a single creditor, if it so wishes, but it enables assets that are not recognised property rights — for example, the good will of a business — to be used as collateral. Provided that the secured creditor will be able to ‘sell’ the good will should the debtor default, for example, by selling the debtor’s business as a going concern, it may be prepared to lend against the value of the good will, and there is no reason to prevent it being used as a form of collateral.

2.3. Flexibility as to the collateral subject of the security right

It follows from the point about ‘global’ security rights that it should be possible to take security over ‘circulating assets’. For many businesses, it will not be feasible to seek the consent of the secured creditors each time the debtor needs to sell an item (for example, when it sells stock-in-trade) or to make a payment to its employees or suppliers. Again, there is no need to prevent the stock-in-trade or the cash funds being used as security. Rather, it is necessary to create the possibility that the security agreement may permit the debtor to dispose of at least some assets free of the security right without obtaining the creditor’s consent on each occasion. To put this in the terms used in the common law world, it should be possible to create a security right that includes a ‘licence to deal’ with the collateral, under what is known in the common law as a ‘floating lien’^{*17} or a ‘floating charge’.^{*18}

2.4. Protection of the debtor and of some other creditors

It may be necessary to protect some debtors from giving ‘too much’ security. For example, it is widely thought that consumers may well not understand or appreciate the danger of giving security. If they hand over goods as a possessory pledge, they will probably understand that they may lose the item of property if they do not repay the sum secured. However, they may be less conscious of the risks involved in giving non-possessory security, particularly when it is given over their assets in general, as opposed to specified items, or over assets they do not yet own. Thus, many systems require that, for ‘consumers’, non-possessory security may be taken only if each item is listed in a written document signed by the consumer and that attempts to take security rights over the consumer’s future property shall be ineffective.^{*19}

¹⁷ Cf. UCC § 9-205, Official Comment 2.

¹⁸ This is the term used in English (and Scottish) law.

¹⁹ E.g., UCC § 9-204 (b); Saskatchewan Personal Property Security Act 1993, § 10 (3). In England, a consumer cannot charge after-acquired goods as the result of the various Bills of Sale Acts: see H. Beale, M. Bridge, L. Gullifer, E. Lomnicka, *Law of Personal Property Security*, Oxford University Press (OUP) 2007, Chapter 9.

Normally, the ‘protection’ offered to other creditors is simply the publicity involved when the debtor surrenders the asset to the creditor or proceeds from the requirement that the security be registered. However, many systems provide that some classes of unsecured creditor (for example, unpaid employees or the tax authorities) should be protected in insolvency — or they may provide for a certain amount of protection for unsecured creditors in general, by establishing an ‘unsecured creditors fund.’^{*20} This may be achieved by way of special rules about the priority of payment in insolvency, but a similar effect may be achieved by limiting the percentage of the debtor’s assets that may be made subject to a global security right. The project will not address this issue, since it does not deal with insolvency, but the point must be borne in mind.

2.5. Simplicity

Simplicity in the law of security rights can take many forms. One lies in the simplicity of any registration requirements; this is discussed below. A second is by having as few different forms of security right as possible — or, to the extent that different forms are needed, as far as possible subjecting them to similar rules. This makes the scheme easier to understand and reduces the number of ‘boundary disputes’. One feature of the scheme found in article 9 of the Uniform Commercial Code (UCC) and the Personal Property Security Acts is that the distinctions among the different types of security right — pledge, mortgage, etc. — are done away with. Rather, there is one form of security interest, which may be ‘perfected’ (made effective in insolvency, etc.) in a number of different ways: by the taking of possession of the collateral (unless it is intangible), via registration, or (for financial collateral and also ‘letter of credit rights’) by the taking of ‘control’.^{*21}

A third form of simplicity overlaps with the aims of speed and cheapness.

2.6. Speed and cheapness

The aim of making it easy and cheap to take security rights argues for a scheme that is simple to understand, thus obviating the need for legal advice on an everyday basis. It also means keeping formalities down to a minimum. Thus formal requirements such as signed written documents should be required only where this is seen as essential — for example, to make the parties ‘stop and think’ before they act (the ‘cautionary function’) or to prevent fraud such as pretending that a security interest was created at a date in the past (the ‘evidentiary function’). For example, the UCC does not require a signed writing in order for the business debtor to be bound to provide security. It does, however, prevent the security right coming into existence (‘attaching’) until there is some signed document, as a way of preventing fraud against other creditors.^{*22} English law, by contrast, requires a signed writing only in very limited circumstances.^{*23}

Ease and cheapness also argues for keeping publicity requirements to a minimum. Later it will be argued that registration can be made very cheap, but even so it should not be required unnecessarily. Most systems, for example, do not require registration when a possessory security right is created over goods — the fact that the debtor no longer has the goods in its possession is thought to be sufficient warning to third parties.

We saw earlier that the Financial Collateral Directive already specifies that security over financial collateral does not need to be registered, provided that the secured creditor has possession or control of it — for example, where investment securities are held for the debtor by an intermediary when the intermediary has agreed to hold them to the order of the secured creditor and not to allow the debtor to deal with them. We may note in passing that, in this case, it cannot really be said that ‘possession or control’ itself provides adequate publicity. It will be quite hard for unsecured creditors, for example, to discover whether or not the investment securities are subject to a security. In this case, the reasoning seems to be different: registration would slow down the financial markets and therefore it is dispensed with.

3. Registration

It is generally agreed that, where a non-possessory security right is taken over assets other than financial collateral, a warning should be given to other people who may deal with the debtor. If that is not done, it may well be hard to discover whether there is a security interest; and this may discourage financiers from coming forward who cannot find out in other ways whether the debtor has created security over its property. Thus

²⁰ E.g., the UK’s Enterprise Act 2002, § 252, inserting a new § 176A into Insolvency Act 1986.

²¹ See UCC §§ 9-308–9-316. The Canadian Acts do not yet provide for perfection of security rights over financial collateral by taking control.

²² UCC § 9-203.

²³ When the collateral is an equitable interest, Law of Property Act 1925, § 53 (1) (c). It does not appear that this requirement is aimed at security rights in particular.

there is broad (though not universal) agreement that such non-possessory security rights should have to be registered. Normally the sanctions are threefold. First, a security interest that has not been registered should not be opposable to an execution creditor. Secondly, it should not be effective in the debtor's insolvency. In other words, the property (if not otherwise encumbered) should be available to be sold for the benefit of all creditors. Thirdly, lack of registration will have consequences for the priority of the security right against the rights of other secured creditors and possibly also against those of buyers of the property.^{*24}

The team also assumes that, for security over moveable property, it makes little sense to have local registers in each jurisdiction when the property may end up in a different jurisdiction. It would be much simpler to have a single, computerised register that would cover security rights over property anywhere in the EU.

There may be some exceptions to the requirement to register. For example, the UCC provides that when a receivable is supported by a personal guarantee, a security right over the receivable confers also a right over the 'supporting obligation', and registration of the right over the receivable is enough for both. Likewise, rights over proceeds do not always have to be registered. But registration is otherwise central to most (but not all^{*25}) schemes of non-possessory security rights.

However, a balance has to be struck between the degree of publicity and that of speed and efficiency. Even if modern information technology is harnessed, it may be inefficient to require the secured creditor to include in the register every detail of the security right. First, it might take quite a bit of effort to assemble all of the associated documentation. Second, unless the documentation used is highly standardised, there is a danger that something will be omitted by accident and that the omission will render the security right ineffective for want of proper registration. Therefore, there is strong feeling in favour of requiring only a brief notice. This will not provide all information a third party might want but still will serve as a warning that the property may be encumbered and will provide information about whom to ask for more information — in other words, about who the secured creditor (or his registration agent) is. Thus the register might simply list, for each debtor (say, each registered company or business), any security right that has been created, giving the name and address of the secured creditor and a brief description of the property subject to the security right.

A second question is who should actually perform the registration, and who should be held responsible if an error is made — for example, if some collateral that is in fact subject to the security interest is not listed. A traditional approach is to say that this should be the responsibility of the registry staff. Thus in England a company that creates a charge over its property (or in practice the secured creditor notionally acting on behalf of the company) is obliged to send to the Companies Register a set of 'particulars' of the charge (on a prescribed form), together with the charge documents. The staff are supposed to check the particulars for accuracy before entering them in the register and returning the charge document along with a 'Certificate of Registration'.^{*26} This certificate is conclusive proof that the charge has been duly registered, and therefore the charge will be fully effective, even if in fact some item has been missed out. The secured creditor is fully protected, and it is a nice (and disputed) question whether the registrar might be liable to a subsequent creditor who takes security over an asset of the company that is not listed as being subject to the first charge when in fact the first charge does apply to it.^{*27}

Most people think that such systems not only are very wasteful in terms of the staff needed but place the risk with the wrong person. In effect, the risk is borne by enquirers who are misled by the incorrect information in the register, while the secured creditor who made the mistake is safe. It would be better to have a simple system that allows the secured party to effect a simple registration itself and to bear the risk of any mistake or omission — but to make it so simple that mistakes are unlikely and will have limited effect. For example, if an item of collateral is omitted, the charge should not be effective in relation to that item but should remain effective as regards the collateral that was listed properly.

It is true that such a scheme will not give enquirers so much information as might be provided if fuller particulars, or even the entirety of the charge documentation, has to be included in the register. Enquirers who want more detail will have to ask the debtor or the secured creditor to supply it. In practice, not all searchers will want it — they probably search to be sure that there is no security right over the relevant assets, and, if they find that there is one, they may not be interested in discovering its details, because they will simply not be prepared to lend against a second-ranking security right. Moreover, if they are seriously thinking of taking a second security right over the same asset, they will need to contact the debtor or the secured creditor in any event, in order to discover the amount of the secured debt. (The amount due will fluctuate from time to time and thus is not something whose registration can be required.) It is thought that the extra cost to the few enquirers who will want more information is more than outweighed by the savings in the vast majority of cases in which extra information need not be placed in the register.^{*28}

²⁴ See for example the Saskatchewan Personal Property Security Act 1993, § 20; UCC § 9-317.

²⁵ German law is a notable exception to this.

²⁶ Companies Act 2006, Part 25.

²⁷ See H. Beale et al. (Note 19), paragraph 12.

²⁸ In practice, because the registration system will be on-line, there may be nothing to stop a secured creditor including the additional information if it wished to do so, for example so that it will not have to answer so many questions from enquirers.

In most cases, the debtor — who, after all, wants the new credit on offer — will be willing to provide information. The problem is that the new creditor may not trust the debtor to supply full and correct information. It would be better to have the registered creditor's word for the matter — and, under most systems, a creditor who gives the enquirer wrong information, for example, in saying that less is owed by the debtor than is in fact the case — will be prevented from acting inconsistently with what he has said. But the creditor may not be willing to give out information. Following broadly Revised Article 9 of the UCC^{*29}, the draft provides that the debtor can require the creditor to supply information directly to a third party. There will be severe sanctions if the creditor fails to comply with such a request.

It is planned to make this kind of registration both fast and cheap by making the register wholly electronic and allowing the secured party to register online. The secured party can print off a record of the registration should it feel the need for documentary proof. Such a system was introduced in New Zealand in 2000^{*30} and seems to be working very well. It requires minimal upkeep, and, even with its very modest registration fees, the registration system paid for itself after six months. The fees subsequently were reduced to NZ\$3. Searching is also available online and is very inexpensive.

A major question is that of whether registration should be possible only once the security agreement has been made. Obviously, this must be the case if registration is seen as a constitutive element of the non-possessory security. An alternative is the UCC/PPSA system of 'notice-filing'.^{*31} This allows registration in advance, so that in effect the registration is merely a notice that a security interest has been created or that it may be in the future. This is of particular value if it is likely that there will be a string of security agreements between the same two parties. That will often be the case in the North American jurisdictions, because their schemes provide for registration of not only traditional security interests but also such functional equivalents as the supply of goods under retention of title and outright sales of receivables. Thus a single registration can cover a string of such transactions even if each is a separate contract and thus creates a new security interest. The team is also thinking of including at least registration of retention-of-title clauses, and therefore it also favours notice-filing.

A scheme that depends on registration by the secured creditor entrains two further problems. First, the registration may become out of date, typically because the secured loan has been paid and the security agreement has come to an end. Secondly and more seriously, it may have been wrong in the first place. It might be accidentally incorrect — for example, listing the security right as applying to property that is not in fact within its scope — or it might even be deliberately fraudulent. Obviously, merely filing does not give the creditor rights if, in fact, there is no security agreement with the debtor. The filing is likely to be an attempt to harm the debtor's business or reputation by making him appear seriously indebted. What can be done to prevent these problems?

The North American systems deal with 'false filings' in two ways. First, penalties may be imposed on anyone who files without a genuine belief that the information filed is correct. Secondly, for both the case of filings that are wrong from the start and the case in which the filing has simply become out of date, there is a procedure by which the debtor can demand that the registration be removed or corrected. In essence, the registry will remove the filing, or correct it in line with the debtor's demand, unless within a certain amount of time the secured creditor (who will be notified of the debtor's claim) shows good reason that this should not be done — for example, via court proceedings.^{*32}

The team is considering a broadly similar correction procedure. But it also is considering a number of other approaches. The principal one is very simple: to require that the debtor consent to any filing before it is made. The debtor can do this in advance by itself enrolling with the register and stipulating that it consents (in advance) to registration by any or certain named creditors — for example, its normal financiers. Alternatively, the speed of modern communications via the Internet is such that it will nearly always be feasible to get the debtor's electronic signature attached to the creditor's application before the application is sent to the registry. I envisage the online application screen as having a facility for the creditor to enter the contact details of the debtor. Unless the debtor's advance consent has been given already, the system will contact the debtor and it will not actually register the security right until it has received a positive reply from the debtor. This would include a personalised electronic signature of some kind; it seems inevitable that, by the date on which our proposed scheme could actually become law, every business and probably every individual will have some such electronic identifier.

Many legal systems already require or permit registration of security interests over certain types of assets, often ones for which there is also a title register. Thus in the UK there are specialist registers for mortgages over ships, aircraft, and certain types of intellectual property rights. Obviously, thought will have to be given

²⁹ UCC § 9-210.

³⁰ Personal Property Security Act 1999.

³¹ This is described in outline in H. Beale, M. Bridge et al. (Note 19), paragraphs 21.82 ff.

³² See, e.g., Saskatchewan Personal Property Security Act 1993, § 50.

to whether it should be necessary to register in both the ‘special’ register and the general register. In the future, it might well be possible to create electronic links between the two, such that registration in one register automatically places the material involved in the other.^{*33}

4. Priority

Having a full registration system for non-possessory security rights also makes it very easy to create a simple scheme addressing the priority between competing rights: it can depend simply on the date of registration. As between a non-possessory and a possessory security right over the same asset, it would depend on whether the possessory right was perfected (by possession being taken) before or after the non-possessory right was registered. Thus the draft scheme provides as follows in its article 4:102, ‘Priority: General Rules’:

- (1) Subject to exceptions, the priority of a security right towards other security rights and other limited proprietary rights in the same asset is determined according to the order of the relevant time.
- (2) The relevant time is
 - (a) for security rights, the time of registration [...], if any, or the time at which the security right has become effective according to the rules of Chapter 3, whichever is earlier;
 - (b) for other limited proprietary rights, the time of creation.
- (3) Effective security rights have priority over any ineffective security right, even if the latter was created earlier.
- (4) The rank of two or more security rights which are not effective is determined by the time of their creation.

There is likely to be at least one major exception to this ‘date of perfection or filing’ scheme. This is the case of ‘acquisition finance security’ or ‘purchase money security’ — where the security right is only over property whose purchase by the security provider was financed by the credit secured. This will be particularly important if retention-of-title devices (such as the supply of inventory on terms by which the goods remain the property of the supplier until paid for, or finance leases) are included. But that is a matter that will be discussed in Professor Veneziano’s paper.

5. Conclusions

I hope that I have said enough to show that the team working on proprietary security over moveable property is seeking to devise a scheme that would be much simpler and more flexible than what has been seen in many jurisdictions to date. This could then be used as a model for either harmonising measures or an optional instrument that would allow parties in different countries to create a ‘European security instrument’ that would be effective in all Member States. This would be a major step toward ensuring that secured credit is readily available throughout the European Union.

³³ In England and Wales such a scheme is envisaged for mortgages created by companies over their land. See H. Beale et al. (Note 19), paragraph 8.62.



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Performance and Remedies for Non-performance: Comparative Analysis of the PECL and DCFR^{*1}

1. Introduction

Surely both performance and remedies for non-performance are among the central categories in the Draft Common Frame of Reference.^{*2} A large proportion of disputes arise from the question of how obligations should be duly carried out and which remedies can be taken up in the event of non-performance. The articles concerning performance are contained in DCFR Book III Chapter 2; those governing remedies for non-performance can be found in Chapter 3 of the same book. The DCFR's Books I–III are based on the Principles of European Contract Law.^{*3} The same applies to performance and remedies for non-performance — DCFR Book III's Chapters 2 and 3 are expansions of the PECL's Chapters 7, 8, and 9. The changes may be divided into three classes: 1) terminological, 2) structural, and 3) substantive. Most of the substantive changes and corrections have been made in DCFR Book III Chapter 3, concerning remedies for non-performance; there are relatively few changes in Chapter 2 concerning performance in comparison to the PECL. The fact that fewer substantive changes were needed in such important parts as the material on performance and remedies for non-performance shows the high quality level of the PECL material, which has indeed stood the test of time.

On the basis of Estonia's experience, we can assure that the PECL articles have justified themselves in real situations. The PECL served as one of the main sources for the Estonian Law of Obligations Act^{*4}, which, in turn, is the most important and the lengthiest part of Estonia's new Civil Code.^{*5} The Law of Obligations Act, the General Part of which is based on the PECL, has been in force since 2002. Considerable judicial practice has developed since then, proving that no major mistakes, discrepancies, or gaps in the regulation have been

¹ The article is based on the presentation "Performance and remedies for non-performance" that was presented by the author at the conference "The Draft Common Frame of Reference" in Ljubljana on 28–29 April 2008. The conference was organised by the Academy of European Law (co-ordinator Dr. Angelika Fuchs) in co-operation with the Ministry of Justice of the Republic of Slovenia, in the framework of the Slovenian Presidency of the Council of the EU.

² Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR). Interim Outline Edition. Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group). C. von Bar, E. Clive, H. Schulte-Nölke, H. Beale, J. Herre, J. Huet, P. Schlechtriem †, M. Storme, S. Swann, P. Varul, A. Veneziano, F. Zoll (eds.). Munich: Sellier 2008.

³ Principles of European Contract Law. Parts I and II. Combined and Revised. Prepared by the Commission on European Contract Law, Chairman: Professor Ole Lando. O. Lando, H. Beale (eds.). The Hague, London, Boston: Kluwer Law International 2000; Principles of European Contract Law. Part III. Prepared by the Commission on European Contract Law, Chairman: Professor Ole Lando. O. Lando, E. Clive, A. Prüm, R. Zimmermann (eds.). The Hague, London, New York: Kluwer Law International 2003.

⁴ Law of Obligations Act (võlaõigusseadus), adopted on 26 September 2001. – RT I 2001, 81, 487 (in Estonian).

⁵ The new Estonian Civil Code consists of five parts; in addition to the Law of Obligations Act they are: General Part of the Civil Code Act (tsiviilseadustiku üldosa seadus), adopted on 25 June 1994. – RT I 1994, 53, 889 (in Estonian); Law of Property Act (asjaõigusseadus), adopted on 9 June 1993. – RT I 1993, 39, 590 (in Estonian); Family Law Act (perekonnaseadus), adopted on 12 October 1994. – RT I 1994, 75, 1326 (in Estonian) and Law of Succession Act (pärimisseadus), adopted on 15 June 1996. – RT I 1996, 38, 752 (in Estonian).

revealed in the application of the provisions of the Law of Obligations Act, which are similar to the PECL articles. Therefore, on the basis of Estonia's experience, we can recommend the DCFR as a good source, especially for those countries that are now preparing their new civil codes.

The scope of one article does not enable analysis of all articles of the DCFR concerning performance and remedies for non-performance in this paper. Neither will such an analysis be necessary in this case. The paper will focus mainly on the principal substantive changes that have been made in the DCFR as compared to the PECL.⁶

2. Performance

2.1. General remarks

Since the main purpose of the DCFR is to specify principles, definitions, and model rules, it pays more attention to principles and definitions than the PECL material does. The central concept is 'obligation', which does not only mean a contractual obligation; rather, it has a broader definition — **an obligation** is a duty to perform that one party to a legal relationship, the debtor, owes to another party, the creditor (DCFR, III.–1:101, paragraph 1).

Performance of an obligation is the doing by the creditor of what is to be done under the obligation or the not doing by the debtor of what is not to be done (DCFR, III.–1:101, paragraph 2). The definition makes it clear that 'performance' covers both positive and negative obligations.

DCFR Book III Chapter 2, 'Performance', is not the only basis for defining due performance of an obligation. Firstly, general principles such as good faith and fair dealing (DCFR III.–1:103) and obligation of co-operation (DCFR III.–1:104) have to be taken as the basis; these principles are also contained in the PECL (articles 1:201 and 1:202). As a new principle, DCFR III.–1:105 sets forth the non-discrimination rule, according to which Chapter 2 ('Non-discrimination') of Book II applies with appropriate adaptations to the performance of any obligation to provide access to, or to supply, goods, services, or other benefits that are available to members of the public.

Another important principle that needs to be taken into account when one is analysing and applying the DCFR articles on performance and remedies for non-performance is the party autonomy principle (DCFR II.–1:102), according to which parties may exclude the application of any of the following rules relating to contracts or other juridical acts, or the rights and obligations arising from them, or derogate or vary their effects, except as otherwise provided.

2.2. Specific rules concerning performance

As mentioned above, the articles of DCFR Chapter 2 are largely based on the relevant provisions of PECL Chapter 7. The most important rules concerning performance are those regulating the place, time, and order of performance, and the method of payment. The place of performance has been defined in the DCFR's article II.–2:101 in accordance with the same main rule as in the PECL — if the place of performance of an obligation cannot be otherwise determined from the terms regulating the obligation, it is:

- a) in the case of a monetary obligation, the creditor's place of business and;
- b) in the case of any other obligation, the debtor's place of business.

Naturally, it should be kept in mind that very often the place of performance is fixed or otherwise determinable by a contract. When compared to the PECL article 7:101, DCFR III.–2:101 contains an additional rule: if a party causes any increase in the expenses incidental to performance by change in place of business or habitual residence subsequent to the time when the obligation was incurred, that party must bear the increase. However, the parties may agree otherwise.

When it comes to the **time** of performance, the wording of DCFR III.–2:102 is somewhat different from that of PECL article 7:102, but the content has remained unchanged; the same applies to early performance — a creditor may reject an offer to perform before performance is due unless the early performance would not cause the creditor unreasonable prejudice (DCFR III.–2:103 and PECL article 7:103).

The DCFR has no essential changes when compared to the PECL as regards the order of performance (DCFR III.–2:104 and PECL article 7:104) and alternative performance (DCFR III.–2:105 and PECL article 7:105).

⁶ The main sources for this article are the PECL Chapters 7, 8 and 9 with commentaries and DCFR Book III Chapters 2 and 3 with draft commentaries.

The provisions governing **performance by a third party** (DCFR III.–2:107 and PECL article 7:106) have been somewhat changed. The basic rule remains the same — where personal performance by the debtor is not required, the creditor cannot refuse performance by a third party, if:

- a) the third party acts with the assent of the debtor; or
- b) the third party has a legitimate interest in performing and the debtor has failed to perform or it is clear that the debtor will not perform at the time performance is due.

The rule that performance by a third party discharges the debtor also remains the same; however, the DCFR sets forth a new exception to this rule, that the debtor will remain not discharged to the extent that the third party takes over the creditor's right by assignment or subrogation. Another new provision is DCFR III.–2:107, paragraph 3, according to which, if personal performance by the debtor is not required and the creditor accepts performance of the debtor's obligation by a third party, although the creditor could refuse such performance, the debtor is discharged but the creditor is liable to the debtor for any loss caused by that acceptance. Whether the third party who discharges the debtor's obligation has any recourse against the debtor will depend on the circumstances and on other rules on benevolent intervention and the law on unjustified enrichment.

The rules on method of payment and on currency of payment, as well as imputation of performance, property not accepted, money not accepted, and costs of performance are essentially the same in the DCFR and in the PECL.

A new article not contained in the PECL is DCFR III.–2:114, 'Extinctive Effect of Performance', which sets out the following rule: full performance extinguishes the obligation if it is:

- a) in accordance with the terms regulating the obligation; or
- b) of such a type as by law to afford the debtor a good discharge.

It is obvious that full performance in accordance with the terms regulating the obligation will extinguish the obligation. Therefore, performance that is not full or not in conformity with the terms regulating the obligation will not extinguish the obligation. This, however, is subject to the qualification that there are various situations wherein the rules of the DCFR provide for the debtor obtaining a good discharge even if performance is not strictly in accordance with the obligation. For example, the rules on assignment sometimes enable the debtor to obtain a good discharge by paying the 'wrong' creditor in good faith.

3. Remedies for non-performance

3.1. General remarks

DCFR Book III Chapter 3 ('Remedies for Non-performance') is based on the PECL Chapters 8 and 9, but, when it is compared to Book III Chapter 2 ('Performance'), major changes have been made and the structure of the articles has been revised. In fact, the PECL Chapters 8 and 9 are already well-structured — the general bases for applying remedies are followed by provisions concerning particular remedies. The Estonian Law of Obligations Act follows exactly the same structure, which has justified itself very well in practice.

The general provisions on remedies are primarily based on the principles set forth in the PECL — such as the principle of excusability and of accumulation of remedies, and rules excluding or restricting remedies. There are two important changes when this material is compared to PECL Chapter 8 in the general provisions on remedies: concerning notice (III.–3:106 and III.–3:107) and cure (III.–3:202 through III.–3:204).

According to DCFR article III.–3:106, if the creditor gives notice to the debtor because of the debtor's non-performance of an obligation or because such non-performance is anticipated, and the notice is properly dispatched or given, a delay or inaccuracy in the transmission of the notice or its failure to arrive does not prevent it from having effect. The notice has effect from the time at which it would have arrived in normal circumstances. This is an exception to the general rule, according to which notice takes effect when it reaches the addressee. However, article III.–3:106 makes an exception, placing the risk of loss, mistake, or delay of transmission of the message with the defaulting debtor rather than with the creditor. This dispatch rule does not apply to notice that is to be given by the defaulting debtor.

DCFR article III.–3:107 is also new in comparison to the PECL content. According to this article, if, in the case of an obligation to supply goods or services, the debtor supplies goods or services that are not in conformity with the terms regulating the obligation, the creditor may not rely on the lack of conformity unless the creditor gives notice to the debtor within reasonable time.

A debtor who has not performed at all knows the position and does not need to be notified, and the creditor should not lose any remedies by not providing notification. The only effect of the failure to notify is that the person supplied loses the right to rely on the non-conformity.

The above rules do not apply if the creditor is a consumer.

As mentioned above, remedy by the debtor of non-conforming performance is regulated in much greater detail than in the PECL. The debtor's possibility for remedy has been extended in DCFR article III-3:202 also in the event that the debtor offers such remedy immediately after the creditor has provided notification about the lack of conformity. In such case, the creditor cannot exercise any other remedies for non-performance save for withholding performance during the time reasonably needed for remedy. At first sight, this rule seems very favourable to the debtor. However, this rule is heavily qualified by the restrictions in the next article — in DCFR article III-3:203, on when the creditor need not allow the debtor an opportunity to provide remedy. For example, the creditor may not allow the debtor a period in which to attempt to render remedy if:

- 1) failure to perform a contractual obligation within the time allowed for performance amounts to fundamental non-performance;
- 2) the creditor has reason to believe that the debtor's performance was made with knowledge of the non-conformity and was not in accordance with good faith and fair dealing; or
- 3) the creditor has reason to believe that the debtor will be unable to effect the cure within a reasonable time and without significant inconvenience to the creditor.

The consequence for the creditor of allowing the debtor an opportunity to render cure is that during the period allowed for cure the creditor may withhold performance of reciprocal obligations but may not resort to any other remedy. If the debtor fails to effect cure within the time allowed, the creditor may resort to any available remedy.

3.2. The right to enforce performance

The right to enforce performance may be regarded as the most important legal remedy. The creditor's main interest is presumed to lie in the debtor's performance of the debtor's obligation. Enforcement of performance is essentially different from all other remedies and the most important of them. Monetary obligations and non-monetary obligations should be distinguished when one is speaking about enforcement of performance.

3.2.1. Monetary obligations

As a rule, it is always possible to enforce monetary obligations. Monetary obligation refers to every obligation to make a payment of money, regardless of the form of payment or the currency. This includes even a secondary obligation, such as the payment of interest or of a fixed sum of money as damages. But, in each case, the monetary obligation must be due before it can be enforced. The principle that monetary obligations always can be enforced is not quite so certain where the monetary obligation has not yet been earned via the creditor's own performance and it is clear that the debtor will refuse to receive the creditor's future performance. The creditor is normally entitled to perform and thereby to earn the price. The debtor's unwillingness to receive the creditor's performance is therefore, as a rule, irrelevant. However, according to DCFR article III-3:301, paragraph 2, there are two situations in which the above principle does not apply: firstly, cover transactions and, secondly, unreasonable performance. A cover transaction means that a creditor who can make a reasonable cover transaction without significant trouble or expense is not entitled to continue with performance against the debtor's wishes and cannot demand payment of the price for it.

Unreasonable performance means that before performance has begun, the debtor makes it clear that performance is no longer wanted. The feature common to these two cases is that the debtor is at risk of being forced to accept a performance that is no longer wanted.

3.2.2. Specific performance of a non-monetary obligation

The creditor is entitled to enforce **specific performance** of a non-monetary obligation by the debtor. This right is more limited than the right to enforce monetary obligations, while it is an especially important remedy, as the creditor has not only a substantive right to the debtor's performance but also a remedy to enforce this right specifically — e.g., by applying for an order or decision of a court.

The right to enforce specific performance of a non-monetary obligation applies not only where no performance at all is tendered by the debtor but also where the debtor has attempted to perform but the attempt does not conform to the terms regulating the obligation. This is made clear by paragraph 2 of article III-3:301. However, the right to enforce specific performance is subject to the exceptions in paragraph 3 and to the time limit in paragraph 4 of the same article.

Whether a creditor should be entitled to enforce specific performance of a non-monetary obligation is controversial. In England and Ireland, specific performance is regarded as an exceptional remedy, but in other European countries it is regarded as an ordinary remedy. There is reason to believe, however, that results in practice are rather similar under both theories. The DCFR takes a pragmatic approach, being based on the

same principles as the PECL article 9:102 and is at the same time an expression of a compromise between the different legal orders.

A general right to enforce specific performance has several advantages. Firstly, through specific relief, the creditor obtains as far as possible what is due; secondly, difficulties in assessing damages are avoided; and, thirdly, the binding force of obligations is stressed.

On the other hand, comparative research into the laws, especially commercial practices, demonstrates that the principle of allowing the enforcement of specific performance must be limited. The limitations are variously based upon natural, legal, and commercial considerations and are set out in paragraphs 3 and 4 of DCFR article III.–3:301. In all of these cases, other remedies, especially damages and — in appropriate cases — termination, may be adequate remedies for the creditor.

If the debtor attempts to perform but the attempted performance does not conform to the terms regulating the obligation, the creditor may choose to insist upon a conforming performance. This may be advantageous for both parties. The creditor obtains what is due, and the debtor obtains a discharge (and any price or other counter-performance that is due) and preserves a reputation as a person who fulfils obligations.

A conforming performance may be achieved in a variety of ways — for example, via repair, delivery of missing parts, or delivery of a replacement.

The right to enforce a conforming performance is, of course, subject to the same exceptions as the general right to enforce performance. Thus, a debtor cannot be forced by court order to accomplish a performance conforming to the obligation if this would be unduly burdensome or expensive or if the creditor has failed to demand performance within a reasonable time, or the performance is impossible or of a personal character.

For obvious reasons, there is no right to enforce performance if it is **impossible**. This is particularly true in cases of factual impossibility — i.e., if some act in fact cannot be carried out. The same is true if an act is prohibited by law. Similarly, specific performance is not available where a third party has acquired priority over the creditor with respect to the subject matter of the obligation.

If an impossibility is only temporary, enforcement of performance is excluded during that time.

Performance cannot be required if it would be **unreasonably burdensome or expensive** for the debtor. Here, ‘burdensome’ does not refer to financial burden. It is broader than that. It may cover something that involves a disproportionate effort or even something that was liable to cause great distress, vexation, or inconvenience. No precise rule can be stated as to when a performance would be ‘unreasonably’ burdensome or expensive.

In deciding whether performance would be unreasonably burdensome or expensive, it may be relevant to take into account whether the creditor could obtain performance easily from another source and claim the cost of doing so from the debtor.

It might be pointless to try to enforce specific performance of certain obligations of a highly personal character. In the main, however, this is based on respect for the debtor’s human rights. The debtor should not be forced to perform if the performance consists in the provision or acceptance of services or work that is of such a personal character or is so dependent upon a personal relationship that enforcement would infringe the debtor’s human rights. The criterion here is not simply the personal nature of the work or services to be provided. To exclude enforcement of specific performance of all obligations to provide work or services of a personal character would be far too broad. Instead, the criterion is whether enforcing performance would be unreasonable. In deciding that question, regard would have to be given to the debtor’s human rights and fundamental freedoms, including in particular the rights to liberty and bodily integrity. For example, an obligation to take part in a medical experiment involving surgical procedures performed on the debtor would not be specifically enforced. There is no reason, however, that a firm of professional carers should not be forced to perform their contracts to supply personal care services. And there is no reason that many ordinary employment contracts should not be enforced, although certain employment contracts requiring work or services of a highly personal nature from the debtor’s point of view, or the continuance of a highly personal relationship, might be covered by DCFR article III.–3:302, paragraph 2 (C). The position is similar in relation to partnership contracts and to contracts to form a company. Some might involve such a close personal relationship that the exception would apply. Others might not.

The expression ‘of a personal character’ does not cover services or work that may be delegated. However, a provision in a contract that work may not be delegated does not necessarily render that work of a personal character. If the contract does not need the personal attention of the contracting party but could be performed by employees, the term prohibiting delegation may be interpreted as preventing only delegation to another enterprise, such as a subcontractor. The signing of a document would not usually constitute performance of a personal character. An obligation to sign a document can be enforced in greatest part, since the debtor’s act can often be replaced by a court decree.

A request for performance of a non-monetary obligation must be made **within a reasonable time**. This provision is supplementary to the normal rules on notification of non-conformity and on prescription and is intended to protect the debtor from hardship that could arise in consequence of a delayed request for performance by

the creditor. The length of the reasonable period of time is to be determined in view of the rule's purpose. It is the debtor who will have to demonstrate that the delay in requesting performance was unreasonably long.

There could be a danger that a creditor, by insisting unreasonably on specific performance by the debtor when the creditor could easily obtain performance elsewhere, could inflate the damages payable for non-performance by the debtor or the amount of a stipulated payment for non-performance that is calculated by the day or week. One control on such abuse is the general provision that remedies must be exercised in accordance with the principles of good faith and fair dealing. Another, more specific, control is provided by paragraph 5 of DCFR article 3:302, which prevents the creditor from recovering damages or a stipulated amount for non-performance to the extent that the creditor has increased the loss or the amount of the payment by insisting unreasonably on specific performance in circumstances wherein the creditor could reasonably be expected to obtain performance from another source. This is also a new rule, not contained in the PECL.

3.3. Termination

Termination of an obligation is the second most important remedy after enforcement of performance. Without underestimation of other legal remedies, enforcement and termination are the most important ones, because a creditor first needs to make a principal choice between performance and termination. More changes have been introduced to the PECL rules when it comes to termination as compared to other remedies. The structure of DCFR Book III Section 5 ('Termination') has been fleshed out greatly when compared to PECL Chapter 9 Section 3 ('Termination of Contract'). DCFR Book III Section 5 is broken down into subsections covering the following: grounds for termination; scope, exercise, and loss of right to terminate; effects of termination; and restitution. Such greater structural articulation makes the regulation easier to follow and understand.

Unlike the other remedies, termination as a remedy in Section 5 of Book III of the DCFR applies only to contractual obligations and contractual relationships. There are two reasons for this. Firstly, it would be extremely unusual for the remedy of termination to be useful in relation to non-contractual obligations. The main usefulness of termination is that it frees the creditor to obtain goods or services elsewhere and, in certain situations, to recover what has been paid or provided already under the contract. In the case of reciprocal non-contractual obligations, other available remedies — withholding of performance, enforcement of specific performance, damages, and interest — should be adequate. Secondly, it could be regarded as inappropriate to allow private persons to terminate by notice obligations arising by operation of law.

The use of the word 'termination' leads to the question of what is terminated. The PECL speaks of 'termination of the contract'. However, in the context of these rules, the expression 'termination of the contract' is not strictly accurate. Once a contract as a juridical act has taken place, it is completed and cannot be terminated. It would be more accurate to say that it is the contractual relationship between the parties that is terminated. However, the relationship is not necessarily terminated completely. There may be cases in which, for example, only a separable part of the parties' obligations and rights under the contract is terminated. In such cases, aspects of the relationship may survive. This is why the relevant articles refer to termination of the contractual relationship in whole or in part.

The grounds for termination under the DCFR are essentially of two types. Firstly, there is fundamental non-performance by the debtor, regulated by article III.–3:502 (covering termination for fundamental non-performance). Secondly are what might be called equivalents to non-performance, regulated by the succeeding three articles. These are:

- 1) where the creditor has allowed the debtor further time to perform but the debtor has not performed within that time (article III.–3:503);
- 2) where there is an anticipated fundamental non-performance (article III.–3:504); and
- 3) where the debtor has failed to provide adequate assurance of performance when called upon to do so (article III.–3:505).

Termination may be effected by the act of the creditor alone; there is no need to bring action in court. Termination is effective only if notice of termination is given by the creditor to the debtor.

Whether, in cases of non-fulfilment of a contractual obligation, the creditor should have the right to terminate the contractual relationship in whole or in part depends upon a weighing of conflicting considerations. On the one hand, the creditor may desire broad rights of termination. For the debtor, on the other hand, termination usually involves a serious detriment. For these reasons, it is fundamental non-performance that will as a rule justify termination. In one respect, DCFR article 3:502 differs from the provision of the PECL that defines 'fundamental non-performance', article 8:103. PECL article 8:103 (a) provides that non-performance would also be fundamental if strict compliance with the obligation were 'of the essence' of the contract. This left it open to a court to treat an obligation as 'of the essence' so that any failure to perform it would give the other party the right to terminate the contractual relationship, even if the non-performance had no serious consequences for the other party. In some situations, the parties may wish certain obligations to be treated in that

way — for example, time provisions in commodity contracts. However, it does not seem appropriate to apply the same approach as a general rule to all contracts. If the parties wish non-performance of an obligation to have that effect, they remain to provide for it in their agreement.

Article III.–3:502, paragraph 2 (a), of the DCFR provides that where the effect of non-performance is substantially to deprive the creditor of what the creditor was entitled to expect under the contract, as applied to the whole or relevant part of the performance, then in general the non-performance is fundamental. This is not the case, however, where the debtor did not foresee and could not reasonably be expected to have foreseen those consequences.

Paragraph 2 (b) of the DCFR article III.–3:502 makes it clear that, even where the non-performance of an obligation does not substantially deprive the creditor of what the creditor could have expected to receive, the creditor may treat the non-performance as fundamental if it was intentional or reckless and gives the creditor reason to believe that the debtor's future performance cannot be relied on.

The terms of the contract will always be important in decision of whether or not a non-performance is fundamental. What a party is entitled to expect depends on what the contract provides. However, the parties may wish to go beyond merely indicating what the creditor is entitled to expect. They may wish to confer an express right to terminate for any non-performance, however minor, or even for something that is not non-performance at all. They are free to do so.

Similarly to the PECL, the DCFR sets out rules according to which, if an additional term is granted and the debtor still fails to fulfil the obligation, the creditor may terminate the obligation even if the breach was not fundamental. Also, the creditor has the right of termination for anticipated non-performance and for inadequate assurances of performance.

The right to terminate is exercised by way of a notice of termination, which must be given within reasonable time after the creditor's right of termination is created. DCFR article 3:508, paragraph 2, contains a new rule according to which, if the debtor has the right of cure, the creditor's right of termination is created after the time for cure has expired and the remedy has not been successful. If the notice is not given within reasonable time, the creditor loses the right to terminate.

Compared to the PECL, the DCFR lays down more specific rules on the effects on obligations under the contract (DCFR articles III.–3:511 to III.–3:515). As the main consequence, the parties no longer have the right of enforcement; however, they have rights and obligations concerning restitution. Certain rights and obligations arising from the contract survive; for example, termination does not affect any provision of the contract for the settlement of disputes. Restitution is not required where the performance was due in separate parts or was otherwise divisible and what was received by each party resulted from due performance of a part for which counter-performance was duly carried out.

3.4. Withholding of performance, price reduction, damages, and interest

The DCFR does not contain major substantive changes from the PECL when it comes to other remedies: withholding performance, price reduction, damages, and interest. There are, however, some new articles on interest — namely, III.–3:709 ('When interest to be added to capital') III.–3:710 ('Interest in Commercial Contracts'), and III.–3:711 ('Unfair Terms relating to Interest').

4. Conclusions

Performance and remedies for non-performance have central meaning in the law of obligations, especially in contract law, as they involve the rules that are often used for settlement of disputes. The rules on performance and non-performance have been thoroughly developed over a long period of time, first in development of the PECL and now in the preparation of the DCFR. Therefore, it may be said that both parts of the DCFR as analysed in this article — performance and remedies for non-performance — serve as a great example to states for legislative drafting as well as useful harmonised provisions of law for the European Union.



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The Draft Common Frame of Reference and “Cancellation” of Contracts

1. Introduction

In February 2008, the “Interim Outline Edition” of the Draft Common Frame of Reference (DCFR) was published under the title “Principles, Definitions and Model Rules of European Private Law”.^{*2} This version of the DCFR was prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group). A final edition, covering some more areas of law and completed with explanatory comments and comparative notes, will be published by the end of 2008.^{*3} The DCFR has the formal outline of a civil code, with books, chapters, sections, sub-sections, and articles. General rules on contracts are to be found in Book II (Contracts and other juridical acts), covering *inter alia* rules on formation, validity and interpretation of contracts, and in Book III (Obligations and corresponding rights), dealing with *inter alia* performance and remedies for non-performance. Book IV — consisting of parts A–G — contains rules on specific contracts.^{*4}

In this article, I will try to describe the interplay between the general and specific parts of the DCFR by testing the possible outcomes in cases where a party to a contract for one reason or other no longer wishes to receive performance from the other party.^{*5} The discussion will concentrate on three different types of specific contracts: sales, leases and construction contracts. First, a buyer of a machine does not want to receive the machine, as he has been offered a better and cheaper machine by another supplier; second, a lessee wants to return the leased car before the end of the lease period, as he has lost his driver’s license for health reasons; third, the client does not want the constructor to build the contracted warehouse on the client’s land, as the business for which the warehouse was intended is no longer profitable. Typically, the buyer, the lessee and the client do this in order to reduce their total liability under the contract.

The term ‘cancellation’ is used in its broadest sense to cover these three situations. However, it is not employed at all in the DCFR, and it is not suggested here as an exact term.

¹ Thanks to research fellow Katherine Llorca for valuable advice, in particular on language.

² C. von Bar et al. (eds). *Principles, Definitions and Model Rules of European Private Law*. München: Sellier 2008.

³ *Ibid*, pp. 3–5.

⁴ All references in the text regard the DCFR unless otherwise indicated.

⁵ As a member of the Study Group on a European Civil Code, I have profited from the discussions of the group and from unpublished drafts with comments and notes. However, all statements made here, errors included, are my own.

2. Delimitations

Several situations where a party is entitled to refuse to receive performance will **not** be dealt with in this article and they will be listed briefly.

We are not dealing with **termination for non-performance** of the seller's, lessor's or constructor's obligations. We will presuppose that timely and conforming performance is offered or would have been offered had the other party wished to receive it. On the other hand, the desire not to receive performance may well turn out to be a result of the party's inability or unwillingness to perform his own obligations.

Neither are we dealing with the situation in which a party invokes **invalidity** of a contract. A party that is not bound by the contract may reject performance by the other party, as there is no valid obligation to co-operate (concerning a contract party's obligation to co-operate, see section 3.2 below).

In some situations a party has a **right of withdrawal**. According to the DCFR, a consumer is entitled — subject to certain conditions — to withdraw from contracts negotiated away from business premises and from timeshare contracts (Book II Chapter 5).⁶ Withdrawal "terminates the contractual relationship and the obligations of both parties under the contract" (II.-5:105 (1)). This right of withdrawal may be exercised without the party having to give any reason and a buyer may well exercise his right of withdrawal just because he has stumbled across a better bargain.

A right of withdrawal or a right of "cancellation", with or without a fee, may **follow from the contract** itself, e.g. where the booking of hotel rooms for a conference may be changed within agreed deadlines according to the contract.

For some contracts, one or both parties may have a right to terminate the contract "for an extraordinary and serious reason", cf. for mandate contracts, IV.D-6:103 and 6:105. This means that a party may terminate the contract beforehand without having to pay damages, cf. IV.D-6:101 (5).⁷ This right to terminate for an extraordinary and serious reason, without liability in damages, should not be confused with the right to terminate a service contract at any time without giving reason (IV.C-2:111); in the latter cases, the other party may have a claim for damages, see section 6 below.

3. The general rules

3.1. Right to enforce performance of monetary claims

The most important rule concerning a contracting party's ability to limit liability by refusing to receive performance is found in III.-3:301, under the Section entitled "Right to enforce performance". This is a rule concerning **the other party's** right to enforce performance of payment. In the first paragraph of this Article, it is stated that the creditor is "entitled to recover money payment of which is due". Exceptions are found in paragraph (2):

Where the creditor has not yet performed the reciprocal obligation for which payment will be due and it is clear that the debtor in the monetary obligation will be unwilling to receive performance, the creditor may nonetheless proceed with performance and may recover payment unless:

- (a) the creditor could have made a reasonable substitute transaction without significant effort or expense;
or
- (b) performance would be unreasonable in the circumstances.

The essence of this provision is not easily grasped at first glance. It needs some reasoning based on the DCFR system of remedies. First, when a creditor is not allowed to enforce performance of an obligation, the most important remaining remedy for non-performance is typically a claim for damages (III.-3:701). Second, a claim for damages is normally limited to the extent that the creditor could have reduced his loss by taking reasonable steps (III.-3:705). Third, when the requirements in III.-3:301 (2) (a) and (b) are met, the party to whom the monetary obligation is owed is not allowed to "proceed with performance" of his own obligation. These three steps lead to the rule: when the requirements in (a) and (b) are met, the party to whom the monetary obligation is owed must accept that his claim for payment is converted into a claim for damages and that he is not entitled to damages for loss that could have been reduced by not proceeding with performance of his own obligation. For explanatory purposes, one might call it a "duty to terminate". From the perspective of the party owing the monetary obligation: by making it clear that he does not wish to receive performance, he reduces his liability under the contract by the amount that can be saved by the creditor's not proceeding with

⁶ See also for explanations and notes concerning relevant EC legislation. Contract I: Pre-contractual obligations. Conclusion of contract. Unfair terms. Prepared by Research Group on the Existing EC Private Law (*Acquis* Group). München: Sellier 2007.

⁷ Note the difference from the rule in BGB § 314, where a "Kündigung [...] aus wichtigem Grund" does **not** exclude damages.

performance – when, that is, the requirements in (a) and (b) are met. The provision in III.–3:302 (2) deals not so much with enforcement of monetary obligations as with the creditor's right to compensation for costs that could have been saved by not proceeding with performance. This is not surprising; the right to enforce monetary claims is not in itself an issue calling for much regulation.*⁸

The content and effects of the rule just discussed are best explained with the help of some illustrations concerning different specific contracts (sections 4–6 below).

3.2. Obligation to co-operate

Some comments should also be made regarding the character of the duty to receive performance. Under the DCFR, the creditor's duty to co-operate, including the duty to receive performance, is in principle a contractual obligation and the general rules on remedies for non-performance of obligations apply. The duty to co-operate is contained in several provisions concerning specific contracts, and it is expressed in general terms in III.–1:104 (Co-operation): "The debtor and creditor are obliged to co-operate with each other when and to the extent that this can reasonably be expected for the performance of the debtor's obligation." The qualification "when and to the extent that this can reasonably be expected" can hardly be seen as a deviation from the principle of regarding the duty to co-operate as an obligation, cf. also the wording "obliged". The qualification is better read as a reminder of the fact that the obligation to co-operate is often less explicitly regulated in the contract and that the contents of this obligation must be established according to the circumstances. There are no separate rules on *mora creditoris*.

One could object that III.–1:104, with its qualification, is rather diluted compared with Principles of European Contract Law Article 1:301 (4), where 'non-performance' is defined as "any failure to perform an obligation under the contract, whether or not excused, and includes delayed performance, defective performance **and failure to co-operate** in order to give full effect to the contract" (bold added). However, there is no reason to believe that this should be seen as a change of approach.*⁹

The obligation to co-operate may in principle be enforced under the rule on enforcement of non-monetary obligations (III.–3:302), subject to the general restrictions found in that provision. However, harmonisation with III.–3:301 (2) is obviously required: to the extent that the creditor is not allowed to proceed with performance under the latter rule, it would of course be contradictory to allow enforcement of the obligation to receive performance.

3.3. Property not accepted

When a party to a contract is not willing to receive "corporeal property other than money" and the other party for this reason is left in possession with the property, the latter party must take "reasonable steps to protect and preserve it". This follows from III.–2:111 (1). The person left in possession is entitled to reimbursement of costs (III.–2:111 (4)). These rules are relevant whether or not the performing party is allowed, under III.–3:301 (2), to proceed with his performance. Even where there is subsequently a substitute transaction, protection and preservation costs may have incurred in the meantime. On the other hand, the rules concerning the discharge of the performing party's obligations on the deposit, sale or disposal of the goods according to III.–2:111 (2) and (3) are relevant only where the party has a right to proceed with performance and recover payment. This will be commented upon in section 4 below.

4. The sale case

Our point of departure is the simple illustration mentioned in section 1: a buyer of a machine makes it clear, prior to delivery and payment, that he does not wish to receive performance. The reason is that he has found a better and cheaper machine elsewhere. How does this affect the contractual relationship?

⁸ Comments to III.–3:302 are not yet available, but the provision corresponds closely to Principles of European Contract Law article 9:101, and the comments to the latter provision confirm the interpretation just made, see O. Lando, H. Beale (eds.). Principles of European Contract Law. Parts I and II Revised. The Hague: Kluwer Law International 2000, pp. 391–394 (notes on national law are also found there).

⁹ See also the interesting comments in P. Schlechtriem, M. Schmidt-Kessel. Schuldrecht: allgemeiner Teil. Tübingen: Mohr Siebeck 2005, pp. 308–309, where the rules of BGB on *Gläubigerverzug* are characterised as *Relikt des alten Systems*, and it is stated that this institute is not known in the *Einheitsrecht* project. For Norwegian law, I have argued that the doctrine of *mora creditoris* (which is not laid down in legislation) is not needed anymore, see K. Lilleholt. Norway: Contract Law and Contract Legislation. – Turku Law Journal 2002 (4) 1, pp. 1–11, 5–6.

Under the DCFR, the buyer has an obligation to take delivery of the goods (IV.A–3:101 (b)), and this obligation is fulfilled by taking steps to enable the seller to deliver and by taking over the goods (IV.A–3:301).¹⁰ Further, the buyer is of course obliged to pay the price (IV.A–3:101 (a)).

There is no rule in Part A of Book IV corresponding to or deviating from III.–3:301 (2). A general reference to Book III, Chapter III is made in IV.A–4:101: “If a party fails to perform an obligation under the contract, the other party may exercise the remedies provided in Book III, Chapter 3, except as otherwise provided in this Chapter.” This means that the situation in our illustration is regulated by the rule in III.–3:301 (2).

Let us first suppose that the machine is ready for delivery at the time when the buyer makes it clear that he does not wish to receive performance.

The test under III.–3:301 (2) is (a) whether or not a “reasonable substitute transaction” can be made “without significant effort or expense” or (b) whether or not performance would be “unreasonable in the circumstances”. It is tempting to turn the question around: when is proceeding with performance **not** unreasonable?

Let us have a look at the alternatives. We must suppose that the seller will normally be interested in getting rid of the machine (in some cases, he might prefer to keep the machine and use it for own purposes, but the reasoning is the same). Further, there is probably no requirement under the DCFR that the seller must “earn” the price by enforcing delivery. It is sufficient that delivery be tendered (albeit this is not entirely clear, cf. the wording “proceed with performance” in III.–3:301 (2)). It seems, however, that the tender must be a lasting one, unless the seller is **discharged** in one of the ways described in III.–2:111 (2) and (3), by depositing the machine, selling it or otherwise disposing of it. The seller may choose to keep the machine ready for delivery for a long time, but he is entitled only to “reasonable” costs according to III.–2:111 (4). It should be noted that the seller is not entitled to keep gains exceeding the agreed payment. If the seller insists on recovering the agreed payment, he may sell the machine or otherwise dispose of it without paying the net proceeds to the buyer. Further, he may not keep and use the machine for his own purposes without crediting the buyer with its value.

- (1) If the seller does not proceed with performance, he will typically sell the machine to another customer (substitute transaction). If the transaction incurs a net profit, the buyer’s liability in damages will be reduced (III.–3:705). On the other hand, it could happen that the substitute transaction results in net costs or that the seller simply has to pay somebody in order to dispose of the machine. Such costs increase the buyer’s liability in damages (III.–3:702).
- (2) If the seller proceeds with performance and the buyer still refuses to receive performance, the seller may deposit the machine, sell it, or otherwise dispose of it (depositing the machine normally entails costs for the seller, so sooner or later he will have to sell the machine or otherwise dispose of it in any case if the buyer does not change his mind), III.–2:111 (2) and (3). A net profit must be credited to the buyer; net costs are added to the buyer’s liability in damages. Deposit costs should only be allowed for a period equal to that required to clarify the buyer’s position. The economic outcome will often be the same under this alternative as under alternative (1) or, put more exactly, typically not more profitable for the seller.
- (3) In principle, the seller may seek enforcement of the buyer’s obligation to receive the machine. Depending on national law, this could be done by way of coercive fines against the buyer or an order allowing the seller to leave the machine at the buyer’s property. Normally, the seller will be responsible for the costs of such enforcement, costs which he must rely on having covered as part of a claim against the buyer for damages. Under the present alternative, the buyer will typically have to pay more than under the two former alternatives, but it is hard to see how the **seller** will be better off.

There may be some odd cases where the buyer is the only person who can take care of the machine (there are some dangerous substances in the machine and the buyer has some monopoly in handling such waste). Then alternative (3) will be the seller’s preferred option. Such cases are odd in the form of sale contracts; normally the owner has to pay to get rid of waste, and then it is a service contract.

Apart from the odd cases just mentioned, our discussion demonstrates that the economic outcome will typically be much the same under alternatives (1) and (2), while alternative (3) is typically more expensive to the buyer, without the seller being better off at all. It seems fair to conclude that proceeding with performance in the form of seeking enforcement of the buyer’s obligation to receive the machine should often be regarded as “unreasonable” under III.–3:301 (2). Further, a substitute transaction – alternative (1) – will typically be “reasonable” as there is nothing to be gained by choosing alternative (2).

Does it make sense for the buyer to refuse to receive performance? If a substitute transaction will result in a net profit, the buyer could receive the machine, resell it at once, and obtain more or less the same result. Refusing to receive performance may, however, be attractive for several reasons: transportation costs can be

¹⁰ There are some terminological discrepancies in the DCFR: “taking over the goods” in IV.A–3:301; “take control of the goods” in IV.B–5:103 (b).

saved; it may be easier for the seller to find a new customer; perhaps the buyer's liquidity does not permit him to pay the full price and then wait for the proceeds from the resale.*¹¹

Now let us suppose that the machine must be produced by the seller or procured from a supplier, in both cases according to the buyer's specifications. At the time the buyer makes it clear that he will not receive performance, the machine has still not been completed or has not yet not been ordered from the supplier.

The alternatives regarding the seller's need to get rid of a half-finished machine are the same as described above and will not be commented upon.

Whether or not it is rational to complete production of the machine depends on the circumstances. Sometimes the value added by completing the production is higher than the costs; sometimes it is the other way round. At this point the seller and the buyer will typically have concurrent interests. A more important observation, however, is that it should normally be regarded as "unreasonable" to proceed with production if this only adds to the seller's loss. Often, it would be a mere waste of resources to complete a machine which is specially designed for a buyer who can no longer make use of it.*¹²

5. The lease case

In the lease case, a lessee wants to return the leased car before the end of the lease period, as he has lost his driver's license for health reasons. It should be noted that a lease for a definite period may not as a rule be terminated unilaterally beforehand by giving notice, cf. IV.B-2:102 (1). Nor is there a right to terminate the lease unilaterally for an "extraordinary and serious reason" or the like.

The lessee is of course obliged to pay rent (IV.B-5:101), and he must co-operate by taking reasonable steps in order to enable the lessor to make the goods available and by taking control of the goods (IV.B-5:103). Further, the lessee has obligations of care etc. during the lease period (IV.B-5:104-108), but the obligation to keep the goods throughout the lease period is expressed more indirectly in IV.B-6:103 (Right to enforce payment of monetary obligations).

It is stated in the first paragraph of IV.B-6:103 that the lessor is entitled to "recover payment of rent and other sums due". The second paragraph regulates the situation where the lessee makes it clear before the goods have been made available to him that he is unwilling to receive performance; the provision is a paraphrase of III.-3:301 (2). The third paragraph is an adaptation of the same rule for the situation where the goods have already been made available to the lessee:

Where the lessee has taken control of the goods, the lessor may recover payment of any sums due under the contract. This includes future rent, unless the lessee wishes to return the goods and it would be reasonable for the lessor to accept their return.

"Cancellation" where the goods are still not made available to the lessee is the closest parallel to the sale case discussed in section 4. These cases will be left aside here. It should merely be noted that possible substitute transactions as well as halting of production or procurement of the goods specified by the lessee are also important elements of a test of reasonableness here.

In contrast to sale contracts, a lease implies a lasting performance, in that the lessor must ensure that the goods remain available for the lessee's use throughout the lease period (IV.B-3:101 (3)). Ordinarily, rent must also be paid at intervals during the lease period (IV.B-5:102). The lessee may therefore be unwilling to receive **future** performance even when the goods have already been made available. The lessee may wish to return the goods for two main reasons: the costs of keeping the goods may be saved and the liability for future rent may be reduced, either by a substitute transaction made by the lessor or by the lessor's making use of the goods for his own purposes.

Theoretically, it could be envisaged that the lessor must accept the early return of the goods without losing the right to recover rent at agreed intervals for the remaining part of the lease period. This is not, however, the solution given in IV.B-6:103 (3). If the lessor must accept return of the goods, he cannot enforce his claim for future rent but must settle for a claim in damages.

The decisive criterion in IV.B-3:101 (3) is whether or not it would be reasonable for the lessor to accept return of the goods (prior to the end of the lease period). The goods belong to the lessor and he must ordinarily be prepared to have them returned sooner or later. It is obvious, though, that the lessor may have a legitimate interest in being relieved of the responsibility of keeping the goods for the agreed lease period. This may even be the main motive for the lease contract in the first place (e.g. where somebody leases out his boat while

¹¹ It has been observed that such constellations typically make room for the parties to negotiate a solution, see H. Beale. Remedies for breach of contract. London: Sweet & Maxwell 1980, pp. 146-147.

¹² "Cancellation" in such cases is specifically dealt with in the Sale of Goods Acts of Finland, Iceland, Norway and Sweden (§ 52).

abroad for a period).^{*13} In such cases the result may be that it is **not** reasonable for the lessor to have to accept return of the goods. The possibilities of a substitute transaction must also be taken into account. If an acceptable new lessee can be found (or a buyer, depending on the circumstances), this may be sufficient to make it reasonable to accept return of the goods. In situations like these, it is therefore not unusual for the lessee to find a prospective new lessee and suggest him to the lessor.

It should be noted that a lessee has fewer choices than a buyer in a situation where the goods cannot be used for their original purpose. The buyer may receive the goods and resell or otherwise dispose of them. The lessee has, as a rule, no right to sublease the goods or assign his rights under the lease contract without the lessor's consent (and no right, of course, to sell the goods), cf. IV.B-7:102 and 7:103.

However, if consent to a sublease is withheld without good reason, the lessee may terminate the lease by giving a reasonable period of notice, cf. IV.B-7:103 (2). This is a right to terminate the contract prior to the end of the agreed lease period and such termination discharges the lessee's obligation to pay future rent.

Our case with the lessee having lost his driver's licence may then have several different outcomes:

- a) The lessee may make it clear that he wishes to return the car before the end of the lease period. If it is reasonable for the lessor to accept return of the car, the lessor may not recover future rent at agreed intervals, but is entitled to damages only. The lessor must take reasonable steps to reduce his loss, typically by leasing the car to a new lessee for the remainder of the lease period.
- b) The lessee may ask for the lessor's consent to sublease the car. If the lessor's consent is withheld without good reason, the lessee may terminate the lease by giving a reasonable period of notice and then be discharged of the obligation to pay future rent.
- c) If it is not reasonable for the lessor to accept return of the car, and there is good reason to withhold consent to a sublease (or it is not possible to find anyone willing to sublease the car), the lessee must keep the car and pay the rent at the agreed intervals.

The outcome under c) is probably practical, at least as far as car leases are concerned, particularly in situations where only a relatively short period remains of the agreed period. The lessor may have entered into a new lease starting from the expiry of the agreed lease period, and may not wish to bring in a new lessee or sublessee for a short period only; taking care of the car in the meantime may also be difficult.

6. The construction case

In our construction case, the client does not wish the constructor to build the contracted warehouse on the client's land, as the business for which the warehouse was intended is no longer profitable.

In the DCFR, construction contracts form a sub-group under service contracts and are regulated partly by general rules found in Books II and III, partly by the general rules on services (Book IV.C Chapter 2) and partly by particular rules on construction contracts (Book IV.C Chapter 3).

The client must pay the price (IV.C-2:101) and he is obliged to co-operate, in particular to provide access to the site where the construction has to take place (IV.C-3:102 (a)).

Under the service principles, the client has a general right to "terminate the contractual relationship at any time by giving notice to the service provider", cf. IV.C-2:111 (1). No damages are payable if the termination is justified, cf. IV.C-2:111 (3). Unjustified termination is dealt with in IV.C-2:111 (4):

When the client was not justified in terminating the relationship, the termination is nevertheless effective, but the service provider may claim damages in accordance with the rules in Book III.

Possible justifications for a termination are dealt with in IV.C-2:111 (5). Suffice it to say that the client in our construction case is **not** justified in terminating the contractual relationship just because he cannot make use of the contracted building. The termination is still effective, but the constructor has a claim for damages that will put him as nearly as possible in the situation in which he would have been had the client's obligation been duly performed.

We see then that after the termination there is no longer an obligation to provide access to the site and hence no such obligation to enforce. Further, the termination puts an end to the client's obligation to make payments under the contract; this obligation is converted into an obligation to pay damages. How much the client will have to pay depends on the circumstances, *inter alia* how much of the work has already been performed when the contractual relationship is terminated. Normally, the termination will save the costs of continued investments in a building that is no longer needed.

¹³ Illustration in K. Lilleholt et al. Lease of goods (PEL LG). Munich: Sellier 2008, p. 264.

7. Conclusions

We have seen that refusing to receive the other party's performance (or further performance) often makes sense for the buyer, the lessee and the client under a construction contract. The formal point of departure, found in III.–3:301, is that the creditor may proceed with performance and recover payment. The other party's obligation to co-operate may in principle be enforced and in some cases it is probably sufficient to tender performance in order to be entitled to payment. There are, however, important exceptions in III.–3:301 (2): where performance would be unreasonable, in particular where a reasonable substitute transaction is possible, the claim for payment is converted into a claim for damages.

The general rules found in III.–3:301 (2) apply fully to sale contracts. We have seen that performance will be unreasonable in many cases where "tailored" goods are to be produced or procured for the buyer and often also in cases where it is possible to obtain a substitute transaction resulting in a net profit. There may, however, be some odd cases where the seller has a legitimate interest in proceeding with performance and sometimes even enforcing the buyer's obligation to co-operate by receiving the goods.

For lease contracts, the general rules must be supplemented, both with a rule concerning situations in which the goods have already been made available for the lessee's use and the lessee wishes to return the goods (IV.B–6:103 (3)) and with a rule on termination of the lease where consent to sublease the goods is withheld without good reason. For lease contracts, too, there may be cases where it is reasonable for the lessor to proceed with performance.

The simplest rule is found in the case of service contracts, including construction contracts: the client may prevent performance (or continued performance) by terminating the contractual relationship, thus converting the claim for payment into a claim for damages. For these contracts, it has obviously not been found sufficient to adapt or to supplement the general rule, as the performance of a service that is no longer wanted should not be allowed. The termination rule should rather be seen as a deviation from the general rule.

The illustrations demonstrate that there are good reasons for supplementing the general rules on contracts with rules on specific types of contracts, this being an achievement of the DCFR as compared with the Principles of European Contract Law. It might be argued, though, that the flexibility of the general rule should make it possible to reach acceptable results for lease contracts and service contracts as well.



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The Present State of Harmonisation of Bulgarian Private Law, and Future Perspectives:

Historical Development and Scope of the Private Law — Compliance with European Private Law

1. Historical development

There are three main eras in the development of the Bulgarian law of contract. The first one was influenced mainly by the French legal tradition and doctrine; the second was predetermined by the same Roman approach to legislation, on the one hand, but also by German scholarship, on the other; and the third is subject to the influence of the market economy and the domination of European law.

In the period 1892–1950 (between the liberation of Bulgaria from the Ottomans and a short time after the socialist period), the resolutions of the French Code Civil were followed primarily, adopted through the old Italian Codice Civile. This led logically to adoption of the French and Italian doctrinal underpinnings.

The reception of the French tradition was not absolute or complete, however. Just as an example, commercial and bankruptcy law followed the German model, received through Hungarian and Rumanian patterns. The procedural law was under strong Russian influence.

In 1950–1989 (from a few years after the seizure of power through the Communists until the political changes of 1989), a full ‘clearing away’ of the ‘old’ law took place. As an interesting example one could mention the law on the repeal of all laws adopted prior to 9 September 1944.¹ This ‘clearing away’ was not, however, a radical one. Most of the ideas of the civilian tradition were kept, although garnished with several ideological patterns. Here should be mentioned the following important legal acts:

¹ Published in *Darzhaven Vestnik* (D.V.) No. 93/1951 (in Bulgarian).

- The structure of the new Law on Obligations and Contracts (LOC) of the year 1950^{*2} was changed in comparison to that of the old one (this structure was more or less influenced by the structure of the general part and the contract law portion of the German BGB). Many of the shortcomings of the old LOC were avoided here; new institutes were introduced (such as representation and unilateral transactions); and material on matters regulated in other laws was included and transposed from other *sedes materiae* and abrogated laws: (1) donation matters (from the Inheritance Law), (2) bill of exchange effects (from the Commercial Law), (3) prescription (from the Law on Prescription), and (4) privileges and mortgages (from the Law on Privileges and Mortgages);
- The Ownership Law (1951)^{*3} was written to be much shorter than the preceding Law on Property, Ownership, and Easements;
- The Inheritance Law (1949)^{*4} established the abolition of unequal treatment of the sexes and limited the scope of the institution of legal heirs;
- The Civil Procedure Code (1950)^{*5} was made much shorter than the previous Law on Civil Legal Procedure, and *ex officio* principles of the civil procedure were introduced;
- Family law saw a rapid and dynamic development through the years — here are to be mentioned only three main acts: the Law on Persons and Family (1949)^{*6}, the Family Code (1968)^{*7}, and the Family Code from 1985^{*8} (which is still in force); and
- The private international law had for a long time no central legal regulation; separate provisions are set forth in numerous statutory instruments and bilateral legal assistance contracts.

In spite of the power of the Communist regime in Bulgaria, private law has remained unaffected overall by tendencies to imbue works overly with ideology. However, its development has been delayed to the point of discontinuance because of the underdeveloped civil circulation. And that, along with the ideological prohibitions on the invocation of Western European literature and the inaccessibility thereof, has had its unfavourable isolating effect upon the doctrine.

Some of the Bulgarian scholars undertook an interesting approach in that era. As they could not cite or refer to a piece of Western literature (because of the ideological prohibitions, the latter could only be condemned), they found Soviet authors who supported the relevant opinion and cited the latter instead of the Western original transcripts.^{*9}

Since 1989, the majority of the existing effective law has been preserved and cleared of its purely ideological traces. New laws are being enacted because of the transition from a centralised to a market economy. Intensive harmonisation of the Bulgarian civil law with the EC and EEC directives took place, in a process that remains in progress. The most important developments here are:

- The adoption of the Trade Law (TL)^{*10} (1991–1996) and a number of specific laws regulating the new business realities;
- The introduction of numerous restrictive regimes regarding (1) exchange transactions, (2) securities, (3) state-owned and municipal property, (4) public procurements, (5) privatisation, and a number of other fields;
- The harmonisation of Bulgarian private law with European law — a number of directives the transposition of which has not been of particularly high quality (with the exception of the directives in the field of company law), with a ‘flood’ of legislative instruments, not infrequently resulting in destruction of the systematics and coherence of private law being observed in the last 15 years — and
- The adoption of the first Bulgarian Code of Private International Law (CPIL)^{*11} (2005).

Today’s Bulgarian contract (and private) law cannot be unambiguously referred to as within any of the three traditional families of law — the Roman, the German, or the Anglo-Saxon tradition.

² D.V. 275/1950 (in Bulgarian).

³ D.V. 92/1951 (in Bulgarian).

⁴ D.V. 22/1949 (in Bulgarian).

⁵ Izvestija (Izw.) 12/1952 (in Bulgarian).

⁶ D.V. 182/1949 (in Bulgarian).

⁷ D.V. 23/1968 (in Bulgarian).

⁸ D.V. 41/1985 (in Bulgarian).

⁹ See, e.g., the books of L. Vassilev. General Part of the Civil Law. Sofia: Nauka i izkustwo 1956 (in Bulgarian); Al. Kozuharov. Law of Obligations, General Part. 3rd ed. Sofia: Nauka i izkustwo 1958 (in Bulgarian); V. Tadjer. General Part of the Civil Law. Vol. 1 (1971) and Vol. 2 (1973). Sofia: Nauka i izkustwo (in Bulgarian).

¹⁰ D.V. 48/1991, last amended D.V. 105/2006 (in Bulgarian).

¹¹ D.V. 42/2005 (in Bulgarian).

Legal regulation is under strong French influence and possesses numerous German elements as well. In certain laws (e.g., the Law on Public Offer of Securities^{*12}, the Law on Registered Pledges^{*13}, and the Law on Companies with a Special Investment Objective^{*14}), the Anglo-Saxon influence can be observed as well.

At the same time, the doctrine is unambiguously under German influence, though with clearly obvious traces of Roman law.

There were two attempts at creating a civil code — in the 1970s and the mid-1990s. The first of these drafts is already forgotten; the second one had very dubious qualities, and, fortunately, there is no real chance for its adoption. The contemporaneous state of extremely dynamic legislation and the division of the private law into three parts (business-to-business, business-to-consumer, and consumer-to-consumer law) makes codification an extremely difficult project and perhaps impossible to plan or realise.

As has been mentioned already, the Bulgarian private law is not a codified one. This circumstance, once evaluated as a shortcoming, is nowadays sooner a blessing, as transposition of the EU legislation can be done without reordering of the corpus of the classic civil law.

Because of this particularity of the Bulgarian legal system, harmonisation with the EU law remained separate in several areas of *leges speciales* and was not incorporated into the classic civil legislation.

2. The three domains of Bulgarian law of contract

Currently, Bulgarian law of contract is not a homogenous phenomenon. Thus, it bears a resemblance to mediaeval legal systems with their guild-type organisation. There exist three parallel regimes: those covering business-to-business, business-to-consumer, and consumer-to-consumer relations. It is only for the latter circle of relationships that the classical law of contract remains valid. For business-to-business relationships, it is the commercial law that is valid, and consumer law applies for business-to-consumer relationships.

It is a consolation that such developments are observed also in a number of other European states. Such influences can be seen in the Principles of European Contract Law (PECL) and in the Common Frame of Reference (CFR) as well.

Fortunately, the differences among these three domains do not amount to a gap. It can be said that commercial law is *jus privatum* regarding *jus commune* of civil law, while consumer law is *lex specialis* regarding *lex generalis* of general private law.

3. The influence of the PECL/CFR and other systems on Bulgarian private law

Unfortunately, there is no influence of the PECL on the Bulgarian legal system. The Vienna Convention on International Sale of Goods (CISG) is part of the internal Bulgarian law; the international usages, practices, and uniform rules of the ICC have a broad acceptance in Bulgaria. However, the PECL, the Principles of International Commercial Contracts, and — because of its novelty — the CFR are not popular.

I remain slightly pessimistic about the rapid acceptance of the CFR in Bulgaria, for the following reasons:

- The consideration of the CFR or PECL is an occupation that constitutes a luxury.
- Luxury occupations are preserved for people whose primary needs are satisfied.
- The latter condition is not yet met in Bulgaria, especially with the Bulgarian legal community.
- The flood of legislation in the last 15 years or so leads most practitioners of jurisprudence to show interest only in the legislation that is in force and not in future developments.
- The gaps and dangers connected with an unknown legal act are frightening for most lawyers.
- The uncertainty of possible (and impossible) interpretations from the courts is not very conducive to further developments either.
- Conservatism plays its disastrous role as well.

¹² D.V. 114/1999, last amended D.V. 52/2007 (in Bulgarian).

¹³ D.V. 100/1996, last amended D.V. 34/2006 (in Bulgarian).

¹⁴ D.V. 46/2003, last amended D.V. 52/2007 (in Bulgarian).

- Fear stemming from ignorance of languages different from Bulgarian has an effect.
- Lack of commentary and related literature does not contribute to the popularity of these rules.
- The possibility for choice of the applicable law is endangered by the uncertainty with regard to the future Brussels II regulation.

Despite the above facts, which seem to amount to huge desperation, there are several circumstances inspiring hope:

- My students are very enthusiastic about the PECL and the rumours concerning the CFR.
- Some of my colleagues are interested as well.
- A new generation is growing up, one that is much more open-minded and cosmopolitan.
- This new generation is gradually occupying the courts of first instance.

The politicians are, from my point of view, in total ignorance of this development.

Some time ago, I met the Minister of Justice because of rumours related to repeated amendments of the Bulgarian Law on Obligations and Contracts. I informed her of the existence of the PECL and the future development of the CFR. On the one hand, the minister's being very surprised was a little sad; on the other hand, however, she was really very interested in the PECL and in the CFR as well, which is promising. I was asked to prepare brief informational material of the memorandum type for submission. By the end of the year, I will have completed this task.

From my point of view, the following measures are possible and indeed necessary in Bulgaria:

- Translation of the CFR into Bulgarian — the high quality of this translation is a prerequisite for further success.
- Further teaching in private law that addresses the context of international soft law frameworks.
- *Exempla docent* — broader acceptance of the rules abroad will become an impulse for Bulgarian doctrine and legislation.
- The European Commission's communication in some way again, after the publishing of the CFR, which should provide a huge push forward.
- A short — I stress, very short — commentary on the CFR, which should prove very helpful.



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Reform of Contract Law in Estonia: Influences of Harmonisation of European Private Law

Estonia has become known as one of the most reform-inclined countries in Europe. Rapid restructuring of the economy in the spirit of liberalism, reform of the entire private law system upon the principle of private autonomy, and adaptation of the legal system to the EU accession requirements were completed swiftly and without long discussions.^{*1} The first laws were the reform laws, the aim of which was to support economic reforms, but also the first parts of the new Civil Code were adopted quite soon after the regaining of independence.^{*2} The legislative process was from the beginning to be largely influenced by the decision of the Estonian Parliament from 1992 on the continuity of legislation, but, fortunately, this was only a parliamentary policy decision and did not indicate a direction that it was obligatory to follow. In practice, the recommendation to use old laws or drafts from the first independence to draft the new legislation on contract law was ignored.^{*3} The Law of Obligations Act^{*4}, adopted on 28 September 2001 and entering into force on 1 July 2002, has been influenced by the most important sources of European harmonised private law, such as the Principles of European Contract Law (PECL), the Principles of International Commercial Contracts (UNIDROIT principles), and the 1980 Convention on Contracts for the International Sale of Goods (CISG). Also the civil laws of European countries were taken into account as models for drafting the LOA. Most influential were the

¹ About the legal reforms in Estonia see P. Varul. The Creation of New Estonian Private Law. – European Review of Private Law (ERPL) 2008/1, p. 95 ff; P. Varul. Legal Policy Decisions and Choices in the Creation of New Private Law in Estonia. – *Juridica International* 2001, p. 104 ff. Also M. Käerdi. Estonia and the New Civil Law. – H. Mac Queen et al. (ed.). *Regional Private Laws & Codification in Europe* 2003, p. 250 ff; N. Reich. Transformation of Contract Law and Civil Justice in the New EU Member Countries: The Example of the Baltic States, Hungary and Poland. – F. Cafaggi (ed.). *The Institutional Framework of European Private Law* 2006, p. 271 ff.

² First was the Property Law Act (*asjaõigusseadus*), adopted on 9 June 1993, entered into force on 1 December 1993. – RT I 1993, 39, 590 (in Estonian). Available in English at <http://www.legaltext.ee/indexen.htm> (18.08.2008).

³ Resolution of the *Riigikogu* (Estonian Parliament) concerning the continuity of legislation. – RT 1992, 52, 651 (in Estonian). During the first independence from 1918–1940 the Estonian codification process had been nearly completed before the Soviet takeover in 1940, but the Civil Code of 1939 was never formally enacted. The Civil Code of 1939 was influenced largely by the German Civil Code and the Swiss Civil Code. The tradition of pandectistic civil codes had been introduced in Estonia even before 1939, as the first major written body of law in the territory of Estonia – The Baltic Private Law Code (BPLC) – dates back to 1863. The BPLC had been in force in Estonia as a result of the so-called Baltic Special Rights granted to the Baltic countries by Russia (Estonia had been a part of Russia from the beginning of the 18th century), and it had been allowed to maintain the predominant Baltic-German law that had been in force here before the Russian Empire. See also M. Luts. Private Law of the Baltic Provinces as a Patriotic Act. – *Juridica International* 2000 (V), pp. 157–167.

⁴ Law of Obligations Act (*võlaõigusseadus*), adopted on 28 September 2001, entered into force on 1 July 2002. – RT I 2001, 81, 487 (in Estonian). Available in English at <http://www.legaltext.ee/indexen.htm> (18.08.2008).

German Civil Code, the Swiss Code of Obligations, and the civil codes of Austria and the Netherlands.⁵ The decision to follow the model of a pandectic civil code and adopt parts of the civil code as separate legal acts guaranteed that the most important fields of civil law were reformed first and that the whole of private law was drafted under the same principles. Work on the Law of Obligations Act started in 1994 when the first commissions were organised.⁶ The principal commission, for the civil and commercial code, started its work in 1992. Today when we are discussing the future development of European private law and the result of the work done by the Study Group on a European Civil Code on a Common Frame of Reference⁷, the experiences of different European countries in modernising or reforming their national private law become highly valuable. The following brief overview of the main sources and influences in the legal drafting of the new Estonian contract law system concentrates only on some critical moments and conclusions.

1. The main influences — our own history and European private law

The relevant guidelines from 1992 in the decision on the legal continuity of the Republic of Estonia determined unambiguously the effect of the historical argument concerning legislation. The main effect entailed by such an approach was the justified ties with the German legal family facilitated by the historical argument of the legislator following regaining of independence.⁸ It must be pointed out that the most important model from the era of the first independence was the draft Civil Code of 1939. It was an updated and simplified version of the Baltic Private Law Code (from 1864), which consisted of five books and had some significant implications derived from the most important classical private law codes of the beginning of the 20th century, such as the German and Swiss civil codes and the Austrian Law of Obligations, as well as legal acts of Scandinavian countries; the draft codes of Hungary, Czechoslovakia, and Poland; international conventions; and draft laws.⁹ The draft from 1939 was prepared under the guidance of Professor Uluots for more than 15 years and could not be approved by the Estonian parliament because of the occupation in 1940. Through intensive discussions in the early 1990s, it became evident that the mere reintroduction of the old draft statutes from the 1940s would not serve the needs of the society and that the goal should be to create a new, modern, comprehensive civil code. Specifically, in the field of contracts and non-contractual obligations it was impossible to follow the old law. Influences from Soviet law were quite strong until 2002, when the new LOA replaced the old Soviet Civil Code from 1965. Here we have to remember that contract law was governed not by the principle of autonomy but by discretionary regulation, obligation to conclude a contract, and binding law. During the time of the Soviet Republic of Estonia, transactions between enterprises (there was no concept of legal person) were regulated by public-law-like rules on state procurement, there was no concept of real property, all land belonged to the state, and contracts between natural persons were restricted to items of personal and family use.¹⁰ Changes in the legal system were revolutionary — they changed the entire way of thinking, understanding the role of law and justice in the society, the tasks of the lawyers, and the meaning of law generally. As the goal of civil law reform was set as creation of a completely new, modern and democratic civil law that meets the needs of a market economy, it influences also how lawyers think of law and understand it. In speaking about the influences from the recent past, we should recognise that the main purpose of the reform was to make a break from the past and build a new legal system, one based on principles common to all European countries and legal systems.

There were many important decisions made that influenced the reform of the system of Estonian private law. The most important of these was the choice of the Germanic family of law as the main model for the drafting of new laws¹¹, but at the same time drafting of the acts was based on a comparative approach. The main

⁵ P. Varul (Note 1), p. 99. See also M. Käerdi (Note 1), p. 250 ff; N. Reich (Note 1), pp. 271–302. See also I. Kull, A. Hussar. *Codi del dret civil d'Estònia: procés i experiència en l'aplicació de la nova llei* (Codification of Civil Law in Estonia — process and experience in applying the new law). *Revista Catalana de Dret Privat* 2006/7, pp. 167–194 (in Catalan).

⁶ H. Mikk. *Tsiviilõiguse reformist Eesti völaõiguse ja tsiviilseadustiku eelnõude valguses* (About the Reform of Civil Law in Estonia on the Example of Drafts of Law of Obligations Act and Civil Code of 1940). Presentation at the Sixth Annual Conference on Notaries and Real Property Registry, 13–15 May 1999. – *Ettekanded. Eesti Vabariigi Justiitsministeerium* (Presentations. Republic of Estonia Ministry of Justice), 1999, pp. 122 (in Estonian).

⁷ Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference (DCFR). Interim Outline Edition. Ed. by Study Group on a European Civil Code/Research Group on EC Private Law (Acquis Group). Sellier, European Law Publishers 2008.

⁸ M. Käerdi. Regulation of Limitation Periods in Estonian Private Law: Historical Overview and Prospects. – *Juridica International* 2001 (VI), p. 66.

⁹ *Ibid.*, p. 67.

¹⁰ More about the “Baltic Revolution” see N. Reich (Note 1), pp. 275–279 ff.

¹¹ About the development of the new Estonian private law see P. Varul (Note 1), pp. 104–118. Also M. Käerdi (Note 1), p. 250 ff; N. Reich (Note 1), pp. 271–302. See also I. Kull, A. Hussar (Note 5), pp. 167–194.

goal was to draft an act that would outlive or at least easily cope with the inevitable unification process of private law in Europe. Here we have to refer to our past once again. In the explanatory memorandum of the draft, Professor Uluots wrote in 1936 that “Estonia is a country with a rich civil law past while its historical development has been excessively unique, consisting of elements that originate from ancient to modern era. This legacy had to be updated and supplemented.”¹² One may see that these words are not outdated even today. There is a tradition of comparative research, searching for the best solutions from other legal systems and adapting them to our own legal traditions and culture — to our understanding of fairness, reasonableness, and needs of real life.

The fact that Estonia was cut off from the roots of its legal traditions had in that sense also some positive effects. As the new civil law was basically initiated with a blank slate, with no predetermined authorities, we were indeed offered a unique opportunity to realise all those unification and harmonisation ideas that most of Europe can only dream of.¹³ A feature specific to the civil law reform in Estonia was the codification in step-by-step principles, starting with the most urgent subject matter in property law and concluding with the Law of Obligations Act in 2002. The first book — the Law of Property Act — came into force in 1993 in order to create a foundation for the emerging immovable property commerce.¹⁴ The second book was the General Part of the Civil Code Act¹⁵ (GPCCA), which represented a mixture of the Civil Code from 1965 and the principles derived from the draft Civil Code of 1939¹⁶ and which was renewed in 2002. Then the Family Law Act¹⁷ in 1995 and the Law of Succession Act¹⁸ in 1996 followed. As a result of the monist system of Estonian private law, the imaginary Civil Code (five books as separate acts) applies to legal relationships between business and private individuals in a uniform manner.¹⁹ It was decided that there would be no commercial code dealing with business transactions and no consumer code for consumer transactions. The Consumer Law Act has been in force since 1994 but from 2002 has consisted of reference to the LOA concerning private law relations. Now the LOA contains special rules and exceptions to general provisions that apply only to B-to-B or B-to-C contracts, mainly granting more freedom in contracts concluded in the course of professional or economic activities and providing restrictions and mandatory rules for consumer contracts.

During the preparatory phase, it was decided not to copy the law of any particular country.²⁰ Thus, the working group decided to select a particular type of legal system as its basic model and use other sources for better solutions (legal acts of Switzerland, the Netherlands, Denmark, France, Italy, and the Nordic countries).²¹ The basic model was the Germanic legal system, and the draft of the LOA was largely modelled on the German Civil Code (BGB) and particularly the draft proposing modification to the BGB (BGB-KE).²² In contrast, provisions on non-contractual liability were based extensively on provisions of the Swiss draft law.²³ The available court practice of the respective countries and the actual application of various provisions were taken into account. Because of time limits, no significant attention has been paid to issues such as the social consequences of innovations and their impact on the formation of legal culture or changes in it. In the understanding

¹² J. Uluots. *Seletuskiri Tsiviilseadustiku 1936. aasta eelnõu juurde* (Explanatory Memorandum to the Draft Civil Code of 1936 written by Professor J. Uluots).

¹³ M. Käerdi (Note 1), pp. 255–257.

¹⁴ It was amended and modified after the adoption many times, because “For certain, the text of the law reflects the lack of knowledge and the chaotic nature of the period”. It was advanced primarily on the basis of the German Civil Code although the codes of, for instance, the Netherlands and Louisiana were also analysed. P. Pärna. *The Law of Property Act. Cornerstone of the Civil Law Reform.* – *Juridica International* 2001, pp. 89, 90.

¹⁵ *Tsiviilseadustiku üldosa seadus*. Adopted on 27.03.2002, entered into force on 1.07.2002. – RT I 2003, 78, 523 (in Estonian); last amendments 21.02.2007. Available in English at <http://www.legaltext.ee/indexen.htm> (18.08.2008).

¹⁶ M. Käerdi (Note 8), p. 69.

¹⁷ *Perekonnaseadus*. Adopted on 12.10.1994; entered into force on 1.01.1995. – RT I 1994, 75, 1326 (in Estonian); last amendments 8.03.2006. Available in English at <http://www.legaltext.ee/indexen.htm> (18.08.2008).

¹⁸ *Pärimisseadus*. Adopted on 15.05.1996, entered into force on 1.01.1997. – RT I 1996, 38, 752; last amendments 15.06.2005. Available in English at <http://www.legaltext.ee/indexen.htm> (18.08.2008).

¹⁹ The Commercial Code entered into force in 1995 and consists of rules regulating commercial corporations, no special rules about the transactions or other civil law matters. See *äriseadustik*. Adopted on 15.02.1995, entered into force on 1.09.1995. – RT I 1995, 26/28, 355 (in Estonian); last amendments 6.12.2006. Available in English, but not updated, at <http://www.legaltext.ee/et/andmebaas/ava.asp?m=022> (18.08.2008). The Consumer Protection Act consists of mainly public law rules on rights of the consumers, consumer organisations and refers to the Law of Obligations Act as main legal act consisting of rules on consumer protection. See *tarbijakaitse seadus*. Adopted on 11.02.2004, entered into force on 15.04.2004. – RT I 2004, 13, 86 (in Estonian); last amendments 15.12.2005. Available in English at <http://www.legaltext.ee/indexen.htm> (18.08.2008).

²⁰ Legal systems have had and will have mutual effects through different channels. The loaning of an entire codification from another country may have a particularly large impact on the legal system. Cf. P. de Cruz. *Comparative Law in a Changing World*. London, Sydney 1999, pp. 485–486.

²¹ The comparative approach was in the Estonian case a pragmatic one. See M. Käerdi (Note 1), p. 257.

²² *Abschlussbericht der Kommission zur Überarbeitung des Schuldrechts*. Herausg vom Bundesminister der Justiz. Köln: Bundesanzeiger 1992.

²³ V. Köve. *The Influence of PECL on Estonian Law of Obligations Act.* – I. Kull (ed.). *Development of Estonian Contract and Company Law in the Context of the Harmonized EU Law I*. Tartu 2007, p. 125.

that any change can be effective only if it is assimilated into the deeper structures of law and social life, the commission intentionally accepted the risk that there will be changes in the society in the future.^{*24}

The Law of Obligations Act stands out in its unusual textbook-like style. Firstly, this is evident in its numerous legal definitions. The attempt to formulate legal definitions becomes apparent in all areas of law, not in private law only. Secondly, Estonian legislation stands out in the detailed nature of its regulation.^{*25} The history of Estonian jurisprudence and legal science had experienced many fallbacks in the last few centuries, and the aim of giving to the legal acts also some didactic functions seemed to be reasonable. One can find, for example, special articles about the principle of dispositivity (LOA § 5), good faith^{*26} (LOA § 6), reasonableness^{*27} (LOA § 7), and *pacta sunt servanda* (LOA § 8) formulated under the models of the PECL and PICC in the LOA. Some of the rules in the LOA were formulated under the influence of court practice and legal science of other European countries that were models for drafting of the LOA, like rules on *culpa in contrahendo*^{*28}, guarantee liability^{*29} (LOA § 103), claim for specific performance as a restricted secondary claim^{*30} (LOA § 108), pre-contract (LOA § 33), and change of circumstances (LOA § 97). Various specific institutes derived from the doctrine of the principle of good faith have been transposed from German law in full.^{*31}

Some rules were pure transplants from legal acts or draft laws. Here the term ‘legal’ is reduced to rules, conventionally taken to refer to legislated texts and, though less peremptorily, judicial decisions.^{*32} It is evident that some rules were not understood entirely but still placed in the draft LOA in the belief that the real meaning of a rule that is not entirely supplied by the rule itself will be explained by the interpreters. Somehow the traditional and largely accepted concept of pre-understanding (*Vorverständnis*) by which the act of interpretation is supposed to be embedded in a language, in a morality, in a tradition, and — in sum — in a whole cultural ambience^{*33} does not work in a country where the legal traditions have been cut off from their roots for a long time. The process of drafting Estonian contract law was a perfect example of Watson’s idea that law develops by transplanting not because some particular rule was an inevitable consequence of the social structure and would have emerged even without a model to copy but because the foreign rule was known to those with control over lawmaking and they observed the apparent merits that could be derived from it.^{*34} At present, the Estonian legal system is developing rapidly under the influence of ideas coming from transplant countries. The Estonian Supreme Court has already declared several times that foreign legal acts, court practice, and legal doctrines can be taken as sources for the interpretation of Estonian law if there exists no court practice and the rules or legal system of the country is similar to the Estonian legal system.^{*35} It makes the Estonian legal system more open to influences from other legal systems and also from the processes of harmonisation taking place in Europe.

²⁴ S. Paasilehto. Challenges for Legal Cultural Change: Innovations and Traditions. From Dissonance to Sense. International Conference in Porvoo, Finland. 28–31 August 1997. Not published.

²⁵ M. Luts. Textbook of Pandects or New Style of Legislation in Estonia? – *Juridica International* 2001 (VI), p. 157.

²⁶ About the principle of good faith see I. Kull. Principle of Good Faith and Constitutional Values in Contract Law. – *Juridica International* 2002 (VII), pp. 142–149. Although the Estonian general provision setting out the mandatory nature of the principle of good faith is similar to German BGB § 242, the second part of the clause, or LOA § 6 (2), is based on the example provided by article 6:248 of the Civil Code of Netherlands.

²⁷ About the principle of reasonableness in LOA see M. A. Simovart. The Standard of Reasonableness in the Estonian Law of Obligations. – I. Kull (ed.). Development of Estonian Contract and Company Law in the Context of the Harmonized EU Law I. Tartu 2007, pp. 65–86.

²⁸ Concept of pre-contractual negotiations and *culpa in contrahendo* was a novelty to Estonian legal system and became as a living part of the legal system only recently. See P. Varul (Note 1), p. 106.

²⁹ V. Kõve (Note 23), pp. 130–134.

³⁰ About the claim on specific performance see A. Hussar. Remarks on Restrictions to the Right to Require Performance in Estonian Contract Law. – I. Kull (ed.). Development of Estonian Contract and Company Law in the Context of the Harmonized EU Law I. Tartu 2007, pp. 27–28.

³¹ Such as changing the proportion of contractual obligations in LOA § 94 and contracts with a protective effect for a third party in LOA § 81 or in part by the provision of relevant rules of conduct in specific sections (e.g., the provisions in LOA § 108 (3) concerning an impermissible delay in the enforcement of a right to terminate the contract).

³² To follow the P. Legrand’s description of legal transplants in P. Legrand. What “Legal Transplants”? – D. Nelken, J. Feest (eds.). *Adapting Legal Cultures*. Hart Publishing 2001, p. 56.

³³ *Ibid.*, 58. See also J. Habermas. *The Theory of Communicative Action*, Vol. I: Reason and the Rationalization of Society. Cambridge: Polity 1991, p. 132.

³⁴ A. Watson. *Comparative Law and Legal Change*. – Cambridge L.J. 1978/37 pp. 313, 315.

³⁵ See decisions of the Estonian Supreme Court from 21.12.2004 No. 3-2-1-145-04 and from 13.09.2005 No. 3-2-1-72-05. Available in Estonian at www.nc.ee.

2. The role of the *acquis communautaire* in the reform process

The civil law reform that started in the 1990s was influenced also by the political and legal link to the European *acquis* under the Europe Agreement^{*36} from 1995, which brought a new dimension to the drafting process and influenced it remarkably. From the very beginning, the drafters attempted not merely to copy the rules of the EC literally but to incorporate them into the rest of the system and creatively harmonise the directives in order to avoid possible conflicts later upon the application of Estonian national law.^{*37} This decision has had certain positive consequences in many ways. First of all, it allows us to build a system of private law based on the same basic principles, terminology, and methods. Secondly, it supported the process of harmonisation of consumer law and general private law in such a way that consumer law had an effect on general private law even if in most cases the rules transferred from consumer law directives and other *acquis* remained *lex specialis*.

We may say now that the implementation of the existing EU consumer law in the context of the Estonian legal system has been quite successful; the LOA contains the rules that fulfil the requirements of all EC directives concerning specific consumer and also non-consumer directives. In many cases, the drafts of the proposed directives were taken into account as well as reform laws of other European countries. Of course, contradictions and problems surfaced regarding the directives themselves and complicated their incorporation. For example, the right to withdraw is regulated as a general rule applicable to all consumer contracts where the right to withdraw is granted. This proved to be a creative challenge, as the directives are going ever more deeply into the essence of contract law itself, affecting the whole system of legal remedies in contractual relations.^{*38} Some directives are incorporated into the general part of the LOA (§§ 35–45), among them the directives on unfair terms in consumer contracts^{*39}, contracts negotiated away from business premises^{*40}, distance contracts with consumers^{*41}, electronic commerce^{*42}, and the late payment directive.^{*43} In the special part of the LOA, the directives on consumer sales^{*44} and product liability^{*45} are integrated as part of the rules on contract of sale (LOA §§ 207 *ff.*) and product liability (LOA § 1061 *ff.*). Also directives on package travel contracts^{*46}, timesharing^{*47}, and cross-border credit transfers^{*48} were implemented in the special part of the LOA. In addition to this, the LOA takes into consideration EC directives concerning insurance contracts and employment contracts. The EC requirements for the *Handelsvertreter*^{*49} have also been incorporated. Electronic payment instruments have been regulated in compliance with the EC recommendation.^{*50}

In implementing the consumer *acquis* in the LOA, Estonia often uses the directives to modernise the entire given field of law, and in consumer contracts the legal remedies provided cannot be contracted out of. For

³⁶ The Europe Agreement was approved by the Estonian Parliament (*Riigikogu*) in 1995.

³⁷ M. Käerdi (Note 1), p. 257.

³⁸ *Ibid.*, pp. 257–258. Estonian experience of implementing consumer *acquis* into the general private law is in its essence predecessor to the process which started with the idea of coherent European contract law (Communications of European Parliament from 2001, 11.07.2001 COM(2001) 398 final and from 12.02.2003 COM(2003) 68 final (“Action Plan”). See also R. Schulze (ed.). *The Common Frame of Reference and Existing EC Contract Law*. München: Sellier 2008.

³⁹ Directive 1993/13/EEC of 5 April 1993 on unfair terms in consumer contracts (OJ L 95, 21.04.1993, pp. 29–34.). Transplanted into LOA §§ 35–45.

⁴⁰ Directive 1985/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises. – OJ L 158, 23.06.1990, pp. 31–33.

⁴¹ Directive 1997/7/EC of 20 May 1997 on the protection of consumers in respect of distance contracts. – OJ L 144, 4.06.1977.

⁴² Directive 2000/31/EC of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market. – OJ L 178, 17.07.2000, pp. 1–16.

⁴³ Directive 2000/35/EC of 8 August 2000 on combating late payment in commercial transactions. – OJ L 200, 8.08.2000, pp. 35–38.

⁴⁴ Directive 1999/44/EC of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees. – OJ L 171, 7.07.1999, pp. 12–16.

⁴⁵ Directive 1985/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products. – OJ L 210, 7.08.1985, pp. 29–33.

⁴⁶ Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours. – OJ L 158, 23.06.1990, pp. 59–64.

⁴⁷ Directive 94/47/EEC of 26 October 1994 on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis. – OJ L 280, 29.10.1994.

⁴⁸ Directive 1997/5/EC of 27 January 1997 on cross-border credit transfers. Council Directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit (OJ L 42, 12.02.1987, pp. 48–53) was implemented in the rules on consumer credit in §§ 402 *ff.*

⁴⁹ Directive 1986/653/EEC of 18 December 1986 on the co-ordination of the laws of the member states relating to self-employed commercial agents. – OJ L 382, 31.12.1986, pp. 17–21.

⁵⁰ Commission Recommendation of 1997/489/EC 30 July 1997 concerning transactions by electronic payment instruments and in particular the relationship between issuer and holder. – OJ L 365, 24.12.1987, pp. 72–76.

example, in sales law the implementation of directive 99/44 influenced also the general law on sales, which means that the remedies of the buyer are nearly identical for B-to-B and B-to-C contracts. For example, parties to non-consumer contracts cannot claim for specific performance in reference to all kinds of non-conformity of goods; they can make a claim only if the non-conformity is considered to be a fundamental breach (LOA § 222 (2)). In some provisions there are also deviations from the directives. Under the LOA § 228, in a consumer sale, the seller who sells goods to a consumer is liable to the buyer for any lack of conformity of the goods that arises as a result of a statement made by the producer, previous seller, or other intermediary with respect to particular characteristics of the goods, and it is presumed that the seller may claim compensation for damage caused thereto by the corresponding person in accordance with the relationship between them and to the extent of the liability of the seller to the consumer. A prerequisite for the claim is that the basis of the liability of the seller toward the buyer has been non-conformity of the goods because of statements made publicly with respect to particular characteristics of the goods by the seller, producer, or previous seller of the thing or by another retailer — in particular, in the advertising of the thing or on labels (LOA § 217 (2)). This seems to be narrower than what is set forth in article 4 of directive 99/44, because in the latter redress can be sought because of a lack of conformity resulting from either an act or omission by the producer.^{*51}

Directive 93/13, on unfair terms in consumer contracts, is incorporated into the general principles of the LOA (§§ 35–45) and applies to all contracts. Two distinct problems are presented in standard-form contracts — procedural fairness of contract and substantive fairness, which relates to the outcome of such contracts.^{*52} In harmonisation of this area of the law, the LOA took up the general clause on unfairness of a contract term as contained in the Unfair Contract Terms Directive and the PECL (article 4:110). Under the Estonian law, a term shall be regarded as unfair if, contrary to the principle of reasonableness, it causes a significant imbalance in the parties' rights and obligations arising under the contract or if a standard term is contrary to good morals, in consideration of the content of the contract, the circumstances attending the conclusion of the contract, the interests of the parties, and other essential circumstances (LOA § 42 (1)). The Estonian LOA does not contain two different lists of unfair contract terms. There is only one list of contract terms, which serves as a 'blacklist' for consumers and a 'grey list' for business contracts (LOA § 42 (3)). The law provides for the nullification of standard terms of the contract where the other party is a consumer if a provision is considered to be unfair. The inclusion of identical terms for commercial contracts concluded in the course of business is entitled to only a presumption of unfairness. Regulation of pre-formulated and standard terms significantly widened the indicative list given in article 3 (3) of directive 93/13, blacklisting 37 terms in total as void in consumer contracts and presumably unfair in B-to-B contracts.

3. The role of model laws (PECL and UNIDROIT Principles) and the CISG in the reform process

The role of the PECL as a source for the LOA is explained in the annotated edition of the Law of Obligations Act^{*53}, where it is stated that the primary importance of the PECL has been in systematising the LOA, though the substantive norms contained in the act have been largely influenced by the German BGB and, in lesser measure, the New Civil Code of the Netherlands^{*54} (BW) and pertinent EU directives. Not only the LOA but also the General Part of the Civil Code Act has been influenced by the PECL and UNIDROIT Principles, the LOA more extensively than the GPCCA. In describing the influence of the PECL and PICC on the process of drafting the LOA, one encounters slightly differing opinions among scholars.^{*55} It must be remembered that in large part the LOA was completed before the first version of the PECL arrived in Estonia (in 1995, with the second version available only from 1999). By the time the version from 1999 reached Estonia, the legislative process for enactment of the LOA was at such an advanced stage that further changes were not possible. The

^{*51} See N. Reich (Note 1), p. 290.

^{*52} T. Wilhelmsson. Towards a (Post)modern European Contract Law. – *Juridica International* 2001 (VI), p. 29.

^{*53} P. Varul, I. Kull, V. Kõve, M. Käerdi. *Võlaõigusseadus I. Kommenteeritud väljaanne* (Law of Obligations I. Commented ed.). Tallinn: Juura 2006 (in Estonian).

^{*54} *Burgerlijk Wetboek*, 1992. F. Nieper et al. *Niederländisches Bürgerliches Gesetzbuch. Buch 6 Allgemeiner Teil des Schuldrechts. Bücher 7 und 7A. Besondere Verträge*. München: C. H. Beck. Kluwer Law International 1995.

^{*55} See V. Kõve (Note 23), p. 124. About the reception of PICC into the Lithuanian private law system see T. Žukas. Reception of the Unidroit Principles of International Commercial Contracts and the Principles of European Contract Law in Lithuania. – E. C. Raitane, E. Lein (eds.). *The UNIDROIT Principles 2004: Their Impact on Contractual Practice, Jurisprudence and Codification: Reports of the ISDC Colloquium* (8/9 June 2006). Zurich, Basel, Geneva: Schulthess 2007 (Publications of the Swiss Institute of Comparative Law (ISDC), Publ. No. 56, in co-operation with the International Institute for Unification of Private Law (UNIDROIT)), pp. 231–243.

third section of the PECL^{*56}, which was publicly released in 2003 — after the entry into force of the LOA — had no influence on Estonian legislation.

When the general part of the LOA was in its final phase of preparation, Estonia was presented with the UNIDROIT Principles of International Commercial Contracts^{*57}, on the basis of which much of the text was rewritten and new provisions added. Even if widespread opinion holds that Estonian contract law was mainly influenced by the PECL, deeper analysis of the articles consisted in the LOA does not support this opinion. We have to remember also that the PECL material deals with contracts in general, and the PICC material only with commercial contracts; therefore, the rules from the PECL were spread far and wide through different parts of the LOA and also in the GPCCA. Of course, we can find many rules in the LOA similar or even identical to those contained in the PECL and much more in the PICC, but, as both of these sets of rules consist of the best regulations from national laws and the most practical and reasonable solutions of modern contract law and are based on the same ethical, technical, and economic considerations^{*58}, discussions about the level of influence from one or another set of rules have no deeper meaning.

Significant influence has been exerted on the LOA by the Vienna Convention on International Sale of Goods (CISG), from 1980.^{*59} In particular, the CISG provided the initial conceptual foundation in creating rules on conclusion of contracts, a system of contractual liability, and a set of remedies and general principles related to compensation for damage.^{*60} For example, the LOA transposed almost identically the main principles of contract law, among them that of the binding nature of usages and practices (CISG article 9, LOA § 25), objective interpretation of declaration of intention (CISG article 6, LOA § 29), freedom of form (CISG articles 6 and 12; LOA § 11 (1)), mitigation of harm (CISG articles 77, 85, and 86; LOA § 139 (2)), and prohibition of abuse of rights (CISG article 80, LOA § 101 (3)). In the special part of the LOA, the rules on the obligations of the seller in §§ 208–211 are in accordance with the CISG provisions in articles 30–32. Also the rules regulating the conformity of goods under a contract of sale in the LOA § 217 are similar to the rules in the CISG article 35.

The technique of the transposition of rules from different sources depended on the legal nature and regulatory purpose of the transplant. Some rules were reformulated and restructured during transposition, while other rules were appropriated word for word. For example, there was a decision that the rules on formation of contracts should be drafted on the basis of the classical elements of the conclusion of a contract — offer and acceptance. There should be consensus between the parties in order to have a binding contract reached by offer and acceptance. At the same time, new rules supplement the classical standard with the principle that a contract is deemed concluded by the mutual exchange of declarations of intention in any other manner if it is clear that the parties have reached sufficient agreement.^{*61} For example, in the CFR the requirements for the conclusion of a contract are the following:

CFR: II.–4:101: Requirements for the conclusion of a contract

A contract is concluded, without any further requirement, if the parties:

- (a) intend to enter into a binding legal relationship or bring about some other legal effect and
- (b) reach a sufficient agreement.

In the PECL:

Article 2:101: Conditions for the Conclusion of a Contract

- (1) A contract is concluded if:
 - (a) the parties intend to be legally bound and
 - (b) they reach a sufficient agreement without any further requirement.
- (2) A contract need not be concluded or evidenced in writing, nor is it subject to any other requirement as to form. The contract may be proved by any means, including witnesses.

⁵⁶ O. Lando et al. (eds.). *Principles of European Contract Law. Part III*. The Hague: Kluwer Law International 2003.

⁵⁷ *Principles of International Commercial Contracts*. UNIDROIT, 2004. Available at <http://www.unidroit.org/english/principles/contracts/main.htm> (18.08.2008).

⁵⁸ O. Lando. *The Structure and the Legal Values of the Common Frame of Reference*. – ERCL 2007/3, p. 245.

⁵⁹ UN Convention of the International Sale of Goods. 11 April 1980. Ratified by Estonia through act of Parliament (*Riigikogu*) on 16.06.1993. – RT II 1993, 21/22, 52.

⁶⁰ P. Schlechtriem. *The New Law of Obligations in Estonia and the Developments Towards Unification and Harmonisation of Law in Europe*. – *Juridica International* 2001 (VI), p. 19. See also, e.g., U. Magnus. *The CISG's Impact on European Legislation*. – F. Ferrari (ed.). *The 1980 Uniform Sales Law. Old Issues Revisited in the Light of Recent Experiences*. Verona Conference 2003. München: Sellier, European Law Publishers 2003, pp. 129–134; H. M. Flechtner. *The CISG's impact on International Unification Efforts: The Unidroit Principles of International Commercial Contracts and the Principles of European Contract Law*. – F. Ferrari (ed.). *The 1980 Uniform Sales Law. Old Issues Revisited in the Light of Recent Experiences*. Verona Conference 2003. München: Sellier, European Law Publishers 2003, pp. 169–183; H.-P. Mansel. *Kaufrechtsreform in Europa und die Dogmatik des deutschen Leistungsstörungenrechts*. *Archiv für die civilistische Praxis*. Bd. 204 (2004), pp. 396–456.

⁶¹ As opposed to CISG article 14 (1), under which a contract is deemed concluded when the parties have reached an agreement on all fundamental conditions by an exchange of offer and acceptance.

In the LOA:

§ 9. Conclusion of Contract

A contract is entered into by an offer being made and accepted or by the mutual exchange of declarations of intent in any other manner if it is sufficiently clear that the parties have reached an agreement.

One can see that the wordings are slightly different but the main idea remains the same in all three sources of law.

4. Some conclusions on the ongoing harmonisation process and the coming CFR from the perspective of Estonia

Almost six years have now passed since the Estonian Law of Obligations Act was adopted. Under the existing court practice and as seen in scholarly writings, it is possible now, at least in general terms, to evaluate the actual vitality of regulations offered by the PECL, UNIDROIT Principles, and CISG, as well as the consumer *acquis* and EU directives and their compatibility with other statutory provisions, though this amount of time is not sufficient to permit ultimate conclusions to be drawn. Transposition of rules from different legal sources should be evaluated as successful. I think that the main reason for this is the decision made to choose one national legal system to be a basis for the entire private law codification project. In consideration of the fact that work for the future development of the PECL and PICC continues within the context of the Common Frame of Reference, the Estonian experience may even provide usable feedback for that project. In Estonia, the civil law reform was surely a reverse process — there was no adaptation of law in response to changes in social relations. Instead, social changes were brought about in the society by law. The harmonisation process and preparing of the CFR involve developments and problems that are not limited to any one country and assert that the changes and challenges in modern contract law are part of the worldwide change in economic relationships. These developments and changes in contract law will influence the national legislative process and also legal practice. There is also an increase in the importance of the transfer of legal ideas and solutions from one legal order to another, with adoption of concepts of international law on the level of national law. As has been mentioned above, the Estonian Supreme Court⁶² opened the gates for foreign legal ideas and court practice in accepting the general principle of applicability of foreign court practice and customs in solving cases under Estonian law if there are similarities in legal regulation and application of law. We should see the process of harmonisation of private law and the CFR not only as an effort of legal engineering but more as an effort to engage the society in inter-cultural communication.

⁶² Estonian Supreme Court already in 2003 (Supreme Court, case No. 3-2-1-9-03). The Supreme Court restricted this principle to the cases where the element of international private law is involved in 2004 (Decision of Supreme Court, case No. 3-2-1-145-04, sec. 39) this principle was widened also to the cases where there are no elements of international private law. See also Note 35.



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The Influence of Harmonisation of Private Law on the Development of the Civil Law in Hungary

If we want to obtain an accurate picture of the present status of civil law in Hungary as a relatively new member state of the European Union, we should start with the history of the civil law. The historical background can explain to what extent civil law was adaptive at the time of the great economic and social changes of the end of the 1980s and into the early 1990s. The more adaptive a civil law regime was, the less urgent need for instant changes in the law occurred. From this point of view, Hungary was in quite a lucky situation: the old rules, with some modifications, could handle the market economy relationships. However, an overall reform of civil law became inevitable. The reasons for, and the process of, such a reform are described in Section 1.

In 2004, Hungary joined the European Union. As a part of the accession process, the Hungarian legal system was harmonised with the legislation of the EU, and as a member state Hungary develops its law in accordance with the European requirements. The footprints of the *acquis communautaire* are observable in the national private law legislation. In Section 2, a general overview of the impact of the European legislation on Hungarian civil law will be given, describing the role of the *acquis communautaire* in the process of private law reform.

Since the fall of the socialist regime, Hungary has had an open market economy whose legal infrastructure should have been adapted to the general trends in the legal developments of international trade. These trends are more or less reflected in those instruments aiming to harmonise, first of all, contract law. Section 3 of this paper deals with the impact of the Principles of European Contract Law (PECL), UNIDROIT Principles of International Commercial Contracts (UNIDROIT Principles), and Common Frame of Reference (CFR) on Hungarian private law legislation.

The main conclusions of the study will be summarised in Section 4.

1. The status of civil law reform

The basic source of private law in Hungary is Act IV of 1959. This act became the first civil code in the country, and until now it has been the only one. Before the civil code was developed, Hungarian civil law was judge-made law strongly influenced by legal customs, traditions, Austrian law, and various drafts of a civil code that were elaborated on from the middle of the 19th century onward. In 1848, the year of the Hungarian bourgeois revolution, the parliament ordered the government to prepare a draft civil code. It could not be a mere coincidence that a revolution aiming to replace a feudalistic regime with a more or less capitalistic social and economic order prompted the question of a civil code that could provide stable, uniform, and safe regulation of relationships under private law. It was an elementary interest of the bourgeois class to have a code that is applicable to everybody, irrespective of the origin of the parties, and to all types and pieces of property. Such a code was deemed to be a prerequisite for the safe turnover of goods and services, as well as for the development of flow of capital through credit institutions.

After the failure of the 1848 revolution, the independent Hungarian codification was struck off the agenda. However, as a consequence of the Hungarian compromise with Austria in 1867, the movement for the codification of Hungarian private law was resumed. From 1871, some partial drafts for a proposed civil code were prepared. Since it turned out that preparing an overall code comprising rules on commercial and non-commercial private law relationships takes a long time, it was decided that a separate commercial code is necessary for responding adequately to the needs of commercial life. The Hungarian Commercial Code was enacted in 1875. It contained regulations on commercial transactions and concerning merchants — including commercial companies — as subjects of such transactions.

However, non-commercial relationships remained unregulated. After the release of some partial drafts, the first consolidated draft for a civil code was completed by 1900. It was developed through a series of professional and political discussions, and new drafts were proposed. The last draft before World War II was dated 1928. Though this draft, too, was never adopted, it served almost as an effective code: the courts used it as a point of reference, and the scholarly literature analysed it thoroughly as a major source of Hungarian private law. This effect can be explained by the fact that the 1928 draft could reflect legal traditions and practice as broadly accepted and followed.

After World War II, Hungary became a part of the political zone influenced by the Soviet Union, and a political, economic, and social regime quite different from a political democracy based on the market economy began to be built. It could be deemed a contradiction that in such circumstances the preparation of a civil code came up again. What is such a code about if the goods are basically in state ownership, if the exchange of goods and services is administered by state agencies, and if state enterprises fulfil only state orders? In spite of the fact that under such conditions a civil code could play only a limited role, it was still needed for regulation of classical civil law institutions — such as property and contracts — which served as a formal framework for the state-organised economy. In addition, a civil code could have been applied also in those relationships where the property rights of individuals or organisations remained in their classical form. However, the domain of such relationships was highly restricted.

It is not a surprise that a civil code whose background is not a classical market economy cannot meet all of the requirements and show all of the typical features of classical codes. What is more surprising is that such a code could survive in the climate of the great economic and social changes that took place in Hungary from the end of the 1980s. How could it happen that a civil code that was in force under the socialist regime remained workable in market economy relationships as well? I think that the flexibility and adaptability of the code came as a compound result of the following factors. As a matter of course, the preparation of the civil code was influenced mainly by legal scholars who had been educated in the previous regime. They respected classical institutions and principles of civil law and tried to preserve them. In strong connection with this, the code was strongly influenced by the pre-WWII drafts, mainly by the 1928 draft. Since these earlier drafts were designed for a market economy, the main elements of such regulation permeated the new code. Finally, the Hungarian Civil Code was viable in spite of the fundamental economic and social changes because such changes did not come to Hungary in a vacuum, without any prior events, and these antecedents were reflected also in legal regulation. The most important factor was that the late 1970s saw a reform of the socialist economic system commence. While the old-fashioned socialist economic system was based on the direct and general decision-making power of state organs, the essence of the reform was to replace the state orders with limited market mechanisms. The state enterprises gained a certain level of independence; they were acknowledged as *quasi*-owners of the properties handled by them; consequently, they had some freedom and flexibility to enter into contractual relationships with each other. Instead of using direct orders to influence the economic sphere, the state relied on normative rules construing incentives for the enterprises. In order to reflect these changes in the Civil Code, the regulation went through an overall modification in 1977. As a result, Hungarian civil law reflected some characteristics of a market economy without the country having a real market. Later, when the state's planned economy was transformed into a market economy, the legal concepts and basic rules of the private law regulation were ready to handle the new relationships properly. Naturally, introduction of extensive amendments was inevitable, but in principle the Civil Code was able to

accommodate such modifications. Therefore, it was not necessary to replace it instantly with a new code. Thus, Hungary could avoid such emergency solutions as reactivation of old laws from the pre-war era or transplantation of a foreign civil code.

Although the above-mentioned factors freed Hungary from the pressure of introducing a new civil code within a short time, in 1998 a government decree ordered the establishment of a 'Codification Committee', whose task was to prepare the draft for a new code. This committee, which included judges, government officials, and academics, published the concept and regulatory syllabus for the new civil code in 2003, after an extensive process of legal, economic, and comparative research. The concept was confirmed by the government, and so development of the language of the draft could start. The first draft of the new civil code and its reasoning had been finalised by the Codification Committee by 2006. After discussions in academic and professional circles and in non-governmental organisations, the Ministry of Justice issued its official version of the draft, which was based on the draft from the Codification Committee, though deviating from it at many points. It is planned that the draft will be discussed by Parliament in 2008, with the draft to be adopted at the end of this year. However, according to plans, the new civil code will come into effect only in 2010.

Which were the most important reasons for starting the codification of a new code? First we have to mention the extremely high number of modifications made to the old civil code.^{*1} One may discover a special contradiction in this fact. I mentioned the adaptability of the code as one of its strengths. However, the adaptation could indeed have taken place via a series of modifications. Why, then, did these modifications result in a need for a new code, if they fulfilled the aim of adjusting the code to the changing circumstances? The answer is that the modifications were sporadic, had no general governing idea, and were missing a solid theoretical basis. Most of the amendments were introduced *ad hoc*, as reactions to the emergence of needs for regulation in particular areas of civil law relationships. The lack of coherence made application of the code very difficult, and it did not aid in coherent interpretation of the rules. Exceeding a certain level, these ambiguities could cause harm, eroding the required rule of law and the level of legal security.

Neither did harmonisation of Hungarian private law with European regulation served the coherence of the national legal regulation. The European private law regulation is rather sporadic; it does not constitute a coherent, general system.^{*2} The main driving force of the European regulation concerning contract law is consumer protection^{*3}, which does not belong to the classical institutions of private law; therefore, in as far as implementation takes place through modification of the civil code, it increases the probability of contradictions, ambiguities, and a fragmented character for the code. In addition, implementation inevitably entails reception of foreign or international legal institutions, notions, and concepts that are unfamiliar to the national legal system and local legal traditions^{*4} and, by being so, may cause further incoherence.

In summary, the great number of new elements in the Civil Code, deriving from the social and economic changes, on the one hand, and from Hungary's European integration, on the other, resulted in a civil code that reflects and answers all of the new challenges but suffers from incoherence. In such circumstances, the decision for adoption of a new code was very well justified. In the course of preparation of the draft, the need for urgent modifications continued, so the situation became worse. Now there is consensus in professional circles that the Civil Code of today will effectively serve the needs of the economy and will aid in restoration of the rule of law in the area of civil law relationships. However, all of these effects are conditional upon steady work for codification that renders all of the necessary efforts to modernise Hungarian civil law in harmony with the main streams of European legal development. Unfortunately, there are some warning signs that forecast that political bargains with and concessions to various interest groups could ruin the results that should be expected from the new code.

It proceeds from the above that the new codification may not follow a single model of codification. In the 19th and 20th centuries, the historical situation could justify Hungarian civil law legislation based on the Austrian and German model. In the present globalised world, Hungary as a member of the European Union, whose member states have different private law systems but are keen on harmonising their laws, may not feel able to afford to bind itself to a single model and to build its civil law exclusively on the chosen system. Accordingly, the aim of the codification was, rather, to create a civil code based on the then-existing code and national legal traditions but reflecting all of the contemporary challenges. In identification of these challenges and the possible solutions thereto, comparative legal studies helped us to a considerable extent. The 'Concept' of the code declares that the codification shall consider the results of civil law codification or other legal developments in

¹ Though there is no official number available, according to my private statistics the number of amendments is higher than 70 since 1977 when a consolidated text was issued.

² See L. Vékás. *Európai közösségi fogyasztóvédelmi magánjog* (Consumer Protection Law in the European Communities). – L. Vékás (ed.). *Európai Közösségi jogi elemek a magyar magán- és kereskedelmi jogban* (European Law in Hungarian Private and Commercial Law) Budapest: KJK-Kerszöv 2001. pp. 28–29. The same in German language: L. Vékás. – M. Pachke (Hg.). *Europäisches Recht im ungarischen Privat- und Wirtschaftsrecht*; Münster: LIT Verlag 2004, pp. 3–4.

³ *Ibid.*

⁴ See G. Benacchio. *Az Európai Közösség magánjoga. Polgári jog, kereskedelmi jog* (Private Law of European Community. Civil Law, Commercial Law). V. fejezet: A szabályok és modellek áramlása (Chapter V: Flow of Rules and Models). Budapest: Osiris Kiadó 2003. p. 111 ff.

other countries and that, after a thorough analysis, some solutions could be adopted from these — yet without any of these national legal systems being taken as a general model. The formal implantation of foreign rules and institutions is definitely rejected. A synthesis of foreign developments could be assisted in a certain sense through the implementation of European legal rules and those international instruments whose aim is the establishment of a uniform contract law regulation. Both European law and international instruments reflect a compromise among the participants, and in this way they can transmit common values and show the broadly accepted main stream of development, which could serve as a reference point for Hungary as well.

2. The role of the *acquis communautaire* in the reform process

Though the domain of private law is quite broad, including, *inter alia*, company law, intellectual property law, financial services, and security law matters, for the purposes of the present paper I limit myself to contract law, because those international instruments that form the subject matter of the analysis are concerned with contract law.

It is well known that new states could join the European Union only if they accepted and implemented the whole of European law, including European private law. In such circumstances, Hungary had no choice of whether or not to adopt European law⁵; the only question was how it should fulfil the obligation of harmonisation. In general terms, there are two possibilities for implementation of European directives concerning contract law matters. One option is to keep them separate from the existing regulation of contract law and implant mere translations of the European rules into the national legal system, leaving the court to solve any problem arising from any contradictions between the classical contract law regulation and the new body of law coming from the European Union. Such an arrangement has some remarkable advantages. First of all, it is the fastest method of implementation; translating a text takes much less time than is required to analyse it and to prepare an original draft that has the legal effect requested by the directive and, at the same time, fits with the other parts of the national legal system. The speed of the legislation was a crucial element in the accession period. There was a desperate need for joining the European Union as early as possible. It would have been unacceptable to hinder the accession process by raising difficulties concerning coherence of the legal system. Priority was given to fulfilling the obligation of harmonisation as soon as possible, even if such harmonisation were to come at the cost of the unity and coherence of the existing system. Another, not negligible advantage of the mechanical implementation was its security in terms of negotiations with the European Union. It was much easier for Hungary to demonstrate that it had fulfilled its obligation to harmonise its law with the EU requirements with a readily identifiable counterpart (frequently a word-for-word translation) of the European legislation appearing in the national legal system than for the country to explain that certain national legal institutions — sometimes in conjunction with each other, as a set of interrelated rules — could have the same effect as that required by European law.

The other method of harmonisation was to implement the European regulation as an organic constituent of the national legal system. That required not only a translation of the words of directives but also a ‘translation’ of their meaning. The main feature of this method is its functionalist approach. That means that the national legislator has to analyse and determine the basic function of the European regulation, then identify in the domestic legal system those legal institutions and concepts that are designed for serving same functions and use these existing elements as vehicles of implementation, even if their appearance and formulation is not identical to that of European law. It goes without saying that, with application of this method, the implementation of European law is much slower and causes more ambiguities where the conformity of Hungarian law with that of Europe is concerned. In spite of these disadvantages, I believe that this second way is superior, because a regulation that fits into the whole legal system has its connection with other legal institutions and works with them smoothly. Being so, such a regulation can be applied more effectively.

The methodology of implementation could determine also the source of law in which the European requirements appear. The formal implementation can take place in separate laws in order to avoid contradictions within a single piece of legislation. If the European rules are placed in the existing laws, especially in a civil code that is intended to regulate civil law relationships in general, then its areas of incoherence are much more visible. In a separate body of law, they are remote enough not to demonstrate contradictions with other rules at first sight.

Taking into consideration the above pros and cons, Hungary followed a mixed approach in its implementation of European private law. There are some directives whose implementation was realised by means of amend-

⁵ In theory, however, it could be a valid question whether harmonisation of private law is necessary, and if the answer is in affirmative, to what extent. See, e.g., W. van Gerven. Harmonization of Private Law: Do We Need it? – Common Market Law Review 2004 (41) April, pp. 505–532.

ments of the Civil Code, and there are others that were implemented as separate laws. If one looks for some regularity, it could be established that the earlier the date of the legislation the more probably it came about in a separate law. The logic of this trend was that at the beginning of the accession process we had no experience with legal harmonisation; therefore, the safety concern with the regulation was predominant. In addition, at the first stage, when the national legislator faced the problem of implementation of a huge amount of European legislation in a relatively short time, the rapidity of the process had priority over the coherence of the legal system. As Hungary's legal system became more and more in concert with the European law, implementation became less urgent, so the quality of the legislation prevailed over the speediness consideration.

Given some examples⁶, one can observe that the early directives on product liability⁷ or consumer credit⁸ were implemented via separate laws⁹, while the directive on sale of consumer goods and associated guarantees¹⁰ was implemented by modification of the Civil Code.¹¹

It could happen that not just the national developments (i.e., the increasing amount of experience with implementation of European law) led us to tend toward harmonisation through modification of existing law. It can be argued that the subject matter of the European law is the decisive factor. However, the two statements do not contradict each other. It is obvious that the European legislation on private law matters started from the periphery and approached the core of contract law gradually. Regulation of peripheral questions is easier in separate laws, because these questions are normally left untouched by the classical contract law regulation. When one takes the example of timeshare contracts, it is not surprising that the Civil Code has not offered any regulation for this matter; therefore, it needed no special explanation when implementation of the directive dealing with such contracts¹² took place via a separate government decree¹³ and not in the Civil Code.

However, in considering the case where the regulation concerned sale contracts, one should not overlook the fact that this type of contract is regulated in the civil code; consequently, any special regulation has some relation to the basic rules, whether it is within or outside the scope of the code. This compels the legislator to think over the relationship of the European law with the national regulation. Once this relationship is addressed, the legislator has no reason to separate the harmonised legislation from the main body of law.

At this point, we can discover a special side effect. In every case of lawmaking, determination of the scope of regulation is a crucial point. The European legislation always seeks to specify clearly the relationships to which it shall be applied. It has great importance especially because the legislative power of the European Union is limited, and it always shall be shown that the given rules fall within the power of European institutions. If European requirements that are valid for only a limited subset of relationships appear in a general domestic law whose scope of application is broader, the implementation can cause an additional effect: it could happen that, as it becomes a part of the national legal system, its effects will be extended to those relationships whose regulation was not originally intended (and perhaps whose regulation was not even allowed) in European law. The case of consumer sales could be mentioned as an example of this phenomenon. Though the relevant directive is aimed at regulating sale contracts that qualify as consumer contracts, the implementation happened through modification of the general law on contracts; thus, the rules implemented are applied to all types of contracts, not only to contracts of sale, and they are applied to contracts between all kinds of parties, not just to parties to consumer contracts. Such a development does not necessarily mean an error. It could be a thoughtful decision of the legislator, and in this case the expansion of the idea of consumer protection could serve the development of the entirety of civil law.

3. The role of the PECL, UNIDROIT Principles, and similar instruments in the reform process

In the course of preparation of the new Hungarian Civil Code, it was a broadly accepted and expressed goal to have a code in keeping with the main trends in the development of civil law in Europe as well as in the world more generally. In order to reach this end, an extensive process of comparative research has been carried out. In addition, the Codification Committee has studied thoroughly those international instruments that reflect the

⁶ For a complete overview of implementation of consumer protection directives see L. Vékás (Note 2).

⁷ Directive 85/374/EEC. – OJ L 210, 7.08.1985, pp. 29–33.

⁸ Directive 87/102/EEC. – OJ L 278, 11.10.1988, pp. 33.

⁹ Act No. X of 1993 on Product Liability; § 7 of Act No. CLV. of 1997 on Consumer Protection and §§ 212–214 of Act No. CXII of 1996 on Financial Institutions.

¹⁰ Directive 1999/44/EC. – OJ L 171, 7.07.1999, pp. 12–16.

¹¹ §§ 305–311/A of the Hungarian Civil Code.

¹² Directive 94/47/EC. – OJ L 280, 29.10.1994, pp. 83–87.

¹³ Government Decree No. 20/1999. (II. 5.).

synthesis of current developments in private law. It was expressly stated in the 'Concept' of the new Civil Code document that in the sphere of contract law the drafters should take into consideration the solutions offered by the PECL and UNIDROIT Principles¹⁴, and that, at those points where such a solution fits the system of Hungarian regulation, rules from the international instruments can be used as a model. This does not mean that Hungary has bound itself to implement these instruments in their entirety in domestic civil law, but it does mean that we think it important to have a civil code that is familiar and acceptable in the international arena and in purely domestic relationships.

In spite of this intention, one should note that not all of the similarities can be treated as results of implementation of rules from international instruments. A number of corresponding rules can be explained by the fact that these rules constitute a part of the common legal culture. Since Hungary has a private law regulation with its origin in the common cores of the civil law traditions, many elements of the PECL or UNIDROIT Principles could have been found in Hungarian law before the emergence of these international rules. As inherent constituents of the national law, these rules should not have been implemented; they simply had to be preserved in the course of the codification.

On the basis of the above, it would be impossible to enumerate all of the places in which the Civil Code draft is identical or similar to the international instruments. It would be similarly hopeless to list those elements that are expressly correlated with one or the other international set of contract law principles. It seems to me more instructive to cite just a few examples of how the PECL and/or UNIDROIT Principles could influence the draft for the new civil code.

My first example concerns the contents of a contract. This subject is dealt with in the 'General Part' of the law of obligations. The current civil code says that the contents of a contract come from two sources: firstly, from the agreement of the parties and, secondly, from the default rules of the code. It is understandable that without regular business relationships it was not necessary to address the problem of how business usage and practices might influence the contents of a contract. However, with market relationships this question cannot be evaded. The draft Civil Code prepared by the Codification Committee provides as follows.

A contract will include as a part of its content:

- usage that was applied in the business relationship of the parties prior to the conclusion of the contract;
- the practice they established between themselves prior to the conclusion of the contract; and
- usage that is generally applied by persons in a position similar to that of the contracting parties, except in the case when the application of such a usage would be unjustifiable when one takes into account, in addition to other elements, the former business relationships of the parties.

Usage is a generally applied procedure and business behaviour that is accepted by the participants of the trade or a certain branch of the trade.

Practice is any procedure established and regularly applied by the parties.

It does not cause any difficulty to identify the models of this proposed rule. It is practically identical to the relevant PECL rule.¹⁵ Furthermore, similar regulation can be found in the Vienna Convention on International Sale of Goods (CISG)¹⁶, which is also cited as a model for the draft, and the UNIDROIT Principles¹⁷ material has a provision very similar to that of the CISG. It is quite clear that, if all relevant international instruments deal with the role of usage and practices, then a new civil code cannot be silent on this question.

A second example is related to the merger clause that is frequently used in contractual practice but it is subject to no legal regulation. Such a situation causes not only a feeling of something being wanting but also a problem for the courts when they have to resolve disputes connected with merger clauses. The draft of the Hungarian Civil Code as prepared by the Codification Committee offers the following solution:

If a written contract contains a clause indicating that the writing completely embodies the terms on which the parties have agreed, the prior agreements of the parties become ineffective.

Former statements shall not be used to interpret the writing.

¹⁴ The Conception and Regulatory Syllabus of the new Civil Code is available on the Internet as of 17 March 2008 at <http://www.irm.hu/?mi=1&katid=193&id=217&cikkid=3309>. The said document states: "In addition to the national codices, the reform of the Civil Code also derives from international legislative achievements. First and foremost among these, the Vienna Sales Convention provides models that can be followed; other than that, the contract law chapters rely in several places on the UNIDROIT Principles of International Commercial Contracts (1994) and The Principles of European Contract Law (I–II: 1999, III: 2002). These latter model law drafts have received considerable professional recognition throughout the world and have broadly influenced both legislation and legal practice." (Introduction A/1/2.) There was no reference to the CFR, because at the time of accepting the Concept of the Code, CFR had not been completed yet. However, at the final stage of drafting the Code also CFR was taken into consideration, though this cannot be documented.

¹⁵ Article 1:105. This rule is repeated in CFR II.–1:104.

¹⁶ Article 9.

¹⁷ Article 1.9.

Here, again the models can be discovered without difficulties. All of the international instruments have some provision concerning the matter.^{*18} However, the Hungarian draft shows some divergence from the models. Comparing this with the PECL and CFR material, one finds it striking that the draft does not draw a distinction between individually and not individually negotiated merger clauses. In this respect, it is closer to the UNIDROIT Principles, which also omit this differentiation. But the draft contradicts both sets of principles in connection with the interpretation rule. While the UNIDROIT Principles and PECL provide that parties' prior statements may be used in interpretation of a contract, the Hungarian draft excludes this possibility, and, unfortunately, it does not offer any reason for such a divergence. This contradiction is more serious when considered in the light of the fact that, according to the PECL and CFR, opting out of the interpretation rule cannot be deemed valid in contracts that are not individually negotiated.

In comparison of the proposed Hungarian legislation with international instruments, a further question arises. How can these instruments be used as models if they are not identical to each other in key respects? The UNIDROIT Principles are designed for international contracts, while the PECL and CFR have broader scope, as they are intended to be applied in domestic contracts as well. Furthermore, the UNIDROIT Principles deal with commercial contracts only, unlike the PECL and CFR, which regulate commercial and non-commercial contracts as well. These differences are more than theoretical. Perhaps the most obvious consequence is that the UNIDROIT Principles do not contain rules on consumer protection, because consumer contracts fall outside the scope of the regulation. However, the difference runs deeper: the general view of the participants of contractual relationships could be different, as is reflected in the standards of behaviour. It is true that the general standard is formulated similarly:

Each party must act in accordance with good faith and fair dealing.^{*19}

However, in relation to specific issues, some differences can be observed that show the difference in approach. For cases of mistake, fraud, or gross disparity/excessive benefit, the UNIDROIT Principles use the standard of "reasonable commercial standards of fair dealing", while the Principles of European Contract Law apply the standard of "good faith and fair dealing".

How could these different approaches have been handled in the course of codification? First of all, we should note that the planned Hungarian Civil Code is a uniform code in the sense that it does not differentiate between commercial and non-commercial relationships or contracts.^{*20} Furthermore, the code is designed for domestic and international use as well. It could be treated as an exception that a separate body of law governs international sale of goods. Normally, the rules of the code are applied in international relationships, provided that the norms of international private law prescribe the application of Hungarian law.

As a consequence, the code is open for adaptation of models from the UNIDROIT Principles, PECL, and CFR equally. In case of differences between these instruments, it could be decided on a case-by-case basis which one shall prevail. Even a mixture of the models is theoretically imaginable.

4. Conclusions

The present situation of the Hungarian civil law is characterised by the preparation of the new civil code. The new code shall conclude an adaptation process through which the legal institutions and behavioural rules of a market economy have become inherent parts of the legal system. This transition was strongly influenced by the need for legal harmonisation with the law of the European Communities. Implementation of European rules had double effect. On the one hand, it helped with the development by transmitting broadly accepted legal concepts and rules that were in conformity with the requirements of a market economy. On the other hand, reception of European law — which was fragmented and did not in itself constitute a comprehensive and coherent system — increased the incoherence of Hungarian law. The problems of incoherence spurred on efforts for the elaboration of the new Civil Code.

In the course of preparation of the new code, the drafters knowingly took into consideration not only the requirements of European law but also those international instruments aimed at international harmonisation of contract law. The new civil code draft utilises all concepts, institutions, and rules of these instruments that fit into the system of the code and the Hungarian legal system as a whole. By so doing, the code may be of better quality and may be able to count on international acknowledgement.

¹⁸ UNIDROIT Principles article 2.1.17, PECL article 2:105, CFR II.-4.104.

¹⁹ UNIDROIT Principles article 1.7, PECL article 1:201, CFR.

²⁰ See L. Vékás. *Az új Polgári Törvénykönyv elméleti előkérdései* (Preliminary Theoretical Questions of the New Civil Code). Budapest: HVG-Orac 2001, Chapter 2.



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European Initiatives (PECL, DCFR) and Modernisation of Latvian Civil Law

1. Introduction

Latvia has codified (to be more precise, partly codified) her civil law. The civil law as a codification act (the Civil Code)¹ was adopted in 1937, shortly before the occupation, and re-enacted in the independent Latvia of 1992–1993. The Civil Code is based on the Local Law Collection of the Baltic Provinces of the Russian Empire (1864), the main drafter of which was Friedrich Georg von Bunge, well known in Estonia. As a result of his contribution, the Civil Code to a greater extent resembles the German *Bürgerliches Gesetzbuch* (BGB), rather than any of the Russian codes. Although the Civil Code contains 2400 articles, its coverage still does not include some important parts of the civil law, such as insurance. At the same time, the Civil Code comprises only symbolic general chapters in relation to such important areas as labour law and carriage of goods and passengers. Instead, employment relationships are regulated by the 2001 Labour Law², whereas the field of transportation is governed by the 2000 Railway Carriage Law³, the 1995 Motor Carriage Law⁴, the 2003 Maritime Code⁵, and other special laws. The Construction Law of 1995 supplements the rules of the Civil Code on work-performance contracts. Insolvency law, competition law, copyright law, commercial law, and consumer protection law exist as branches of special private law.⁶ In 1997 Latvia ratified the Convention on International Sales of Goods (CISG).

In 2000, the Commercial Law was adopted. However, at that initial stage only three out of four parts were approved. It was only after a lengthy interruption until September 2007 that work on the code resumed and the draft of the missing final part D, “Commercial transactions”, was submitted to the Latvian Parliament (*Saeima*) and passed at its first reading on 15 November 2007 and at its second reading on 28 February 2008. Part D contains provisions specific to commercial transactions.

¹ The Civil Law of Latvia. Riga: Translation and Terminology Centre 2001.

² Doc. No. EO223[1], Translation and Terminology Centre. Available at <http://www.ttc.lv/index.php?id=10&tid=50&l=EN&seid=down&itid=13779> (15.09.2008).

³ Dzelzceļa pārvadājumu likums. – Latvijas Vēstnesis, 5.01.2001, No. 3 (in Latvian).

⁴ Autopārvadājumu likums. – LR Ziņotājs, 1995, No. 20 (in Latvian).

⁵ Jūras kodekss. – LR Ziņotājs, 2003, No. 14 (in Latvian).

⁶ K. Balodis. Latvian Private Law and European Enlargement. – M. Bassani, U. Mattei (eds.). Opening up European Law. The Common Core Project towards Eastern and South Eastern Europe. Berne: Stämpfli Publishers 2007, pp. 223–231.

The intensive development of private law that took place prior to Latvia's accession to the European Union can be considered very successful, as indeed for all three Baltic States. In connection with EU accession, it was not necessary to amend the Civil Code's chapters on contract law and property law, though some amendments were made to the chapter on family law. Necessary directives were implemented mainly through adoption of separate laws (*lex specialis*), such as the Consumer Rights Protection Law, the Law on Safety of Goods and Services, and the Law on Liability for Defects of Goods and Services. This is not to say that no amendments were made to the code as such. Indeed, some new rules, such as rules on delayed payments and interest (deriving from directive 2000/35/EC), were introduced into the code.

2. Relative stability and future plans

Currently, development of private law in Latvia is mainly proceeding through implementation of EU directives. This is perceived as a high priority by the domestic legislator. Official information on the Web page of the Ministry of Justice states that Latvia has already implemented 1694 directives, or 99.59% of all directives to be implemented.⁷

Some attempts to introduce directives into the Civil Code reveal problems that should also be taken into consideration by drafters of directives. The delay in implementing some directives shows that the problem does not lie in the unwillingness of Latvia to implement them but, rather, in the way the directive provides resolution to, for example, non-discrimination issues. No political groups in Latvia support discrimination. However, a number of Latvian sectoral ministries and the parliament have been unable for two years to decide how, and in which law, to implement the directive on equal treatment of persons, irrespective of racial or ethnic origin, and the directive on equal treatment of men and women in access to and supply of goods and services.

One draft provided that these issues would be addressed in the Civil Code's chapter on contract law. However, along the way, a number of problematic issues were identified, such as:

1. Whether other forms of discrimination, which are not listed, would be permissible in public supply of goods and services, for example, on the basis of religion, age, and political views.
2. Whether the prohibitions apply only to public supply in the goods and services sector, or whether they should be applied generally and therefore be included in the introductory chapter of the Civil Code.
3. While working on these issues, the drafters have realised that the directive also applies to commercial relationships. This led to elaboration of another draft law – Amendments to the Commercial Code — setting out a list of prohibitions, which ended by saying “[...] based on gender or other basis”. No progress on any of these draft laws can be reported so far.

With regard to initiatives not derived from directives, it must be said that doctrine and academic proposals are developing more rapidly than their implementation in specific legislative drafts. The necessity for modernisation is currently recognised mostly by academics and their students, who in their research and studies are focusing much more on private law processes in Europe. Many papers were published in 2003–2007⁸ comparing the concepts of the Principles of European Contract Law, the UNIDROIT Principles, and available parts of the Draft Common Frame of Reference (DCFR). A doctoral thesis entitled “Main Modernization Directions of Latvian Contract Law” was defended by Janis Karklins. This suggests a firm theoretical foundation. But it is not sufficient for legislative activities.

As the situation stands now, state institutions, and in particular the Ministry of Justice and the parliament, find other drafting matters more pressing, such as criminal law, competition, insolvency, and reorganisation of the court system. Nevertheless, the Civil Code has not been forgotten, although research is scheduled for 2007–2009 — but only on **possible** modernisation. Work has started on elaborating an inventory of gaps and out-of-time rules in the Civil Code. More than 100 provisions contained in the Civil Code's chapter on contract law were found not to correspond to today's requirements from the standpoint of their wording, as

⁷ Available at http://www.tm.gov.lv/lv/jaunumi/tm_info.html?news_id=1679 (15.02.2008).

⁸ K. Torgans. Eiropas Jurisprudences vērtības civiltiesībās: pārņemt vai nogaidīt (Values of European Jurisprudence: To Adopt or to Keep Waiting). – Jurista Vārds, 20.11.2007, No. 47 (500), pp. 17–19 (in Latvian); K. Balodis. Proposed Regulation of Commercial Transactions in the Commercial Law of Latvia. – Humanities and Social Sciences Latvia. Current Topics in Latvian Law 2003, pp. 1010–140; V. Jarkina. Ceļā uz Latvijas Republikas Civillikuma modernizāciju (On the Way of Modernisation of the Civil Law of Latvia). – Jurista Vārds, 19.06.2007, No. 25, pp. 9–10 (in Latvian); K. Torgans. The Concept of Fault in Latvian Contract Law Requires Adjustment. – Humanities and Social Sciences Latvia. Current Topics in Latvian Law 2003, pp. 96–1009; K. Torgans. Contract Law: Latvian and European Union. – Problems of Transformation of Law in Connection with European Integration. International Conference. Riga 2002, pp. 24–39; K. Torgans. Komerclikumā jāiestrādā Eiropas līgumu tiesību principu normas (The PECL Rules should be Introduced into the Commercial Law). – Jurista Vārds, 20.02.2007, No. 8, (461), pp. 1–4 (in Latvian); V. Jarkina. Vai sabiedrība ir gatava grozījumiem Civillikumā (Is Society Ready for Amendments to the Civil Law). – Jurista Vārds, 6.11.2007, No. 45, pp. 14–16 (in Latvian).

well as for the precision of a proposed solution. However, most changes are technical, and no more than 15 fundamental conceptual amendments could be highlighted. This has fuelled discussion on whether introduction of amendments will be enough or whether a completely new version of the civil code should be prepared. However, creating a new civil code is an enormous legislative task, justifiable only by very strong grounds recognised at government level.

3. The first bundle of important amendments

In summer of 2007, the fourth part of the Commercial Law, drafted by a group of young academics engaged by the Ministry of Justice, was completed. During public discussion of its general portion on commercial transactions, the idea came up that more provisions should be included, such as those recognised in the PECL, UNIDROIT Principles, and CISG alike. Seven draft articles were proposed at a meeting organised by the Latvian Lawyers' Society, also attended by representatives from the Ministry of Justice, including the Minister himself.

The proposed provisions are the following:

First of all, to soften categorical application of the *pacta sunt servanda* principle, by introducing a 'hardship' concept (as provided by article 6.2.2 of the UNIDROIT Principles) and negotiations on amendments to the contract (UNIDROIT Principles article 6.2.3).

Secondly, to introduce a concept of 'fundamental non-performance' as formulated in article 7.3.1 of the UNIDROIT Principles, article 25 of the CISG, and article 8:103 of the PECL, as the basis for terminating a contract, consequently softening the *pacta sunt servanda* principle, also demonstrating that termination for minor breaches is not permissible.

Thirdly, to introduce a concept not previously contained in the law — namely, an 'additional period for performance' (PECL article 8:106).

Fourthly, and quite revolutionary for Latvia, to prepare an amendment concerning foreseeability of loss and its remoteness (PECL article 9:503 and UNIDROIT Principles article 7.4.4):

The non-performing party is liable only for the loss which it foresaw or could reasonably have foreseen at the time of conclusion of the contract as a likely result of its non-performance, unless the performance was intentional or grossly negligent.

Although such provisions may seem quite obvious to law specialists from other countries, thus far they have not been included in the Latvian Civil Code.

Finally, three other proposals were made, concerning the jurisdiction of the courts to decrease unreasonable contractual penalties, mitigation of loss, and the less well-known 'reminder or warning on duty to pay interest' to be required for charging interest after recovery of the main debt.

A couple of weeks later, the first official reaction was that the **draft provisions are not bad** but that those that do not give rise to doubt must be included in the Civil Code, as the Commercial Law is *lex specialis* in relation to the General Provisions of the former. Consequently two options collided:

- a) to introduce modern regulation only for commercial transactions in, for example, the Commercial Code to test these provisions, and then to expand their application by introducing them into the Civil Code and
- b) to amend the Civil Code.

Preference was given to the option of amending the Civil Code.

Deliberations on amendments submitted for comment to ministries and other institutions revealed a number of arguments that probably should be forwarded to EU legal scientists and institutions.

Firstly, and quite unexpectedly, it was noted that some provisions are unnecessary, as the general principles in the Civil Code are enough. For example, the principle of good faith should be applied (Civil Code article 1). Additionally, it was observed that no examples exist of cases that the courts have failed to resolve as a result of lack of legal provisions.

Secondly, it was noted that some CISG provisions are not guaranteed to work well with domestic contractual transactions. Representatives of the business world expressed doubts such as whether the rules on hardship or fundamental breach are applicable to construction or credit contracts.

Thirdly, overly broad judicial freedom may lead to corruption, so less scope should exist for uncertainty created by concepts such as remoteness, hardship, and minor or fundamental breach.

While the author of this paper does not share these views, nonetheless this was the reaction from officials. To summarise, one can conclude that state institutions are unenthusiastic about reviewing the Civil Code. At

the same time, financing for wider research and development of drafts is not sufficient, although activity by academics is growing with new blood in the shape of new doctors of jurisprudence, Ph.D. candidates who have spent quite a long time exploring EU law and foreign practice.

Governmental institutions responsible for legislative procedure (ministries, the Cabinet of Ministers, and the State Chancellery) are quite reserved with respect to proposals based on the PECL, the UNIDROIT Principles, or other documents **without binding force** for internal relations. **Soft law** as a category of law has not gained recognition with national courts used to applying clear provisions of written law. In Latvia, where the rule of law as a priority is strongly declared, it is hard to accept the soft law concept, opening the door to considerable possibilities for different courts to resolve similar disputes differently, which causes rumours of corruption in the courts. One argument is that none of these authoritative documents is final and nobody can predict when, for example, the Common Frame of Reference will be completed.

4. View of the DCFR from the standpoint of Latvian law

With publication of the Draft Common Frame of Reference, within contract law and tort law the unification project has gained a certain degree of completeness. In any case, this document allows a comparison between the Civil Code and DCFR for purposes of finding solutions to problems highlighted during inventory of the Civil Code in the form of differences in the manner in which major questions are handled in the Latvian Civil Code and under prevailing concepts in EU law.

In this relation, let us examine some examples that have recently become the subject of debate.

1. Two options are available to resolve the issue of contract validity: in one case a party may avoid the contract (II.–7:201, 7:205, 7:207); in another, the contract is void (II.–7:301). Worthy of note, comparison shows that the DCFR contains additional grounds for invalidity besides mistake, fraud, and threats — i.e., unfair exploitation and, as a general rule, infringement of fundamental principles or mandatory rules. It remains to be seen whether the Civil Code's provisions on non-conformity with law and good faith are appropriate for the 'infringement of fundamental principles and mandatory rules' formula and contain 'unfair exploitation' criteria. The difference is that, according to the Civil Code, the contract is void in cases of mistake. A special novelty for Latvia will be the procedure for avoidance. No litigation for that will be necessary. Avoidance will be established by notice to the other party (II.–7:209). Another novelty will be the existence of two notice periods: (a) notice of avoidance is effective only if given within a reasonable time and (b) if a party entitled to avoid a contract confirms it, expressly or implicitly, then avoidance is excluded after the term of notice of avoidance begins.
2. Presumably positive could be provisions for adapting a contract in the case of a mistake (II.–7:203) and modification in particular circumstances, even if a contract infringes principles recognised as fundamental in the laws of EU member states (II.–7:302).
3. A new approach exists to issues of price in relation to all contracts (II.–9:104). Namely, where the amount of the price under a contract cannot be determined from the terms agreed upon by the parties, from any other applicable rule of law, or from usage or common practice, the price payable is the price normally charged in comparable circumstances at the time of signing the contract or, if no such price is available, a reasonable price.
4. Such an approach in Latvia is recognised only in relation to purchase agreements. In other cases, the purchase price must be expressly determined as an essential element of the contract. Failure to do so may invalidate the contract. Preference should be given to the solution proposed in the DCFR.
5. In relation to inadequate contract performance, it is expected that Latvia will provide for a wider range of possibilities for the party in default to carry out a cure. Article III.–3:202 expresses the following rules: if a debtor's performance does not conform to the terms regulating an obligation, the debtor may make a new and conforming tender if that can be done within the time allowed for performance, or promptly after being notified of lack of conformity.
6. A wider option exists also to foresee withholding of performance of a reciprocal obligation (III.–3:401) and many other elements unique to Latvian civil law.

At the same time, it must be noted that some provisions are controversial.

To understand the content of the DCFR, the definitions provided in its Annex I are of crucial importance or, as the Introduction states, "essential for the model rules". In this relation, several comments should be made, which follow.

Three terms used are interconnected and even overlap. These terms are ‘recklessness’, ‘negligence’, and ‘gross negligence’. A question arises as to whether the term ‘recklessness’ corresponds to the term ‘gross negligence’ or encompasses both forms of ‘negligence’. This question arises in relation to the definition of fundamental non-performance. Of course, it is possible to introduce four ‘degrees of guilt’: intent, recklessness, gross negligence, and slight negligence. But difficulties arise even with the distinction between gross and slight negligence. Problems will occur in relation to recklessness of legal persons. It seems that it would be enough if the DCFR included only ‘negligence’ and ‘gross negligence’.

The definition of gross negligence includes the expression ‘if a person is guilty’. This raises the question of the meaning of guilt or fault within the context of civil liability. In addition, the ‘self-evidently’ criterion is highly subjective. It would be truly revolutionary to waive the use of terms characterising degrees of guilt (fault) and turn to an objective evaluation of behaviour using the same terms as are still used in relation to negligence: if a person fails to meet the standard of care that could be reasonably expected (a) from a prudent person or (b) from a professional or otherwise if a higher standard is required. The PECL and other unification documents show a tendency to evaluate excuses of non-performance rather than fault.

The term ‘business’ so far has had several meanings, *viz.* to describe employment, occupation, profession, or entrepreneurial activity. Within the meaning of the DCFR, it is also used to describe a person who enters into an agreement. This could lead to the following confusing assertion: An enterprise conducts business in its place of business or outside it. It should be noted that the definition of a consumer contains the expression ‘not related to his business’ (as an activity), while the definition of franchise uses the expression ‘business method’. The term ‘business’ can be used to contra-distinguish one group of people or community from, for example, consumers. However, it cannot be used to describe an individual seller or a company. ‘B-to-B’ and ‘B-to-C’ are common terms used in everyday speech; however, they are not appropriate for use in statutory acts. Instead, terms such as ‘business person’, ‘merchant’, and ‘commercial entity’ should be used. The proposed wording would begin as follows: “‘business person’ means any natural or legal person acting [...]”.

The beginning of the definition of ownership shows strictly that ownership is an absolute right as opposed to a relative right. It is not necessary to say ‘most absolute’ because absolute is absolute. But, further on, the definition also contains the words ‘rights granted by the owner’; it is unclear what this means. Does it mean that besides the legal owner somebody else may be the owner? Or does it refer to the previous owner? This should be clarified by adding the wording ‘or restrictions (limitations) made by the owner’ or ‘rights granted to another person’.

The DCFR is called academic. For this reason, it should provide a complete structure of obligations (contractual and non-contractual) law, which would be of special importance for scholars and students. In reading the DCFR through, a question arises as to why some widely recognised types of contract are not included.

Of course, freedom of contract permits creation of new, as yet unknown, types of contract. Besides, each Member State has developed its own peculiar kinds of contract. Still, it is difficult to find reasons that well-known kinds of contract such as commission (consignation), apartment rental, civil law partnership, and others are left out of Book IV. The draft contains a remark that gift and loan contracts could be incorporated afterwards, and that special considerations affect transportation and insurance contracts. Studies of directive 2006/123/EC allow the remark that, although many fields are not covered by this and other directives on services, one cannot deny the existence of contracts for carriage of goods and passengers, insurance, sale of immovables, and other agreements.

The **proposal** is to declare reservations and name the specific types of contracts to be included in the DCFR in the future. Otherwise the impression could arise that some contracts are not recognised in the EU. Ignoring contracts of lending, contracts of carriage, and others creates the danger of categories of recognised and unrecognised contracts. This somewhat resembles the situation in ancient Rome, where recognised agreements (*contractus*) and non-recognised agreements (*pactum*) existed. Let us remember the origin of *pacta sunt servanda*. The reference in the DCFR that it does not cover the sale of immovables creates an incorrect perception that a contract for sale of immovables is not a civil contract. However, general provisions (e.g., on formation, validity, mistake, or fraud) and definition of sale also apply to it. A formula should be found to positively express that these contracts belong to the civil contracts category, even though their regulation has certain particularities.

Most contracts described in the DCFR are those in which no great divergences between Member States exist and they will probably not require introduction of any changes in national law. It could be more helpful to include those types of contracts that are still developing — for example, those pertaining to concession and package tourism. This would promote the DCFR truly becoming a handbook for national legislators.

As follows from Part C of Book IV, the group of ‘Contracts for Services’ would be a significant novelty for Latvia, and presumably also for Lithuania, Estonia, Germany, and a couple of other countries.

Part C contains General Provisions announcing, *inter alia*, that this group is to contain such types of contracts as construction, processing, design, and treatment contracts. This shows that the EU will give up the work-performance contract recognised in many states (see, for example, paragraph 631 of the German BGB on

Werkvertrag) and also regulated in the laws of Latvia, Lithuania, and Estonia. From one side, this could be justified by the provisions of article IV.C–2:106 that in all contracts covered by Part C a specific result must be achieved (emphasised as the relevant issue for contracts for work performance). From the other side, the question of definition of services and types of services remains open. Part C can be read in two ways. The first is that contracts for services are all encompassed in contracts itemised in Chapters 3–8 and since, consequently, all service contracts should be encompassed in one of these itemised contracts, no simple (general) contract for services exists. The second possible reading is that the starting point is a service contract, followed by subtypes or modified types of contracts, such as for construction, or design, with special designations of the party: constructor, processor, storer, designer (not service provider as in IV.C–1:101(1)). If this was intended, then a specific definition should be given for ‘service contracts’, one setting forth criteria via which service contracts can be distinguished from processing, storage, treatment, and other contracts. Currently, instead of criteria to be used for distinction, common general rules are provided (Chapter 2). The definition given is rather circular, as it fails to disclose the essence of both ‘supply of service’ and ‘service’.

The grouping of contracts in Book IV is not internally consistent with this. Only two groups are distinguished: Part C (Services) and Part E (Commercial Agency, Franchise, and Distributorship). The first group can be found to follow from the sphere of activity being regulated. The second group involves another distinction criterion — the area of commercial activity. This grouping could also be used in relation to other contracts. The Latvian Civil Code, for example, deals with the following groups: alienation contracts (including sales, barter, maintenance, and supply contracts), contracts requiring return of a thing (loan, lending, and bailment contracts), and contracts for management of another person’s affairs (mandate and commission contracts). Although such a grouping can be questioned, it is important that no general rules exist for each group. On the other hand, purchase contracts in the Latvian Civil Code are classed into subgroups containing the word ‘sale’ or ‘purchase’, such as ‘instalment purchase’, ‘repurchase’, and ‘sale by auction’. The various subgroups of the service group have their own names. They may, of course, be expanded to include the word ‘service’; for example, a contract for design may be called a contract for provision of design services. Nevertheless, the system seems not to be ideal.

It would be acceptable to find a new name, or several names (for example, maintenance or network service), for a contract that would encompass those agreements that do not fall under contract definitions for, e.g., construction, design, and processing (Chapters 3–8). This would not be called a service contract, because then it would contradict the terminology of EU directives where the term ‘service’ is used in a very broad meaning, as reflected by the title of Part C. So the matter remains open of what to call contracts for regulation of all contracts not encompassed by the six proposed groups of contracts. Directive 2006/123/EC declares what kinds of contract are not covered by that particular directive, among them electronic communications, audiovisual, and port services contracts. For these kinds of contracts, directives are expected to be drafted in the future. Although the directive does not deny that these are service activities, neither does it say that they must be regulated by a single kind of contract and that this necessarily must be a ‘service contract’ (for example, gambling does not fall under a service contract). It is simple to declare that a particular directive does not apply to certain things or activities, whereas the CFR as a toolbox cannot ignore that contracts are also used in these particular areas.

Probably more than one new kind of contract should be introduced — for example, a long-term service contract on joining a service network. This is recognised in Russia in relation to electrical supply (however, sale is dominant in this contract). In such contracts it would be appropriate to call one party the recipient (see article 4 of directive 2006/123/EC) and not the client. In other cases, the term ‘maintenance’ probably may be used safely.

In conclusion it should be emphasised that the Principles of European Contract Law and DCFR are already documents of considerable value. Published materials should be studied in universities, by legislative bodies, and also within law offices. It is good and right that the academic DCFR is still going to be improved and adjusted in light of various proposals up to the end of 2008. Nevertheless, it is clear that considerable time will pass before official EU institutions accept them in one or another form.



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The Influence of Instruments of Harmonisation of Private Law upon the Reform of Civil Law in Lithuania

The declaration of independence of Lithuania in 1990 was a natural consequence of the national movement that had started in 1988. This two-year concentration of change was a time of demonstrations, songs, and national euphoria. Thus it is no accident that this time is called a 'singing revolution'. It was also natural that the driving forces in those two years were feelings and emotions rather than rational thinking about the future after the main task — the declaration of independence — had been achieved. There is no surprise that nobody in those two years seriously discussed the model of the future legal system of Lithuania to be introduced in the aftermath of the declaration of independence. So Lithuanian society reached independence without a clear vision for the system of law, including private law, of the future independent Lithuania. The consequence of such inactivity was the temporary retention of the Soviet legal system.

1. Possible approaches for the creation of the new system of private law

As Lithuania restored its independence on 11 March 1990, a need arose to create a new system of law, including private law. A completely new political, economic, and social situation demanded the complete abolishment of, or at least significant changes to, the laws inherited from the Soviet era. In the area of civil law, the main source has remained the Civil Code of 1964. However, this civil code was a typical example of the Socialist civil law that did not recognise private ownership and private business, freedom of contract, or other main institutes of the Western legal tradition. Thus, the Civil Code of 1964 was not suitable for the new political and economic situation and could not serve as a basis for the new system of civil law. Naturally, the legal society was faced with an existential question similar to that of Hamlet, pondering what to do. There were at least two possible ways of introducing a new system of civil law in Lithuania. The first one was the reintroduction of the pre-war system of private law, which was applied between 1919 and 1940. The idea of restoration of the former pre-war legal system of Lithuania was even supported by some of the politicians who were defending the so-called doctrine of continuity of the state. According to the doctrine of continuity, Lithuania was not a newly established state but simply a continuation of the former Republic of Lithuania of 1918–1940. The idea of continuity of the state was quite strong in the area of constitutional law. For example,

the newly elected parliament restored the validity of the Constitution of 1938. However, on the same day, the parliament suspended the validity of the Constitution of 1938 and adopted a new provisional constitution, which was later replaced by another document, the Constitution of 1992.^{*1}

The reintroduction of the pre-war system of private law was even more complicated. The problem was that a purely Lithuanian system of private law had ceased to exist in 1840 because of the division of the Polish–Lithuanian state among other states. The laws of Prussia, Russia, and other states were introduced in the relevant parts of the territory of Lithuania. For these historical reasons, a reception of four different legal systems of private law took place in 1918 when Lithuania declared its independence. Between 1918 and 1940, the Russian Civil Laws of 1830 were applied in the largest part of Lithuania. In the Klaipėda region, the German *Bürgerliches Gesetzbuch* (BGB) was applied. In the territory on the east side of the river Nemunas, the French Civil Code was applied. In the regions of Palanga and Zarasai, the Third Part of the Digest of the Baltic Local Laws of 1864 was applied.^{*2} Such a decentralised system of private law in a small country was not acceptable, and the Commission for the Preparation of the Civil Code of Lithuania was established in 1937. Unfortunately, the activities of this commission were terminated in 1940 and the drafts of several parts of the Civil Code were lost during the war. Thus it was clear that this first option — reintroduction of the pre-war system of private law — was not possible, because of its complexity and the difficulties of adaptation to the present economic, political, and social situation.

The second possibility was to start the preparation of a completely new civil code. This was a more realistic path than a reintroduction of the pre-war system. Nevertheless, this way also presented some difficulties. The main problem was the time factor. Everybody understood that the preparation of a new civil code was a time-consuming job that could take many years. But the state and society needed a new civil code as soon as possible because the application of the Civil Code of 1964 was no longer acceptable from the political, economic, and social points of view. Therefore, the working group established for the preparation of the new Civil Code material had time for neither detailed research nor analyses.^{*3} The second problem was that pertaining to sources — which sources had to be used for the preparation of a new civil code? The working group was charged by the parliament and the Ministry of Justice with a singular task — to prepare a new civil code in the shortest possible time. No other tasks or instructions regarding the model, content, etc. were issued for the working group. Hence, the working group was given free rein to decide upon all questions related to the future new Civil Code of Lithuania. The lack of political instructions meant that on the one hand the working group was free to decide upon the model of the future civil code and the sources to be used for its preparation. On the other hand, such freedom imposed a great responsibility on the working group.

The working group had no intentions to prepare a ‘pure Lithuanian’ civil code (such a task was in 1937 prescribed by the Ministry of Justice for the working group).^{*4} On the other hand, for various reasons, the working group also decided not to use as its model the civil code of any particular country. It was clear that the new Lithuanian Civil Code had to be a modern legal act to regulate relationships in the 21st century. Thus, it was natural that the main sources that served as a model for the working group were the results of the new 20th-century national codifications of civil law (the new Civil Code of the Netherlands, the new Civil Code of Quebec, etc.) as well as the outcomes of the international harmonisation and unification of private law.

In 1995, Lithuania signed an agreement establishing an association between Lithuania and the European Communities and their Member States. The political decision of Lithuanian politicians at that time was very clear — integration into the European Union. In order to achieve this task, Lithuania needed to harmonise its laws with European Union law. It was also clear for the working group that the future civil code had to be in full compliance with European Union law. Consequently, the preparation of the new civil code at the same time meant incorporation of European Union laws into the national law. The majority of European Union directives valid until 2000 were incorporated into the Civil Code. Among those directives, the provisions that have become articles of the Civil Code are the following, among others:

- directive 93/13/EEC on unfair contract terms in consumer contracts (article 6.188 of the Civil Code);
- directive 85/557/EEC to protect the consumer in respect of contracts negotiated away from business premises (articles 6.356–6.357 of the Civil Code);
- directive 86/653/EEC on the harmonisation of legislation of the member states concerning independent commercial agents (articles 2.123–2.139 of the Civil Code);

¹ C. Taube. Constitutionalism in Estonia, Latvia and Lithuania. A Study in Comparative Constitutional Law. Uppsala: Iustus Förlag 2001, pp. 33–45; D. A. Loeber. Regaining Independence — Constitutional Aspects: Estonia, Latvia, Lithuania. — Review of Central & East European Law 1998/1, pp. 1–2.

² V. Mikelenas. Unification and Harmonisation of Law at the Turn of the Millennium: the Lithuanian Experience. — Uniform Law Review 2000/2, pp. 253–261.

³ The Working Group for the preparation of the new Civil Code of Lithuania was established in 1992 and consisted of seven members.

⁴ For a more detailed overview of attempts to unify private law during 1937–1940 in Lithuania, see P. Stravinskis. Kaip ruošėme Lietuvos Civilinį kodeksą. — Teisininkų žinios 1958/25–26, pp. 15–16 (in Lithuanian).

- regulations 1983/83 and 1984/83 concerning distributorship (articles 6.782–6.792 of the Civil Code); and
- directive 84/450/EEC concerning civil liability for misleading advertising (articles 6.301–6.304 of the Civil Code).⁵

The working group also decided to incorporate into the Civil Code other instruments of European Law; e.g., the Rome Convention on the Law Applicable to Contractual Obligations of 1980 was incorporated into articles 1.37 and 1.39 of the Civil Code.

Notwithstanding the efforts of the working group to incorporate the relevant provisions of European Union law into the Civil Code, the results of such implementation were not always satisfactory. The main problem was that the responsibility for the implementation of European law during the accession period was distributed among various ministries and departments. For example, the Ministry of Justice was responsible for the preparation of the Civil Code, while, at the same time, the Ministry of Economics was responsible for the modernisation of company law. A dispute between these two ministries arose regarding the content of the Civil Code — the Ministry of Justice insisted that the Civil Code had to establish general provisions on legal persons as well as special rules on specific types of legal persons (stock corporations, co-operatives, foundations, partnerships, etc.). On the other hand, the Ministry of Economics argued that specific types of legal persons had to be regulated by special laws outside the Civil Code. The government supported the position of the Ministry of Economics; thus, the regulation of specific types of legal persons and questions of bankruptcy was excluded from the scope of the Civil Code. Because of this, the majority of the European Union directives on company law were implemented not by means of the Civil Code but through special laws.

The same could be said about other areas of law covered by European Union law. For example, a special section of Book Six of the Civil Code provides for specific contract concerning tourism services. The articles of this section implement the European directive on package travel contracts. At the same time, the Department of Tourism initiated drafting of the Law on Tourism, which also established rules on the contracting of tourism services. A similar situation can be seen in the area of consumer protection. Notwithstanding the fact that the relevant articles of the Civil Code implemented the above-mentioned European Union directives in the area of consumer protection, a special law on consumer protection was adopted, which repeated the same provisions.

Nevertheless, the European Union laws that existed at the time when the Civil Code was being prepared were not the only source used in the drafting process. The working group tried to incorporate into the Civil Code as many international instruments as possible. At the time of the beginning of the preparation of the Civil Code, Lithuania had ratified only a few international conventions in the area of private law. For example, on 19 January 1993, Lithuania ratified the United Nations Vienna Convention on Contracts for the International Sale of Goods of 1980. But many other important instruments on international harmonisation and unification of private law were not ratified. The working group decided to use these international instruments as a source in the drafting of various parts of the Civil Code. For example, the following instruments were incorporated into the Civil Code: provisions of the UNIDROIT Convention on Agency in the International Sale of Goods (articles 2.140–2.146 of the Civil Code), provisions of the UNIDROIT Ottawa Convention on International Financial Leasing (articles 6.562–6.569 of the Civil Code), provisions of the UNIDROIT Ottawa Convention on International Factoring of 1988 (articles 6.883–6.892 of the Civil Code), and provisions of the Convention on the Liability of Hotel-keepers concerning the Property of their Guests of 1962 (article 6.851 of the Civil Code).

In addition, the working group used as a model various documents of the Council of Europe. For example, the regulation of civil contractual liability in the form of civil penalty is based on resolution No. 3(78) of the European Council of Ministers on Penal Clauses in Civil Law, of 20 January 1978 (articles 6.71–6.75 of the Civil Code). Article 6.52, dealing with the place of the performance of monetary obligations, is based on the European Convention on the Place of Payment of Money Liabilities of 1967.

The activity of the working group is a good example of how international instruments could become part of the national law without a long ratification procedure as applicable to international treaties. On the other hand, Lithuanian experience of incorporation of international instruments into the national law by the above-mentioned method illustrates the importance of law professors for the national legislation process and for international harmonisation and unification of law. As was mentioned by J. H. Merryman, the civil law is a law of the professors.⁶ This is particularly true in respect of Lithuania. On the one hand, the Civil Code of Lithuania is a product of the work of law professors, as all of the members of the working group were professors of the Faculty of Law of Vilnius University. On the other hand, thanks to the effort of the members of the working group, many international instruments in the area of private law today are part of Lithuanian private law. If the question of incorporation of those instruments had been left to politicians to be dealt with

⁵ According to the official data of the European Commission, Lithuania has implemented about 98% out of the EU law and in this respect is a leader among the new Member States.

⁶ J. H. Merryman. *The Civil Law Tradition*. 2nd ed. Stanford, California: Stanford University Press 1985, p. 56.

by ratification procedure, probably the majority of those instruments never would have been incorporated into Lithuanian law. In this respect, the Lithuanian experience is a good example of the autonomous and voluntary use of international instruments for the creation and modification of national law.

However, the importance of one particular source of the Lithuanian Civil Code must be given more detailed mention here — the UNIDROIT Principles of International Commercial Contracts (the UNIDROIT Principles).

2. The UNIDROIT Principles — the way to national law

Lithuanian experience of the use of the UNIDROIT Principles in the modification of national contract rules has already been discussed. It has been mentioned in several articles that the contract law provisions of the new Lithuanian Civil Code to a great extent follow the UNIDROIT Principles.⁷ Though this is an accurate assessment, it nevertheless needs some clarification.

The first version of the UNIDROIT Principles was published in 1994. At that time Lithuania was not yet a member of UNIDROIT, and, unfortunately, Lithuanian representatives did not participate in the process of the preparation of the UNIDROIT Principles. Consequently, at that time the Lithuanian role in the process of harmonisation of contract law in Europe was that of a 'bystander'. In 1994, the working group finally finished the first draft of the Civil Code, including the chapter on the general provisions of contract law. However, after the working group had discovered the fact of the publication of the UNIDROIT Principles, it was decided to return to the provisions concerning contract law, once again. Despite the UNIDROIT Principles not constituting a binding instrument, it was clear to the working group that this instrument was some kind of 'better law' that could serve as a model for the contract law of the new millennium. The decision of the working group to consider the provisions of contract law again in this light could be explained by the importance of this part of the Civil Code for the society in transition, the aim of which was to create an effectively functioning market economy and a system of private ownership. On the other hand, contract law in the Civil Code of 1964 was undeveloped and the working group tried to modernise contract law as much as possible.

Nevertheless, the decision of the working group to re-draft the chapters on the general provisions of contract law was not so easy to implement. Various problems emerged before the working group. Here one might mention just a few of them.

First of all, the UNIDROIT Principles are a 'fragmented code' or a miniature contract code. Conversely, the national civil code is a comprehensive, sometimes very general and systemic act that covers not only contract law but also persons, property law, family law, succession law, different kinds of obligations, specific contracts, etc. For example, the draft Civil Code of Lithuania consisted of six books. Book One included general provisions on the notion and types of legal transactions, the form and validity of legal transactions, etc. Book Six provided general provisions on obligations, such as performance of obligations, effects of non-performance, and contractual and tort liability. The structure of the Civil Code was not exactly conducive to a consistent incorporation of the UNIDROIT Principles. It was clear that incorporation of the UNIDROIT Principles into the Civil Code would require adaptation of some provisions of these principles. For example, notwithstanding the fact that the majority of the UNIDROIT Principles are incorporated into Part II, 'Contract Law', of Book Six of the Civil Code, some provisions of the UNIDROIT Principles could be found in relevant chapters of Book One regarding legal transactions and in relevant chapters of Book Six regarding general questions of the law on obligations. On the other hand, the structure and system of the Civil Code did not allow full acceptance of some provisions of the UNIDROIT Principles. For example, article 3.4 of the UNIDROIT Principles, on the definition of mistake, was incorporated into article 1.90 of the Civil Code only partly, i.e., the Civil Code defines a mistake as erroneous assumption relating to facts only, not relating to law. Such partial acceptance of article 3.4 of the UNIDROIT Principles could be explained by article 1.6 of the Civil Code, according to which ignorance of laws or improper understanding thereof does not exempt one from the application of the sanctions established therein and may not justify failure to comply with the requirements of laws, and likewise improper compliance therewith.

⁷ M. J. Bonell. The UNIDROIT Principles in Practice: The Experience of the First Two Years. — *Uniform Law Review* 1997/1, p. 37; E. H. Hondius. Export van Westers recht naar Oost-Europa: het voorbeeld van Litouwen. — *Import en export van burgerlijk recht*. AW — *Krant Jaarboek* 1997 (13), pp. 113–127; N. Reich. Transformation of Contract Law and Civil Justice in the New EU Member Countries — The Example of the Baltic States, Hungary and Poland. — *Penn State International Law Review* 2004–2005 (3) 3, pp. 587–598; T. Zukas. Reception of the UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law in Lithuania. — E. Cashin Ritaine, E. Lein (ed.). *The UNIDROIT Principles 2004. Their Impact on Contractual Practice, Jurisprudence and Codification*. Reports of the ISDC Colloquium (8/9 June, 2006). Zürich: Schulthess 2007, pp. 231–243.

The second difficulty related to the incorporation of the UNIDROIT Principles was that they were conceived for international contracts. The working group understood that some liberal provisions of the UNIDROIT Principles would not be accepted by politicians during the process of adoption of the Civil Code in Parliament. For example, ideas of formalism in contract law were quite strong in Lithuania. Such a conclusion is supported by the fact that Lithuania, when ratifying the Vienna Convention on International Sale of Goods, exercised the right provided by articles 12 and 96 of this convention and made reservations regarding the application of articles 11 and 29 of said convention. According to this reservation, articles 11 and 29, or Part II of the convention, allowing a contract of sale or its modification or termination by agreement or any offer, acceptance, or other indication of intention to be made in any form and not just in writing, shall not apply where any party to the contract has his place of business in Lithuania. Because of this and also the fact that the Civil Code regulated contracts regarding acquisition of real property and real rights, special rules on the form of legal transactions were provided by the Civil Code and article 1.2 of the UNIDROIT Principles was not accepted.

The third problem was that the UNIDROIT Principles were basically conceived for commercial contracts. The Civil Code was intended to regulate three different types of contracts — commercial, civil, and consumer. Therefore, it was necessary to provide general rules applicable to all types of contracts and special rules applicable only in respect of commercial or consumer contracts.

The time factor and the issue of human resources must be mentioned also. As has been mentioned above, the working group was asked to prepare a new civil code within the shortest possible time. As a result, the group did not have enough time to study all relevant materials related to the UNIDROIT Principles and methods and the consequences of their incorporation into the Civil Code. On the other hand, as was also mentioned, the working group consisted of only seven members and the possibility to employ consultants and advisers was limited also. Nevertheless, the working group applied its initiative and sought advice from foreign specialists involved in the process of the preparation of the UNIDROIT Principles — namely, Professors J. Bonell, P. Schlechtriem, and U. Drobnig. We are most grateful to all of them for their useful advice.

Finally, the last but not the least reason for not all provisions of the UNIDROIT Principles being incorporated into the Civil Code was the critical attitude of the members of the working group to some of the provisions of the UNIDROIT Principles. It is almost a universal rule that uniform international documents are largely the result of compromise. This approach means that other solutions to a given problem are also possible and that a solution reached by way of compromise is not always the best solution. Even uniform international documents have weak parts and are sometimes subject to criticism, often justifiably.⁸ Thus it was natural that some provisions of the UNIDROIT Principles were not compatible with the ideas supported by the members of the working group. For example, the working group insisted on strict application of the principle of *pacta sunt servanda*. The elements of this principle are clearly established by the relevant provisions of the Civil Code. For example, Part 1 of article 6.189 of the Civil Code provides that a contract formed in accordance with the provisions of the law and that is valid shall have the force of law between its parties. Obviously, it is not possible for a party either to unilaterally avoid a contract or to unilaterally refuse to perform an obligation that arises out of a contract (under article 6.59 of the Civil Code). For these reasons, the working group decided not to accept the institute of avoidance of a contract, as provided by articles 3.14–3.17 of the UNIDROIT Principles, because unilateral avoidance of a contract could lead to instability of civil relationships. As a result, the Civil Code provides that in the event of mistake, fraud, or threat, the interested party must start court proceedings for the annulment of a contract.

On the other hand, it was necessary to enshrine in the Civil Code the contract law provisions that were widely accepted though, as a consequence of their general recognition, not made explicit in the UNIDROIT Principles, among them the principle of the freedom of contract and types of contracts. The necessity of the inclusion of such generally recognised provisions is explained by the lack of such provisions in previous legislation. For example, the Civil Code of 1964 did not provide the principle of the freedom of contract, as this principle was not recognised under Soviet legal doctrine.

The adoption of a new version of the UNIDROIT Principles has raised a number of new questions about the relationship between the new chapters of the UNIDROIT Principles and the Civil Code. At the moment, there is no intention to make a revision of the Civil Code and to incorporate these new chapters of the principles into the Civil Code. Nevertheless, the new chapter of the UNIDROIT Principles of 2004 will be used in the interpretation process of the relevant provisions of the Civil Code. We even have some examples of such interpretation. For instance, in one arbitration case, article 6.101 of the Civil Code, which allows non-assignment clauses, was interpreted in the light of article 9.1.9 of the UNIDROIT Principles of 2004, which provide that the non-assignment clause shall not be valid in respect of the monetary claims of the creditor. Such examples allow one to make optimistic assumptions that, in the future, all contract law provisions of the Lithuanian Civil Code will be interpreted in the light of the UNIDROIT Principles of 2004.

⁸ U. Mattei. The Issue of European Civil Codification and Legal Scholarship: Biases, Strategies and Developments. – Hastings International and Comparative Law Review 1998 (21), pp. 898–901; P. Linzer. Validity under Chapter 3 of UNIDROIT Principles of International Commercial Contracts. Available at www.bibliojuridica.org/libris (19.02.2008).

3. Experience of seven years of application of the Civil Code: A case study approach

The new Civil Code of Lithuania entered into force on 1 July 2001. Thus, we have approximately seven years of practical experience of the application and interpretation of the rules of this 'private law constitution' and it is possible to draw some conclusions.

The first conclusion that follows from the experience of these seven years is the confirmation of the well-known division between the 'law on the books' and 'law in action'. Yes, Lithuania transferred into its statutory law — i.e., into the Civil Code — many harmonised and uniform rules of private law, including provisions of European Union law, provisions of several international conventions, the Council of Europe documents, and the absolute majority of the provisions of the UNIDROIT Principles of 1994, among other materials. In this respect, the codification process in Lithuania between 1990 and 2000 could be described in the words of Professor A. Watson as a process of 'transplantation'.⁹ Nevertheless, the transplantation of uniform international instruments into national statutory law is only the first step. The second, a more important and more complicated step, is the practical application and interpretation of these uniform provisions. The process of transplantation of international and foreign instruments into national law could be implemented by a few lawyers, as happened in Lithuania during the preparation of the Civil Code. However, the whole of the legal community must be involved in the process of application and interpretation of transplanted provisions. In this respect, the results of legal reform depend to a great extent on the qualification, knowledge, openness, and willingness of all members of the legal community. Unfortunately, the legal community in Lithuania still possesses many features of the former Soviet legal system. Over the last decade, the legal thinking and legal practice in post-Soviet states have been submitted to extensive critical assessment. For example, former Justice of the European Court of Justice David A. O. Edward highlighted the 'legal deficit' in post-Soviet states — the lack of rich law libraries and good textbooks, as well as lack of publication of court judgments.¹⁰ Other critics mentioned the weakness of the judiciary in these states.¹¹ These critical comments are, of course, valid. Despite the efforts of legal harmonisation and unification, there is no single, common legal community in Europe, and legal thinking and legal methodology are still divided at the European level. It will take many years to eliminate the legacy of the Soviet legal mind and to improve the knowledge of lawyers who were educated during Soviet times. Only when new generations of lawyers, educated in Western universities, replace the old generation of jurists can we speak of a more real common European legal thinking.

The outlook for this aspect of private law reform looks more doubtful and even pessimistic. For example, since the entry into force of the civil code, the courts of Lithuania have heard a thousand civil cases in which they have applied the contract rules of the new code. Several hundred of these cases reached the Supreme Court of Lithuania. Unfortunately, only in 11 contract law dispute cases did the lawyers of the parties base their arguments on the UNIDROIT Principles and only in four cases did the Supreme Court itself mention the UNIDROIT Principles. Even in these four cases, the application of the UNIDROIT Principles in fact entailed only a reference to the relevant article of the UNIDROIT Principles rather than proper extensive argumentation based on the doctrine, court practice of other states, or arbitral awards applying the same provision of the UNIDROIT Principles.

The best way to show the difficulties in applying and interpreting the provisions of the UNIDROIT Principles that are 'transplanted' into the Lithuanian Civil Code might be an analysis of one civil case. The case in question concerns the application of articles 1.7 and 2.15 (2) of the UNIDROIT Principles, regarding good faith in pre-contractual relationships. The provisions of the above-mentioned articles of the UNIDROIT Principles are incorporated into several articles of the Civil Code. Article 1.5 of the Civil Code provides that, in exercise of their rights and performance of their duties, the subjects of civil relationships shall act according to the principles of justice, reasonableness and good faith. The same article provides that, in interpreting and applying laws, the courts shall be guided by the principles of justice, reasonableness, and good faith. Article 6.4 of the Civil Code provides that the debtor must conduct himself in good faith, reasonably and justifiably both at the time the obligation has been created and is existing and at the time it is under performance or extinguishment. According to article 6.158 of the Civil Code, each party to a contract shall be obliged to act in accordance with good faith in handling of contractual relationships. A special article (article 6.163) of the Civil Code establishes obligations of the parties in pre-contractual relationships. According to this article, in the course of pre-contractual relationships, the parties shall conduct themselves in accordance with good faith.

⁹ A. Watson. *Legal Transplants. An Approach to Comparative Law*. Edinburgh: Scottish Academic Press 1974, pp. 4–5.

¹⁰ D. A. O. Edward. What Kind of Law Does Europe Need? The Role of Law, Lawyers and Judges in Contemporary European Integration. — *The Columbia Journal of European Law* 1998/5, pp. 1–14.

¹¹ Z. Kühn. European Law in the Empires of Mechanical Jurisprudence: the Judicial Application of European Law in Central European Candidate Countries. — *Croatian Yearbook of European Law and Policy* 2005 (1), pp. 55–73; F. Emmert. Administrative and Court Reform in Central and Eastern Europe. — *European Law Journal* 2003 (9) 3, pp. 288–315; Z. Kühn. The Authoritarian Legal Culture at Work: The Passivity of Parties and the Interpretational Statements of Supreme Courts. — *Croatian Yearbook of European Law and Policy* 2006/2, pp. 19–26.

The same article provides that the parties shall be free to begin negotiations and negotiate and that they shall not be liable for failure to reach an agreement. However, a party who begins negotiations or negotiates in bad faith shall be liable for the damages caused to the other party. It shall be considered bad faith for a party to enter into negotiations or continue them without intending to reach an agreement with the other party, or to conduct any other actions that do not conform to the criteria of good faith. One can see that the requirement of good faith in pre-contractual relationships is clearly established by the Civil Code. However, as evidenced by the analysis of the applications of these provisions, the reality is much different from what is set out in the rules of the statutory law.

The facts of the case are as follows. The plaintiff — closed stock corporation Vilnius Vingis Cinema (the Plaintiff) — on 12 March 2002 announced a closed tender for the construction of a cinema building in Vilnius. The tender documents, including the standard conditions for the construction contract, were sent to several construction companies. Participating in this closed tender, defendant closed stock construction corporation Eika (the Defendant), on 2 April 2002 sent to the Plaintiff two proposals and confirmed its participation in the tender and its obligation to start construction work immediately after receiving the relevant instructions of the Plaintiff. These proposals also provided that the proposals (i.e., the offer) were to be irrevocable for a period of two months. After receiving these proposals, the Plaintiff on 15 April 2002 sent to the Defendant an explanatory letter aimed at the clarification of the price of the future construction work. On 17 and 18 April 2002, new irrevocable proposals of the Defendant were sent to the Plaintiff regarding the price of the future construction work. During the negotiations of the representatives of both parties on 18 April, the Defendant confirmed that he found all of the tender documents to be clear and the parties agreed that the Defendant would send the final offer by 2:30 pm on 19 April 2002. The minutes of the meeting also indicated that the Defendant had to inform the Plaintiff about the date of the start of the construction work, and the Defendant also asked the Plaintiff for advance payment. The next meeting between the parties took place on 19 April 2002. According to the minutes of this meeting, the parties finally agreed that the final price of the construction work would be 8,475,000 litas. The parties also agreed that the Defendant on the same day would send the final proposal containing that price and the Plaintiff would send to the Defendant the letter of intent. The parties also agreed that the contract would be signed on 22 April 2002. On 19 April, the Plaintiff sent to the Defendant the letter of intent confirming that the Defendant had been selected as a contractor for the construction of the cinema building and that the contractor would be able to start the construction work immediately. The letter of intent also stated that the construction contract had to be signed on 22 April 2002 and that until that date the letter of intent together with the proposal of the Defendant comprised a contract of obligatory force. Nevertheless, the Defendant did not respond to that letter of intent and on 22 April 2002 informed the Plaintiff of his refusal to sign the contract. After some time, the Plaintiff entered into a new construction contract, with another construction company, though the price of the construction work under the latter contract was higher by 1.9 million litas.

The Plaintiff sued the Defendant for damages, claiming 1.9 million litas as the difference between the price agreed for the construction work with the Defendant and the actual price paid to the other construction company, plus expenses incurred during the negotiations with the Defendant. However, the courts of first and second instance dismissed the Plaintiff's claim, arguing that no contract had been formed. The Supreme Court reversed the judgment of the Court of Appeal and remanded the case to be reheard. The main arguments of the Supreme Court related not only to the procedure of the formation of a contract but also to the correspondence of the activity of the parties to the requirements of the principle of good faith. In its judgment, the Supreme Court presented a comparative analysis of the procedure of the formation of contract and cited foreign comparative contract law sources.^{*12} The Supreme Court mentioned that sometimes it is difficult to distinguish between offer and acceptance. According to the Supreme Court, a contract is very often a result of consensus reached during a lengthy process of negotiation during which the parties exchange numerous proposals and counter-proposals. In the case under discussion, the Supreme Court pointed out that the parties had entered into negotiations. According to the general principle of good faith, parties are free to begin negotiations and negotiate without being held liable for failure to reach an agreement. Nevertheless, the above-mentioned principle requires the negotiation to be carried out in good faith. The Supreme Court, when interpreting the notion of good faith in negotiations, turned to the practice of the Dutch Supreme Court, which in its judgment of 18 June 1982 in the *Plas v. Valburg* case formulated the doctrine of three stages of negotiations. According to the Supreme Court, termination of negotiations during the last stage of negotiation without serious reasons is contrary to the principle of good faith. The Supreme Court also cited the 'Commentary' section of the UNIDROIT Principles.^{*13} According to the Supreme Court, articles 6.4, 6.158, and 6.163 of the Civil Code of Lithuania had been prepared on the basis of articles 1.7 and 2.15 of the UNIDROIT Principles and therefore had to be interpreted in the light of these principles. The Supreme Court ruled that, according to the facts of the case, the negotiation process between the parties had reached the final stage. The actions of the Defendant (asking for advance payment, the clarification of the day of the beginning of construction work,

¹² For example, the Supreme Court made references to the well-known book H. Beale et al. (eds.), *Contract Law: Cases, Materials and Text*. Oxford: Hart Publishing 2002.

¹³ UNIDROIT Principles of International Commercial Contracts with Commentary. Rome 1994.

etc.) created reasonable reliance on the part of the Plaintiff that the intentions of the Defendant were serious. According to the Supreme Court, Part 3 of article 6.163 of the Civil Code imposed civil liability for breaking off negotiation in bad faith. In the opinion of the Supreme Court, which is based on the Commentary of the UNIDROIT Principles, the Plaintiff was entitled both to recover the expenses incurred during the negotiations and to claim for the lost opportunity to conclude another contract with a third party on the same conditions (reliance or negative interest). The Supreme Court also pointed out that the lower courts had failed to investigate the facts of the case and the activities of the parties in view of the principle of good faith. According to the Supreme Court, even if the conclusion that the parties had not entered into a contract were valid, the lower courts' duty was to evaluate the activities of the parties during the negotiation process in the light of the requirements of good faith. The Supreme Court pointed out that the facts of the case made it obvious that, by his refusal without due reasons to sign the contract in the final stage of negotiations, the Defendant acted in bad faith; therefore, it held that he was to be held liable for the violation of the duty to act in good faith during the pre-contractual relationships. As the facts of the case were not investigated in terms of articles 6.4, 6.158, and 6.163 of the Civil Code, the Supreme Court quashed the judgment of the Court of Appeal and remanded the case to the Court of Appeal for a new hearing.^{*14}

Unfortunately, the outcome of the case before the Court of Appeals remained the same — the Court of Appeal dismissed the claim. When evaluating the behaviour of the Defendant, the Court of Appeal devoted just one sentence to indicating that the Defendant had acted in good faith.^{*15} No reference to the UNIDROIT Principles or other comparative law sources cited by the Supreme Court was made.

Analysis of the practice of Lithuanian courts shows that the courts are not ready to implement new provisions of the Civil Code that are based on the UNIDROIT Principles and other uniform international documents. There are many reasons for such a situation, but, in any case, it does not seem likely that this state of affairs might change in the nearest future.

Nevertheless, quite a different situation manifests itself in the area of arbitration. The parties and the arbitrators are more willing to apply the UNIDROIT Principles and other uniform international documents in deciding contractual disputes. Unfortunately, arbitration is not popular in Lithuania (only 10–15 cases per year are administrated in Lithuania by the Vilnius Court of Commercial Arbitration).

4. Conclusions

The creation of the national private law system in a post-Soviet state like Lithuania is a long-term process that requires many intellectual, political, and economic efforts and capabilities. The final task of this process is not just to prepare a civil code. Preparation and adoption of any code is only the first step, however important it may be, of this process. The final task of a reform is to make the private law system more modern, more predictable, more understandable, more just, and more efficient. In its material sense, the preparation and adoption of a civil code is a creative process. In order to ensure that this creative process is efficient and to achieve the final tasks of the reform, some prerequisites must be met. The success of private law reform and the transformation or transplantation of uniform international instruments into the form of national law need a relevant legal and cultural atmosphere, well-developed doctrine of law, qualified and active judiciary, good knowledge of comparative law on the part of the entire legal community, etc. We must also keep in mind that the law is absolutely not an autonomous subject. The statutory law, legal thinking, and legal practice depend on many cultural, political, economic, and other factors. Today Lithuania is part of the European Union. However, cultural, economic, legal, and other features in the East and West, in the North and South of the European Union are quite different. It is obviously because of these differences that the same rule of the UNIDROIT Principles could be interpreted and applied in different ways in various Member States. Consequently, it is not possible to achieve a more harmonised and uniform legal system without reducing the economic and cultural differences among the Member States.

¹⁴ Supreme Court, judgment of 19 January 2005, case No. 3K-3-38-2005. – Lietuvos Aukščiausiojo Teismo biuletenis Teismų praktika (Bulletin of the Supreme Court of Lithuania) 2005 (23), pp. 145–155 (in Lithuanian).

¹⁵ Court of Appeals, judgment of 5 April 2005, case No. 2A-161/2005. Unpublished.



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European Initiatives and Reform of Civil Law in Poland

1. The formative period of modern Polish civil law

Poland has a well-established tradition in adopting a comparative law approach to the codification of civil law. This has to a large extent been due to our historical experience.

When Poland lost its independence after it was partitioned by the neighbouring states at the end of the 18th century, Polish law was replaced with the legal systems of those countries. Thus, for over a century, until Poland regained independence in 1918, the Austrian, German, and Russian legal systems applied in various parts of the Polish territory; French law applied on the territory of the former Grand Duchy of Warsaw established by Napoleon Bonaparte. Having regained independence, the reborn Polish state proceeded swiftly to re-establish a uniform Polish system of law.*¹ This task was given to the Codification Commission, composed of the greatest experts in private law — professors and lawyers educated in various foreign legal systems. The comparative law approach toward establishing modern civil law in Poland not only was indispensable for achievement of the best results in that domain but was also quite natural and obvious for members of that commission who were brought in and experienced with various foreign legal systems and legal traditions. It has exercised a great influence on the shape and contents of all legislative acts enacted in various areas of private law.

The most important of these legal codes were the Code of Obligations of 1933 and the Commercial Code of 1934. They created a modern system of law based to a large extent on the achievements of various foreign national legislators. The Code of Obligations, an original modern piece of legislation from the 1930s, was inspired in many respects by the Swiss, French, German, and Austrian civil law codifications, and also the results of the work of the French-Italian commission working on the draft of a new civil code. The Code of Obligations may be recognised as some sort of bridge between various legal traditions. It is worth noting that it has never given rise to a legal nationalism, a trait characteristic of civil law codification in some European countries.

¹ Cf. F. Zoll, *The Future of European Contract Law from the Perspective of a Polish Scholar*. — *European Contract Law*, Special issue (ERA Forum — *scripta iuris europaei*) 2006, p. 90 *ff.*

2. Transition from ‘socialist law’ to civil law

The development of the civil law codification process was stopped by brute force during the Second World War and subsequently by the Communist regime, again imposed by force. The Code of Obligations was repealed. The new Civil Code of the Polish People’s Republic, elaborated by a new Codification Commission, entered into force in 1965. Fortunately, this commission included some professors of law who had participated in the pre-war Codification Commission. It was due to their efforts that the Civil Code, although based on the assumption of ‘socialist’ civil law, could preserve some institutions and provisions of the former Code of Obligations.

Enormous reforms in various areas of civil law were carried out when the Communist regime was gradually dismantled in the 1990s. They were greatly facilitated by the possibility of returning to Poland’s pre-war traditions. The Civil Code of 1964 was gradually changed by several consecutive law reforms. The complex task of preparing reform of the whole system of civil law was given to the Commission for Civil Law Reform as established by the Minister of Justice in 1989. The commission decided that this reform had to be carried out on a step-by-step basis in order to complete the task gradually.

The first phase of the reform started immediately in 1990 and aimed at eliminating ‘socialist’ distortions to the civil law and adjusting it to the emerging market-oriented economy. Fundamental changes were made in property law in order to eliminate the legal regime based on the socialist concept of ownership distinguishing social, personal, and private ownership, each of them being accorded a different level of legal protection. The highest level of legal protection was reserved for ‘socialist state property’, the lowest for private property as a means of production being treated as a remnant of the past capitalist epoch. This differentiation among various types of ownership, with the associated difference in the scope and intensity of their legal protection, had to be abolished, and the traditional unitary concept of ownership reflecting the equality in law of all owners, be they public or private, was reintroduced.

In the area of the law of obligations, specific institutions and special rules concerning economic relations in the socialised, planned economy between the so-called ‘units of socialised economy’ were eliminated. The principle of freedom of contract almost totally absent in a socialised economy was reintroduced, as were some other legal institutions and rules from the pre-war Code of Obligations.

The ‘returning to the roots’ tendency visible during this process of reform was combined with a modernisation approach aimed at establishing a legal framework adjusted to the requirements of a modern market economy.^{*2} Here again, going back to Poland’s pre-war traditions of a comparative law approach to civil law reform was very helpful.

3. Modern law reform: Implementation and impact of EU directives

On 16 December 1991, Poland signed the Europe Agreement, establishing an association between Poland and the European Communities and their Member States. The work of gradual harmonisation of Polish civil law with European rules and standards started in the following year.^{*3} This work has been intensified and accelerated since 16 April 2003, when Poland signed the Accession Treaty, by which it undertook to accept the entire *acquis communautaire*. Since that time, enormous work has been done to implement it in Polish law.^{*4}

Implementation of all EU directives concerning various institutions and rules of private law took place over a relatively short time. This has not always permitted adjusting them perfectly to the system of Polish civil law and undertaking proper research and studies on the potential impact of certain changes on various parts of civil law or even on the system as a whole. Only a few directives have been integrated into the Civil Code. The majority of them were implemented outside the Civil Code either by way of the enactment of specific statutes or through introducing their rules into existing special enactment.

Thus, for example, the implementation of the Council directive of 25 July 1985 concerning liability for defective products (85/374/EEC) led to the introduction into the Civil Code of a set of provisions, a new Title VI¹ of

² Cf. J. Rajski. Legal Aspects of the Transition from a State Directed Economy to a Market Economy. – Law, Economics and Business in the Melting Pot. Vedback 1997, pp. 183 ff.; J. Rajski. Quelques aspects juridiques du passage de l’économie d’Etat planifié à l’économie de marché en Pologne. – Revue internationale de droit compare 1991/1, p. 119 ff.

³ Cf. J. Rajski. Progressive Harmonization of Polish Civil Law with European Rules: Product Liability. – Liber Amicorum Guy Horsmans. Bruxelles 2004, p. 971 ff.

⁴ Cf. E. Łętowska, A. Wiewiórowska-Domagalska. The Common Frame of Reference — the Perspective of a New Member State. – European Review of Contract Law 2007/3, p. 270 ff.

Book Three (on obligations), located between the titles containing provisions on delictual and on contractual liability, respectively. Implementation of the Self-employed Commercial Agents Directive of 18 December 1986 (86/653/EEC) resulted in profound changes to the legal regime of the agency contract set out in Title XIII of Book Three of the Civil Code. The Council directive of 5 April 1993 on unfair terms in consumer contracts (93/13/EEC) was implemented by way of including new language in Title III of Book Three of the Civil Code on general provisions concerning contractual obligations. Finally, implementation of the directive of 8 June 2000 on electronic commerce (2000/31/EC) led to the introduction of a number of provisions on the declaration of will in an electronic form, electronic offers, electronic contracts, and electronic form of juridical acts into the general provisions of Book One of the Civil Code (on conclusion of contracts).

Implementation of a number of directives led to the enactment of specific legislative acts. Thus, for example, the directive of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees (1999/44/EC) was implemented through the enactment of a special act of 27 July 2002 on the particular terms of consumer sales⁵, which amended the general regulation of sales in the Civil Code. Implementation of the Council directive of 25 December 1985 to protect the consumer in respect of contracts negotiated away from business premises (85/577/EEC) was carried out through the enactment of the Act of 2 March 2000 on the protection of certain consumer rights.⁶ That Act was amended in 2004 by a law⁷ that introduced to it a new Chapter 2a, containing provisions implementing the Directive of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services (2002/65/EC). The Council directive of 22 December 1986 concerning consumer credit (87/102/EEC) was implemented through the enactment of the Act of 20 July 2001 on consumer credit.⁸ Implementation of the directive of the European Parliament and of the Council of 26 October 1994 on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis (94/47/EC) was carried through in the enactment of the Act of 13 July 2000 on the protection of purchasers of usage rights to premises or living quarters at a specified time of each year⁹, which amended some provisions of the Civil Code on the right of usufruct of natural persons.

Several directives have been implemented by way of introducing relevant provisions into some special acts. Thus, for example, as part of implementation of the Council directive of 13 June 1990 on package travel, package holidays, and package tours, new provisions (90/314/EEC) were introduced to the Act of 29 August 1997 on tourist services.¹⁰ The directive of the European Parliament and of the Council of 6 October 1997 amending directive 84/450/EEC concerning misleading advertising so as to include comparative advertising (97/55/EC) was implemented in the Act of 16 April 1993 on unfair competition.¹¹ The directive of the European Parliament and of the Council of 19 May 1998 on injunctions for the protection of consumers' interests (98/27/EC) was implemented in the Act of 15 December 2000 on the protection of competition and consumers.¹²

Through the implementation of the EU directives, Polish civil law has been harmonised with European rules in a way adequate to the nature of those directives, which deal with particular subject matter, create fragmentary regulations prepared in an internally non-harmonised law-making process, and are badly lacking a coherent legal framework. Time pressure has not permitted the elimination of all incoherence and ambiguities in the directives during the process of their implementation. The necessarily hasty implementation of the directives has also not permitted the proper evaluation (i.e., assessment after thorough studies and research) of their impact on the system of Polish civil law.

The dispersion of many of the implemented rules across a number of legislative enactments separated from the Civil Code has made the task of their adjustment to the background and framework of Polish civil law more difficult. This has also had a negative impact on the effectiveness of their application in judicial and contractual practice. In consequence thereof, among other things, the real influence of the EU directives on the development of general civil law in Poland has been rather limited.

⁵ Dz. U. Nr 141, poz. 1176 ze zm. (Journal of Laws No. 141, item 1176, as amended).

⁶ Dz. U. Nr 22, poz. 271 ze zm.

⁷ Dz. U. Nr 116, poz. 1204.

⁸ Dz. U. Nr 100, poz. 1081 ze zm.

⁹ Dz. U. Nr 74, poz. 855 ze zm.

¹⁰ Tekst jednolity: Dz. U. z 2004 r. Nr 223, poz. 2268 ze zm. (Uniform text: Journal of Laws of 2004, No. 223, item 2268, as amended).

¹¹ Tekst jednolity: Dz. U. z 2003 r. Nr 153, poz. 1503 ze zm.

¹² Tekst jednolity Dz. U. z 2005 r. Nr 244, poz. 2080 ze zm.

4. Modern law reform: Harmonisation with uniform rules and standards

In the process of recent reforms of some areas of Polish civil law, great attention has continually been paid to the solutions adopted in the Principles of European Contract Law (PECL) and the UNIDROIT Principles of International Commercial Contracts, as well as those accepted in international conventions establishing uniform rules — in particular, the UN Convention on Contracts for the International Sale of Goods (Vienna Convention of 11 April 1980).

This approach has been adopted in order to achieve a proper level of harmonisation of certain rules of civil law with international and in particular European rules and standards.

A number of new rules introduced to the Civil Code have been inspired by solutions adopted in European (PECL) and UNIDROIT (UPICC) principles of contract law.

The Act of 2 March 2000 amending some provisions of the Civil Code^{*13} introduced a provision concerning the conflicting general conditions, which was inspired by article 2:209 of the PECL and article 2:22 of the UPICC. The new article 385⁴ of the Civil Code provides that a contract between entrepreneurs using different standard terms does not embrace conflicting provisions of those terms (§ 1). However, the contract is not concluded if a party, after having received the offer, informs the other party without delay that he does not intend to conclude the contract on such terms (§ 2). The 2003 reform that amended a number of provisions of the Civil Code introduced important changes to its general provisions concerning conclusion of contracts, which were inspired by the PECL, the UPICC, and the Vienna Convention of 1980.

Important modifications have been made in respect of provisions concerning an offer and its acceptance. A concept of revocation of the offer inspired in particular by article 2:202 of the PECL has been introduced but restricted to business-to-business relations (article 66² of the Civil Code). A concept of modified acceptance of the offer was modelled on article 19, p. 2 of the Vienna Convention; article 2.1.11, p. 2 of the UPICC; and article 2:208 of the PECL. The scope of application of this rule has also been restricted to business-to-business relations (see article 68¹ of the Civil Code).

New important rules have been introduced concerning negotiations of contracts. A new article 72, § 2 of the code modelled on article 2:301 of the PECL imposes liability on a party who, when negotiating a contract, acts contrary to good faith and thereby causes damage to the other party. According to this provision, a party having entered into or carried on negotiations in breach of good faith — in particular, with no intention to enter into a contract — is obliged to provide compensation for damage suffered by the other party as a result of expectation of conclusion of the contract. A new article 72¹ of the Civil Code introduced a rule on breach of confidentiality accepted in the law of EU member states and modelled on article 2:302 of the PECL. According to this provision, if confidential information is supplied by a party in the course of negotiations, the other party has a duty not to disclose that information and transmit it to other persons or to use it for its own purposes, unless the parties to the contract agreed otherwise. In a case of non-performance or improper performance of the above duties, the aggrieved party may demand from the other party compensation for damages or restitution of the benefit received by the other party. Adoption of the institution of ‘professional’s written confirmation’, previously unknown to Polish law, has also been inspired by the provisions of the PECL and UPICC (articles 2:210 and 2:12, respectively). According to article 77¹ of the Civil Code, if confirmation of a contract concluded between entrepreneurs without satisfying a written form is given to the other party without delay in writing that does not materially alter its contents, the parties are bound by the contract as specified in the written confirmation, unless the other party does not object to the content in writing without delay.

It may be concluded that the PECL and UPICC have exercised an important influence on the modernisation of Polish civil law.

5. Conclusions

Profound changes of civil law in Poland introduced by a number of legislative enactments, many of which have not been integrated into the Civil Code, have led to a certain degree of disintegration of the codified system of law. The problem of its reintegration promoted by the legal doctrine is under consideration by the Codification Commission, whose composition is regularly changed according to its four-year term of office. At the end of its term, the form of the Codification Commission established in 2002 published a Green Book

¹³ The Civil Code was enacted in 1964, it entered into force in 1965 and has been amended a number of times; only some of the amendments are discussed in this article.

on the optimal vision of a civil code in Poland indicating the general direction of civil law reforms and opening discussion on the paths of their implementation.

The fundamental dilemma facing the Polish legislator is whether to proceed with further profound amendments to the existing civil code or to elaborate a new one. Different opinions in that respect have been expressed in public discussion and legal writings. The Codification Commission appointed in 2006 has been given as its principal tasks to prepare the assumptions and general directions of changes in civil, family, and private law, taking into consideration the need for harmonisation of Polish law with European rules. Although a formal decision has not yet been taken in that respect, the commission has undertaken preparatory research and work aimed at elaborating a new civil code, reinforcing the legislative unity and integrity of civil law by integrating into the code the provisions concerning both business-to-consumer and business-to-business relations. The whole body of civil law should be further modernised in order to be better adjusted to contemporary economic and social needs. It should be fully harmonised with European rules and standards. In that respect, it is worth noting that the preparatory research and work undertaken recently by the Codification Commission has taken into consideration the academic Common Frame of Reference (CFR) and those parts of the Principles of European Patrimonial Private Law that have been published. The CFR and the above principles will certainly have an important impact on the final shape of Polish civil law.



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Integration of the European Developments in Private Law into Domestic Civil Law: Factors Framing the Reception of the DCFR in Romania

1. Introduction

The reform of private law took a different shape in Romania from how it proceeded in most Western European and Central-Eastern European Member States of the EU over the past two decades under the influence of the *acquis communautaire* and of the various European projects aimed at the unification of private law in Europe. However, civil law both in the western and eastern parts of Europe is indeed one of the most conservative fields of law, which copes in different ways and to differing extent with the disintegrative effect of the private law *acquis* on the unity of private law thinking, on the basis of the primacy of the respective civil codes. The reception of soft law and legal scholarship in the area of unification of private law is thus a more or less speedy process, mostly depending on the involvement of the national legal scholarship rather than on legislative measures that are policy-guided.

The literature reviewed for the purposes of writing this paper, including the leading Romanian tort law and contract law commentaries, casebooks, and course books published in 2005–2007, shows a lack of acknowledgement and involvement by leading academics in the process of internalisation of the concept and solutions of the CFR into domestic civil law.¹ Not one single mention can be found of this European undertaking in these reference books, and the private law *acquis* in general is not presented or debated in the civil law literature. The only exception is a leading course book on civil law contracts, published by a distinguished legal scholar, who presents the Community legislation on consumer law in the context of civil law contracts and makes a few references to the Principles of European Contract Law.² Therefore, it would be unrealistic and too early to speak in Romania about the role of academic scholarship in pursuing European soft-law solutions

¹ For most relevant recent publications see C. Stătescu, C. Bîrsan. *Teoria Generală a Obligațiilor* (General Theory of Tort Law). București: Hamangiu 2008 (in Romanian); T. Prescure, A. Ciurea. *Contracte Civile* (Civil Contracts). București: Hamangiu 2007 (in Romanian); C. Macovei. *Contracte Civile* (Civil Contracts). București: Hamangiu 2006 (in Romanian); F. Cuitacu. *Codul Civil Annotat*. București: Monitorul Oficial 2007 (in Romanian); C. Toader. *Drept Civil. Contracte Speciale* (Civil Law. Special Contracts). București: All Beck 2005 (in Romanian).

² C. Toader (Note 1).

within the framework of the reform of the civil law. Scholarship framing debate on European unification of civil law, which would assist and guide legislative policy and the judiciary, is still missing in Romania. The situation does not differ much at the level of legislative policy. The most obvious example is that both the 2004 draft and the recently completed second draft *Cod Civil* (new civil code) prepared by legal scholars did not consider the ongoing CFR project as a reference work.

The assimilative capacity of Western European or of other Central-Eastern European jurisdictions to integrate European soft law vary, depending on the main characteristics of the domestic legal culture, and especially of the judicial culture, which reacts differently to soft law and legal projects such as the CFR. Therefore, in those countries, such as Romania, where the private law culture is reluctant to embrace non-binding law and legal projects/scholarship, since it is characterised by strong legal positivism and textualism, we won't find the solutions of the DCFR integrated into legal acts or in court decisions, as, in its current form, the DCFR integrates both hard-law and soft-law elements developed through various European initiatives on unification of private law. There are also legal-cultural reasons behind the current state of Romanian legal literature on European soft-law developments in private law. The unity of the *Cod Civil*'s approach is not questioned and challenged by legal scholars. This is how the vicious circle of influences of legislative policy, legal scholarship, and judiciary works, and how it makes the elaboration of comparative studies based on a functional approach difficult in many Central-Eastern European countries. However, it is the primary task of legal scholarship to break the vicious circle and effectively assist makers of legislative policy and the judiciary to prepare to respond with workable solutions to the new regulatory needs of private law both in substance and in terms of legislative technique/legal drafting methodology. Romania only joined the EU in 2007, and thus it may not yet sufficiently feel the influence of EC law on legal theory. Sources of law and the balance between hard and soft law in private law were not reconsidered under the influence of EC law. This is why, as will be seen in Section 3, there was a kind of indirect reception of some elements to be found also in the current version of the DCFR, but one can identify in Romanian private law only those provisions that were approached by the DCFR from the community *acquis* on consumer law (hard law).

A second factor framing the assimilative capacity of Romanian private law to integrate European soft law is the reform strategy itself. The reform of private law in Romania takes place along three strategy lines, which do not perfectly converge and often give rise to contradictory discourses in doctrine and case law: i) the reform of the *Cod Civil*, an ongoing process since 1999 (the main models used are the Quebec *Code Civile* as the most recent code, the French *Code Civil*, and the Swiss *Cod Civile*); ii) the implementation of the *acquis communautaire* on consumer law, which is perceived as more of an external conditional element related to EU accession and membership than as addressing an internal regulatory need for consumer law provisions; and iii) the influence of French doctrine and case law, which continues to be the strongest determining factor, with strong historical roots. Soft law and European projects such as the CFR seem to have remained outside the confluence of the diverging strategy lines that frame the development of civil law in Romania.

The strongest influence on Romanian civil law comes from French law, far outweighing the influence of EC consumer law. This is first of all because the comparative studies mainly focus on French law. The ongoing doctrinal discussion in Romanian private law is mainly led by references to the French doctrine and case law. However, the situation is different in tort law and contract law. Whereas contract law is more open to non-French solutions and illustrates developments of German law and some of the solutions of other European jurisdictions, the national tort law remains more conservative and presents almost exclusively the developments of French law. Comparative studies are rather formalistic in approach and usually are limited to an objective presentation of the foreign solutions without a critical assessment of the domestic law or of the foreign solutions. It is also worth mentioning the phenomenon in case law as concerns the divide between tort and contract law. Although tort law scholarship is more conservative in approach, tort law jurisprudence was more open to developing new law, and more ambitious in this regard, than contract law was in the past two decades.

The dominant influence of French civil law on the development of Romanian private law has a strong legal historical background. The Romanian *Cod Civil* was adopted in 1864 (entered into force in 1865) and imported most of its provisions from the French *Code Civil*. Some influence from the Italian *Codice Civile* and the Belgian *Code Civile* of 1851 are also to be found in the Romanian civil code. From a legal cultural point of view, the systemic connection of Romanian civil law thinking to the French *Civil Code* 'tradition' has always been strongly stressed. This is why most legal scholars continued to look toward the solutions of French civil law. In 1945–1990, the evolution of Romanian civil law took a wildly different approach, but even during Communist times certain solutions of French doctrine and case law were adapted to the Romanian legal policy of those times, and the provisions of the *Cod Civil* survived that period mainly untouched.

Romania was always reluctant to touch the **unity** of the *Cod Civil*. The reform of the civil law after 1990 took place in the form of special laws, these prevailing the provisions of the *Cod Civil*. This is reflected also at doctrinal level. The private law *acquis* transposed into the Romanian law is considered to be part of commercial law as consumer law rather than part of the civil law. This is one of the possible explanations behind the missing references in civil law publications to European developments aimed at unification of private law.

The focus of this paper is on the factors that frame the assimilative capacity of Romanian private law in the search for explanations for the current situation, with the hope that this work can offer useful insight into

the private law culture. Limited by the constraints presented above, Section 2 of this paper presents the most significant novelties of the 2004 draft of the new *Cod Civil* in light of the regulatory values pursued by the DCFR, whereas Section 3 offers a critical assessment of the Romanian strategy in the implementation of EC consumer law in the domestic law.

2. The Draft *Cod Civil* and the Common Frame of Reference

In 2004, a draft of the new *Cod Civil* was ‘finalised’ and adopted by the Romanian Senate but not by the Chamber of Deputies.³ This draft aims to adapt the main civil law institutions to the needs of a market economy and to realign the *Cod Civil* with European developments in private law. However, a new working group, entrusted with the task of preparing further amendments to the 2004 draft, was set up in 2006. The new draft has not yet been made public and therefore could not be addressed directly in this study. This is the reason this brief analysis mainly deals with the regulatory policy behind the solutions and enters into a comparative presentation of only selected provisions.

The very first policy remark that should be made about the reform of the *Cod Civil* is that the codification work and civil law doctrine seem not to converge. The civil law doctrine continues to be mainly limited to French civil law developments, whereas the *Cod Civil* project is more receptive to other European and worldwide developments. Thus, there are two main, different ongoing discourses on the civil law reform. The second remark concerns the approach and structure of the new *Cod Civil*. Although labelled as a new civil code, in its approach and structure it strongly preserves the unity of the Napoleonic *Code Civil* currently in force. With a few exceptions, the amendments consist of a set of new provisions, especially on consumer issues, added to the traditional institutions, with those institutions remaining mostly unchanged. A different label, such as ‘amendments’, perhaps would have made the parliamentary and professional/public debates faster and easier. My personal view is that it would be better to have a structurally new and coherent civil code and that this would create fewer difficulties at enforcement level than the current draft, which is based on a formalistic and not a functional approach, with piecemeal solutions. As has been stressed in the introductory part of this study, the Romanian legal culture is strongly positivistic and the courts have very limited statutory freedom to develop new law. Therefore, it bodes less well to keep the approach and unity of the current code, which does not match the current ‘regulatory needs’ of private law.

However, the achievements of the 2004 draft should not be underestimated. The ‘new’ *Cod Civil* attempts more or less successfully to merge civil and commercial law, as declared at the level of principles in article 1: “the code governs, in accordance with the ECHR and other international treaties and agreements to which Romania is a signatory, civil and commercial relations of pecuniary and non-pecuniary nature, between natural or legal persons.” There are several provisions aimed at merging civil and commercial law related to contractual matters and torts: extension of the protection granted in consumer contracts to ‘business-to-business’ contracts and to ‘civil-to-civil’ contracts; insertion of provisions on consumer protection in tort law, and extension of product liability for the non-consumer injured party; and special provisions on economic torts. However, modern business contracts remain outside the Draft *Cod Civil*.

An overall presentation of the approach of the Draft *Cod Civil* would far exceed the scope and other limits of this paper. Therefore, the comparison with the solutions of the DCFR covers only consumer protection issues and those aspects of contract and tort law that are of specific importance from the standpoint of the regulatory needs of an increasingly globalised-risk society. Thus, issues such as marketing and pre-contractual information, special contracts, abusive clauses, framework contracts, product liability, and personal injury compensation will be presented.

2.1. On contracts

Contrary to the expectations of most business lawyers and to the principle stipulated in article 1 of the draft on merging civil and commercial law, business contracts were not integrated into the *Cod Civil*. The only novelties of the draft in respect of specific contracts relate to the carriage contract (articles 1549–1592), the guarantee contract (articles 1678–1683), personal guarantee contracts (articles 1733–1766), and the arbitration contract (articles 1778–1784). Contracts like lease, service, construction, processing, design, information and advice, franchise, distributorship, and treatment contracts, dealt with by the DCFR, are not covered by the Draft *Cod Civil*. Most of these contracts remain governed either by general contract law or by specific laws, mainly in

³ This article comments on the draft available at http://www.dsclex.ro/legislat_r1.htm.

business law. Specific legal provisions on distribution, supply, and franchise became part of Romanian private law via transposition of the EC competition law on group exemptions into Romanian competition law.

It is not surprising that the Draft *Cod Civil*, although committed to integrating civil and commercial law at the level of principles and general provisions on contracts, has not included modern business contracts in civil law. Legal scholarship is very conservative in this area. Whereas the majority of legal scholars strictly follow the categorisation scheme of the Napoleonic *Code Civil*⁴, those who depart from it step in other directions and give weight to other transactions, such as sponsorship contracts, arbitration contracts, and the mediation contract.⁵ Academic debates on civil contracts and openness to the solutions of foreign law mainly concern general contract law and not special contract law. Thus, developments in the civil law doctrine on contracts do not act as a driving force toward integration of business contract material into civil law and its codification in the *Cod Civil*.

The drafters of the new *Cod Civil* focused on general contract law, introducing specific provisions on framework contracts (article 926) and consumer contracts (article 927). However, article 915, after adopting the European definition for consumer contracts, simplifies the issue by stating that consumer contracts are governed by special laws on consumer protection.

Other important developments in general contract law involve special provisions on contracts/documents on electronic support (articles 969–971), including the presumption of validity and the burden of proof; provisions on ‘external contractual clauses’ (article 1003); and provisions on unintelligible clauses and those that cause harm to consumers or the parties to a framework contract, which are considered unwritten unless the other party proves that the nature and effects of the clauses were explained before the contract’s conclusion (article 1004). Framework contracts fall under the same legal regime as consumer contracts, which is an important step in integrating consumer law with civil law and business law within the new *Cod Civil*. The wording of the draft code is general, not specifying what types of framework contracts are covered. One hopes that this will be interpreted as including both civil and business contracts, in line with the provision of the DCFR on contractual terms not individually negotiated, II.–9:103. Abusive clauses are considered to be null and void in consumer contracts and framework contracts (in a merger of the legal regime for consumer contracts and business contracts). According to article 1005, “a clause is considered abusive when it is excessive or unreasonably brings a disadvantage for the consumer or the person who is party to a framework contract, by infringing the requirement of good faith, an example being clauses that depart from the essential obligation characteristic of the type of contract concerned”. These provisions are in line with section 4 of the DCFR (II.–9:401 ff.).

These provisions attempt to integrate into the civil code and expand to non-consumer contracts the *acquis communautaire* on consumer law as implemented by national law 193/2000 on unfair contractual terms. These are in line with the DCFR (II.–9:404). However, this law relates only to business-to-consumer contracts and does not cover private and business contracts. Although the provision of article 993 of the draft is worded in general terms, it could be applied in the meaning of covering all three cases mentioned by the DCFR (II.–9:409). Corresponding provisions to those of the DCFR (II.–9:411) are to be found in Romanian law 193/2000, Annex 1. Article VI of law 363/2007 implements the DCFR’s article II.–9:408 on factors to be considered. Unsolicited goods and services, per CFR II.–3:401, are governed by the law on distance selling, law 130/2000. Rules on marketing and pre-contractual obligations is to be found in specific legislation on consumer protection and not in the Draft *Cod Civil*.⁶ The implementation of marketing and pre-contractual obligation, spread across more than ten different legal acts on business law, is a good example of the piecemeal approach demanding integration within the framework of the new *Cod Civil*.

There is no specific provision in the Draft *Cod Civil* on prohibition of discrimination and definition of discrimination similar to those stipulated in Chapter II of the DCFR. This issue is regulated in specific laws.⁷

⁴ C. Toader (Note 1); C. Macovei (Note 1).

⁵ T. Prescure, A. Ciurea (Note 1) pp. 172–189, 356–379.

⁶ The *acquis communautaire* transposed by the following legal acts: articles 3–4 of Government Ordinance (G.O.) No. 130/2000 on protection of consumers in conclusion and performance of distance contracts (Ordonanța nr. 130/2000 privind protecția consumatorului la încheierea și executarea contractelor la distanță. – M.O. nr. 431 din 2/9/2000), amended by Law 51/2003 (Legea 51/2003 pentru aprobarea Ordonanței Guvernului nr. 130/2000 privind regimul juridic al contractelor la distanță. – M.O. nr. 57 din 31/01/2003); articles 6–10 of G.O. No. 107/1999 on the sale of tourism service packages (Ordonanța privind activitatea de comercializare a pachetelor de servicii turistice. – M.O. nr. 431 din 31/08/1999); article 4 of Law No. 282/2004 the rights of consumers on timeshare contracts (Legea nr. 282/2004 privind protecția dobânditorilor cu privire la unele aspecte ale contractelor purtând asupra dobânditorilor unui drept de utilizare pe durată limitată a unor imobile. – M.O. nr. 431 din 02/09/2000); articles 6–7 of G.O. No. 947/2000 on price indications on products offered to consumers (Ordonanța nr. 947/2000 privind modalitatea de indicare a prețurilor produselor oferite spre vânzare consumatorilor. – M.O. nr. 524 din 25/10/2000); article 5 of Government Decisions No. 289/2004 on consumer credit contracts (Hotărârea Guvernului nr. 289/2004 privind regimul juridic al contractelor de credit cu consumatori. – M.O. nr. 611 din 06/07/2004) articles 5–6 of Law No. 365/2002 on electronic commerce (Legea nr. 365/2002 privind comerțul electronic. – M.O. nr. 483 din 05/07/2002). These are the most important legal acts not covering the legislation governing the financial transactions.

⁷ G.O. No. 137/2000 on prevention and sanction of any form of discrimination (Ordonanța nr. 137/2000 privind prevenirea și sancționarea tuturor formelor de discriminare. – M.O. 431 din 02/09/2000), modified by Law No. 48/2002 and Law No. 77/2003, which prohibits the refusal

We also do not find reference in contractual law to personal injury compensation, although significant steps were taken in tort law to codify the case law that has evolved over the past two decades.

It is a new approach and indeed a welcome development that attempts are being made to merge civil and commercial law by instituting the same regime for consumer contracts and contracts in which there is a lack of economic balance or there is major informational asymmetry (see article 927).

Besides these positive developments, one also must stress that the draft lacks an integrated approach to obligations in that it preserves the former approach involving the division between contracts and obligation. There continue to be separate provisions on execution of contractual obligations, on contracts, on specific contracts, and on performance of obligations. The new civil code should remedy this structural failure.

2.2. On torts

Whereas the Draft *Cod Civil* is more conservative in the area of contracts, with regard to torts major steps were taken to bring the Romanian legal solutions closer to European developments. The most significant achievements are the integration of product liability into the *Cod Civil*, codification of the case law on non-pecuniary damages, liability for abuse of law, and other provisions that improve the position of the injured person — such as liability in the case of the injured person's inability to identify the tortfeasor when the damage was caused by more than one person (article 1121) — and specific provisions on joint liability (article 1122).

2.2.1. Liability for damages caused by goods and product liability

The draft leaves untouched the old provision on “liability for damages caused by goods under our supervision”, as a specific form of tort liability as stipulated in article 1107 (3) and introduces provisions on liability for defective products. On product liability we find provision in article 1126 — as a general provision — followed by special provisions in articles 1128, 1129, and 1133 (2) (3). These provisions were meant to be a simplified version of the product liability regime governed by the Romanian law implementing EC directive 85/374 to the extent that could be covered from a drafting method point of view in three articles.

The provisions of the *Cod Civil* on product liability are limited to the issues of definition of product liability, the notion of defect, and exoneration from liability. Although this drafting attempt failed to preserve the substance of the product liability regime, in compliance with the requirements of EC directive 85/374, the inclusion in the text of the *Cod Civil* of special provisions on product liability is a tremendous achievement in the process of integration of the private law *acquis* into Romanian civil law. This step may have positive effects on the development of the case law related to EC directive 83/374, although product liability continues to be governed by the national law implementing EC directive 85/374, law No. 240/2004. At least product liability finally will be considered by both leading scholars and Romanian legal practice to be part of civil law.

It should not be neglected that in certain respects the Draft *Cod Civil* represents progress in comparison to the way the above-mentioned EC directive was transposed by law 240/2004, including the latter's extensive handling of the category of persons who benefit from the protection of product liability law. Correctly, the drafters avoided using the word ‘consumer’ in the product liability context and opted for the term ‘third party’, in article 1116. As would be expected, the Draft *Cod Civil* takes on elements of the French approach in its implementation of the EC directive and includes under the product liability regime the distributor and provider of defective products, in general.⁸ The Draft *Cod Civil* draws distinction between defectiveness and lack of safety without any further specification (article 1117). Defectiveness is defined as the security to be reasonably expected by the injured person in view of the presentation of the product. This is a very narrow definition of defectiveness when compared to the approach of EC directive 85/374. On the other hand, the Draft *Cod Civil* specifies that defectiveness includes all three types of defect — design, manufacturing, and information defect — as does US product liability, with the innovation that a fourth category of defectiveness has been introduced, that of defective conservation of the product. Information defect includes both lack of information on risks and lack of information and indications concerning how these risks may be prevented. According to article 1121 (2), the producer, distributor, or supplier is not obliged to compensate for damage caused by lack of security of a product if it can be proved that the user or consumer of that product knew or ought to have known the defect or it was foreseeable. According to article 1121 (3), one will not be liable when proving that it was not possible to know the defect would arise in the product, given the level of scientific and technical knowledge.

to sell, rent, offer a loan, and refusal of other transaction with natural or legal persons on reasons of race, nationality, religion, age, sex or sexual preference.

⁸ However, the qualification as implementation failure of the institution of the same liability regime for the distributor as for the producer is debatable, although the ECJ's standpoint on this matter has been clarified in Case C-52/00 *Commission v. France* (ECR 2002, I-3827) and C-177/04 *Commission v. France* (ECR 2006, I-2461). Leaving the supplier's liability as a subsidiary liability significantly weakens the deterrence effect of the European product liability law.

Nor is the development risk issue handled correctly, as the moment when the state of science and technology to be considered is not specified.⁹ This could give rise to different interpretations in practice.

In comparison to the provisions of the DCFR on “accountability for damages caused by defective products” (VI.–3:204), the provisions of the Draft *Cod Civil* are superficial and narrow. As it is now, the concept of the Draft *Cod Civil* on product liability departs from the approach of EC directive 85/374 where the main aspects of liability are concerned and weakens the position of the injured party. However, law 240/2004 on product liability, which is *lex specialis* in relation to the common provisions of the future *Cod Civil*, is in line with the DCFR. Hopefully, the deficiencies of the 2004 draft will be cured by the final version of the new *Cod Civil*.

2.2.2. Non-pecuniary damages

Explicit recognition and detailed rules on moral damages are long-awaited developments that fill the gaps of 20 years of cautious legislative policy that consistently failed to catch up with developments in the case law.¹⁰ In Romania, courts started awarding moral damages in 1990, after an almost 50-year prohibition period, instituted by a special law issued in 1952. The Draft *Cod Civil* defines moral harm and the right of the injured person to moral damages (in article 1134), institutes joint liability of tortfeasors (article 1135), contains rules on shared liability (article 1136), sets criteria for award of damages (articles 1141–1142), lists the persons entitled to claim damages in the event of the death of the injured person (article 1143), and cites the cases and limits of reparation of moral damages (articles 1144–1146). Although ambitious in its scope, the Draft *Cod Civil*’s attempt is indeed a risky undertaking since it codifies the solutions of relatively young, unsettled case law. Instead establishing general rules and principles that leave room for the courts to further develop this legal institution, the drafters of the *Cod Civil* limit the changes that could be wrought by more liberal developments, by giving preference to those solutions of the case law that have a restrictive approach. Thus, the Draft *Cod Civil* is a step backward from the pro-injured-person case law, starting with the definition of personal injury torts and continuing with the conditions for liability and specification of those persons entitled to compensation. Article 1107 of the Draft *Cod Civil*, unlike articles 998 and 999 of the present *Cod Civil*, specifies moral injury as a distinct category of harm from pecuniary harm and bodily injury. Article 1134, on reparation for damages, also uses the three-part categorisation of injuries (pecuniary, bodily, and moral harm). Article 1100 brings a new element in addition to the conditions for liability. Although the tortfeasor continues to be liable for even the slightest negligence as under current case law’s approach, the circumstances of the case gain importance.

Entitled ‘Cases and limits of moral damages’, article 1143 is suggestive in defining moral harm in a restrictive way by stipulating that in cases of bodily injuries and harm to the health, compensation may be awarded for “restrictions caused to family and social life”. Damages caused to one’s professional life are not specifically mentioned as a distinct category. The category of indirect victims is restrictive as well, covering only relatives, in compliance with the family law concept concerning relatives. Only ancestors and descendants, the brother/sister, and the spouse of a victim are entitled to damages, according to article 1143 (2). Despite these deficiencies, the Draft *Cod Civil* has similar provisions to those of VI.–2:101 (4) (b) on relevant damages, VI.–2:201 on personal injury and consequential loss, and VI.–2:202 on loss suffered by third parties as a result of another’s personal injury or death.

2.2.3. Other important developments in tort law

Other important developments are the provisions on liability for abuse of law (article 1111), unauthorised use of professional secrets (article 1115), and liability of the instigator and co-author in cases of torts (article 1120). These provisions are in line with the regulatory values promoted by VI.–2:205, VI.–2:202, and VI.–2:211 of the DCFR.

More detailed provisions were introduced on pledges on movables, separate-provision non-possessory pledge (articles 1862–1867), and possessory pledge (articles 1868–1872), as well as specific provisions on securities on receivables (article 1880–1887) and open guarantees on movables (articles 1888–1894). Mitigation of damages acknowledged in contract law is missing from tort law; no provisions may be found in the Draft *Cod Civil* that would impose such a right or obligation on the injured person as VI.–1:102 of the DCFR does concerning prevention of damages.

⁹ This should be the moment when the product was put on the market where it reached the consumer, not when it was marketed for the very first time as established by the ECJ in case C-300/95 Commission v. UK. – ECR 1997, I-2649; case C-127/04 Declan O’ Byrne v. Sanofi. – ECR 2006, I-1313.

¹⁰ For relevant literature on case law see C. Vintilă, Gh. Futună. Daune Morale, Studiu de Doctrină și jurisprudență (Non-pecuniary Damages, Doctrine and Case Law), All-Beck, 2002 (in Romanian); Gh. Matei. Daune Morale, Practică Judiciară (Non-pecuniary Damages, Case Law). Hamangiu 2008 (in Romanian).

3. Transposition of the consumer law *acquis* into the domestic law

The *acquis communautaire* was and continues to be the most visible motor of the private law reform in Romania, but so far it remains less internalised by the private law culture.

However, before considering details of the process of transposition of the *acquis communautaire* that resulted in inclusion in the Romanian private law of provisions also found in the DCFR that integrate the consumer *acquis*, there is use for the purposes of the present study in outlining specific characteristics of the legislative approximation strategy in Romania in the field of consumer law, for a better understanding of the outcome of the process and thus its place in private law.

The transposition of consumer law *acquis* started later in Romania than in the rest of the candidate countries in Central and Eastern Europe. The timing of the process has left its mark on the approach. Although unusual, in Romania the timing determined the approach and not the approach the timing; hence, with the requirement to comply with an external set of conditions (for EU accession), the assessments and deadlines from Brussels have defined the steps of the legislative process. After a first overture in the early 90s towards enacting the general framework provisions on consumer law, a second set of rules followed, in line with the resultant requirements for the obligations undertaken by Romania within the framework of the Association Agreement and preparations for EU accession, but only in 1999–2002. However, the legal acts serving as pillars of the *acquis communautaire* were postponed until the very last stage of the accession negotiations and adopted only by the end of 2004, in the form of Government Decision 1553/2004 on illegal commercial practices in the field of collective consumer interests, entering into force on 1 January 2007; law 449/2003 on sales of goods and associated guarantees, which entered into force by 1 January 2007; and law 245/2004 on general product security, with derogation until 1 January 2007. It is difficult to accept from a consumer perspective why the implementation of the consumer law *acquis* took so long and was perceived as external conditionality, although a proper legal framework in the domestic law was largely missing, whereas these rights are usual consumer rights and there was an internal regulatory need for legislation to be in place. This slow development is somehow in contradiction with the general ‘over-performance’ that characterised other legal fields when harmonisation came to be an issue and also with the prevailing paternalistic, **public law perception of consumer law** during the first two stages of the process of implementation of EC consumer policy in Romania, at least at the level of legislative strategy. Even the national legal provisions implementing EC Directive 85/374 initially were integrated into the text of the framework law on consumer protection alongside the public law provisions.^{*11} Later, in 2004, product liability gained an independent status, in the form of a specific law that governs only this legal institution, as law 296/2004.

The piecemeal and rather more formal than functional approach to legal approximation caused few difficulties at legislative level but will cause more problems when these laws are to be enforced. This is why there is very weak internalisation of the consumer law *acquis* in the Romanian private law thinking, starting with the legal terminology and continuing with the discussions of the legal nature of specific civil law institutions imported into the domestic civil law via transposition of EC law. The formalistic approach has the consequence that the law is lacking in doctrinal foundation and does not promote development of the new legal institutions from within the domestic civil law.

In order to integrate consumer law and increase its role and weight in private law, the Consumer Code^{*12} (law No. 296/2004) was enacted in 2004, to enter into force by 1 January 2007. There is no legal policy reason for this legal act entering into force only by the date of accession, because it does not add new rights to those regulated in existing laws. Its entry into force only upon accession confirms once more its simplistic role as policy document issued for reinforcing Romania’s commitments to comply with the expectations of the European Commission and strengthen consumer policy.

The Consumer Code is a very short document of 16 pages with only 88 articles. This code contains mostly private law provisions: Chapter II stipulates the obligations of producers, service providers, and distributors concerning consumer safety according to the *acquis*; Chapter III specifies in summary form the basic consumers rights; Chapter IV addresses the institutional framework for consumer protection; Chapter V deals with the common framework on general product safety; Chapter VI sets forth a common framework for the obligation to inform and educate consumers, including product and service labelling; Chapter VII establishes a common framework for prices and tariffs; Chapter VIII covers advertising products and services; and Chapter IX addresses pre-contractual rights of consumers. Its structure and approach correspond to the pillars of the EC

¹¹ Law No. 322/2002 (Legea nr. 322/2002 privind aprobarea Ordonanței de Urgență a Guvernului nr. 146/2001 pentru completarea Ordonanței Guvernului nr. 21/1992 privind protecția consumatorilor. – M.O. nr. 408 din 12/06/2002) that transposed EC directive 85/374 into Law No. 21/1992 on consumer protection.

¹² Enacted as Law No. 296/2004 (Legea nr. 296/2004 privind Codul Consumului. – M.O. nr. 593 din 01/07/2004).

consumer policy approach: protection of consumer safety, protection of the consumer's economic interests, and safeguarding of the consumer's right to information.

All consumer legislation not mentioned in the Consumer Code becomes an annex to it, as stated in article 87 (1). However, the Consumer Code is less than a code and not more than a framework law. It contains a list of definitions of consumer law terms, as an attempt to systemise and unify the terminology of specific laws on consumer protection. The list provides a synthesis of the main obligations of the producers, distributors, and services providers, and of the consumer rights stipulated in specific consumer laws, but in a brief version.

In order to avoid contradictions between the definitions of the special laws and this list, the code states that the terms of the annex on definitions are enumerated only as examples, which causes further confusion instead of bringing more clarity to interpretation of the specific laws on consumer protection. A definition cannot consist of examples, or a list of definitions.

However, the Consumer Code is not free from novelties in safeguarding consumer interest, again with the aim of performing well before EU accession and mostly in line with market integration considerations. It has its own unorthodox approach to integrating consumer interests with market values when it explicitly promotes free movement of goods and services as taking priority over consumer protections issues: "Legislation on consumer protection should not contain barriers to the free movement of goods and services" (article 3 of the Consumer Code). Such over-performance in pursuing market values in balance with consumer interests should not have its place in a consumer code primarily aimed at strengthening the importance of consumer rights within private law. The drafters of the 'code' went even further and stated among the fundamental principles of consumer protection the principle of mutual recognition of free movement of goods of a sort affording equivalent protection to that found under Romanian law (article 4). Although the provision promotes consumer choice, which is a consumer right, from a consumer protection point of view this is at least an 'unusual' concern, given that consumer protection may be invoked for exceptions under EC article 30 and acknowledged by the case law of the European Court of Justice (ECJ) on mandatory requirements. However, this is not the place to comment on the neo-liberal approach of EC consumer law and policy. I should state nonetheless that I consider these two provisions to be 'anti-consumer', knowing that the deficiencies of the pro-market approach of EC consumer law become more evident in the new Member States, on account of their specific consumer culture, market conditions, weak market surveillance capacity, etc. Let us attribute this regulatory policy failure to the phenomenon of 'over-performance' so often encountered in the pre-accession period and hope that it will be remedied in the future.

The rough picture of Romanian legislative policy on consumer law would not be complete without mention that, on the other hand, the state tries to maintain a paternalistic role in relation to consumer issues, at least in formal terms. This is also reflected in the Consumer Code, which declares (it is deliberate that I do not use the word 'stipulates') in article 5 (e) that the state as central authority in the field of consumer protection guarantees effective compensation of consumers. How the state can guarantee this is not detailed, either in the code or in subsequent legislation, as concerns remedies under private law. It is not clear why and how the state should guarantee this effective compensation, in addition to the provisions of contractual and tort law on consumer protection. This is another declaratory provision only.

Despite its policy values, it can be concluded that the Consumer Code fails to perform as a code and, instead of bringing more clarity and legal certainty, causes confusion for the legal practitioner. Therefore, its function and achievement in integrating the consumer law *acquis* into Romanian private law are artificial.

4. Conclusions

The development of Romanian civil law is a typical example of a legal culture characterised by a strong legal positivism and textualism that decisively defines its assimilative capacity for soft laws. Despite this, Romanian private law contains specific elements of the DCFR, even if the source of inspiration for the legislator continues to be the solutions of the national civil laws in Europe or outside Europe, on one hand, as the Draft *Cod Civil* demonstrates, and the consumer law *acquis*, on the other, to the extent to which the DCFR codifies these solutions. A closer look at different driving forces of the specific developments reveals that there are different discourses in progress — hidden and official ones — and that a complete picture and understanding of the phenomenon labelled 'influence of EC law on Romanian private law' demands consideration of the whole legal cultural environment in which private law develops.

The findings of a comparative analysis that solutions of the DCFR may be found in Romanian private law should not lead the reader to draw mistaken conclusions concerning the influence of European soft laws on Romanian or other domestic law. These provisions are to be found mostly in the implementation laws that transposed the consumer *acquis* into the Romanian domestic law as a consequence of compliance with the conditions for accession and thus not the achievements of a voluntary approximation to European developments.

It is a success story of complying with hard-law requirements that says little in itself about the assimilative capacity of Romania private law.

The codification concept and regulatory needs assessment policy on which the DCFR is founded and which constitute the very essence of this European undertaking do not have an influence yet on Romanian legislative policy and civil law doctrine. This is a major deficiency of the current Romanian approach to private law reform, which either is not yet aware of what Western European civil laws experienced under the influence of EC law or is aware of it but ignores this experience and continues to opt for piecemeal transpositions, mainly outside the Civil Code and outside civil law. Such steps, although more easily sold as legislative measures and more readily accepted by the defenders of the Napoleonic approach, may cause much deeper disintegration effects in the whole body of private law in comparison to a more integrated, systemic, and clear approach, such as the DCFR, which was developed in order to assist the domestic laws of the Member States to cope with this phenomenon. The main message of the CFR project seems not to be perceived in Romania, although the difficulties caused by the consumer law *acquis* at enforcement level are even greater in this new EU member state, where academic scholarship is not yet prepared to propose solutions for the integrated interpretation and enforcement of EU and Romanian law in the field of private law and the judiciary's comparative skills of interpreting domestic law in compliance with EU law are still weak. However, these difficulties are not yet obvious and not yet present in doctrinal debates or at the level of case law, because professional and public awareness, in general, of these developments is low. This leaves the phenomenon of disintegration of the unity of private law more or less out of control and little dealt with, the codification efforts being focused along other strategy lines. Protecting the domestic *Cod Civil* from the influences of the European projects on unification of private law and using mostly business law as a legal framework where the private law *acquis* would have its place will not offer workable solutions for the judiciary, because the regulatory needs of modern private and business transactions demand integrated solutions.

Romanian regulatory policy in the sphere of private law and the codification projects seem to be experiencing a series of regulatory failures at both civil code and Consumer Code level by trying to simplify and integrate existing legal provision via references. On one hand, it is not enough to integrate only the consumer law *acquis* into the *Cod Civil* and leave soft law to the side. On the other hand, consumer law could be integrated and regulated in detail in a single body of law, a consumer code, while the *Cod Civil* should contain general provisions on consumer issues and address the questions of integration of civil, consumer, and business transactions. All levels of codification should be based on the same regulatory concept, not as seen currently with the severe inconsistencies between the specific legislation, the Consumer Code, and the draft new civil code. Besides legislative policy factors, this situation is mainly due to legal drafting failures. Codifiers are currently confronted with the regulatory traps of complying with the demands of the traditional legal drafting culture for a civil code and the requirements inherent to the drafting techniques for EC law that is transposed into domestic law and that cannot be ignored. The DCFR is meant to overcome this type of difficulty through its solutions and would improve the quality of codification if considered in the future. The consequences of Romania's membership in the EU have only begun to be manifested at the level of legal drafting strategy, now that formal compliance with the *acquis* no longer suffices, unlike in the pre-accession period; the legislative and doctrinal need to look for a more functional approach has not evolved yet.

It will not be an easy task for any legal scholar to propose solutions in the form of a future legislative strategy to handle the disintegrative effects of EC law on domestic law within a legal culture such as the Romanian. Legal positivism would argue in favour of codifying European soft law into domestic hard law, whereas a functionalist would argue against such a course of events. Since the regulatory needs of private law develop with uneven dynamics under the conditions of market integration in Europe, Romania should adopt a functional approach, developed from within its legal system, which requires further efforts but will be more effective and more easily accepted by legal thinking with a civil focus.

Judicial culture, as always, has the final say as to the effects of foreign and European law on the private law culture, and changes in positive law do not suffice if the judiciary is not yet prepared for such changes. It would have been too early upon EU accession to make value judgements as to the future role of European soft law in framing the development of private law in Romania via case law. As domestic cases with Community dimensions will arise in private law, Romanian courts as well will start looking for European instruments (including soft law), and the positivism of the country's judicial culture will change. Legal practice, including consulting, may have an increasing role in framing judicial openness toward European soft law, especially in the field of contract law. Even in the pre-accession period, legal practice in many instances acted as a strong driving force in the pursuit of case law developments in line with the EU approach. Therefore, at least in Romania, it seems that integration of European private law (hard and soft law) into the domestic law can successfully occur via case law, if adequately pursued and assisted by legal scholarship and the work of the legal profession.

Legislative policy may well take a positive turn in the future once the DCFR becomes a policy document in the form of a Green Book or White Book, or some of its elements will be integrated into the 'political CFR'.¹³ As the pre-accession period demonstrates, EC policy instruments were quickly and easily complied with by

¹³ Term used by the DCFR, Interim Outline Edition. Sellier European Law Publishing 2008, p. 6.

the Romanian legislative, because legislative policy measures related to integration were and are strongly politics-guided.

Romania's case confirms once more that unification of private law in Europe is a challenging undertaking for which there is no universal solution that could accommodate diverse regulatory preferences while taking properly into consideration common or similar regulatory needs. The domestic instruments and their effectiveness will differ, depending on the factors that frame the development of private law in the specific country concerned. Both the 2004 draft of the *Cod Civil* and the Consumer Code failed to perform an integrative function. It seems that in Romania we can expect a much slower and more natural integration of the *acquis*, to be promoted primarily by legal practitioners and the judiciary, rather than one guided by legislative policy measures. However, for this to happen requires first of all a paradigm change in Romania at the level of legal scholarship, legal policy, and the actions of the judiciary.



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The Influence of Harmonisation on Civil Law in the Slovak Republic

1. Introduction

“We can agree with the idea that new member countries can learn a lot from the Western countries. However, the opposite is true, as well. The West can also learn from the new member countries about their law of the socialist era, how they succeeded in accepting *acquis communautaire*, how they solved the problem of consumer regulations: to integrate them into the civil law or into separate consumer protection laws [...]”¹

These were the words that Ewoud Hondius used to welcome the newly joined Central European members to the EU in 2004. However, in my opinion, the optimistic invitation will not lead to the expected results if we consider the reality. We should express disappointment with the current state of harmonisation. The pace of harmonisation commitment we have to carry as a new EU member and the burden of the past specific to Central Europe may be among the reasons for this. According to Vékas, “it is possible to establish that the recently joined Central European members tend to follow the examples set by the old continental countries, rather than Central European states offering an example for the old ones” and that “the relationship between a common European law and national laws shows the same kind of problems in the new member states as in the old ones”.²

At the same time it can be stated that Slovakia, which was established as an independent country in 1993, has not had an opportunity to deal with perfection of harmonisation at the highest level, since resolving everyday demanding issues is beyond the economic and personnel capabilities of this country, as I and others would argue.

¹ E. Hondius. Vítejte do Evropské unie, Česká republiko! (Welcome to the European Union, Czech Republic!). Praha: EMP, časopis o českém, slovenském a evropském právu 2004 (3), p. 3 (in Czech).

² L. Vékas. Models in Central-Eastern European Codes. – S. Grundmann, M. Schauer (eds.). The Architecture of European Codes and Contract Law. Kluwer Law International. Private Law in European Context Series 2006 (8), pp. 117–128.

2. Historical overview

To explain our position in the field of civil law, it is necessary to provide a brief outline of the recent history of Slovakia. Slovakia has witnessed constant, substantial changes over the last 50 years. Their chronology is as follows.

Case customary law of Hungarian origin more or less prevailed in Slovakia up to 1950, although from 1918, after its separation from the Austro-Hungarian Empire and integration into Czechoslovakia, in its application by Slovak courts the law was greatly influenced by the *Allgemeines Gesetzbuch der Republik Österreich* (ABGB), which was in force on Czech territory before Czechoslovakia was established. In the first Czechoslovak Republic, a codification draft based on the ABGB was drawn up. The Slovak side was critical of it, and with the disintegration of Czechoslovakia just before World War II its adoption was blocked.

The year 1948 signified a radical turn from capitalism to socialism. Elimination of private property and transformation to a socialist societal structure with stress on a socialist approach to property (private property was to be eliminated) became its economic foundation.

In 1950, the first common Czechoslovak Civil Code was adopted. It was designated as for the transitional period from capitalism to socialism, and its legal and political intention was expressed as being to destroy the base of bourgeois civil law.

In 1964, the Civil Code, based on the socialist conception of property, was adopted. It was far removed from the traditional institutions of the law of obligations and considerably distant from the European private law tradition.^{*3} At the time of its adoption it signified the final result of the transition to socialism.^{*4}

Then, 1989 brought a radical turn in the opposite direction when compared with that of 1948: one aimed at wide re-privatisation. The society was not prepared for this act after 40 years of socialism.

As a result of these revolutionary changes, in 1991 sweeping amendment of the Civil Code and the adoption of the new Commercial Code (which substituted for the cancelled State Business Code) were enacted. The 1991 amendment was, once again, a move qualified as transitional, and since then Slovakia and the Czech Republic have been heading for re-codification of the Civil Code, which has now been 18 years in coming...

The splitting of Czechoslovakia on 1 January 1993 meant the beginning of independent development of the civil law in both successor states and other re-codification efforts.^{*5}

The EU Association Treaty's conclusion in 1993 and the subsequent EU accession of Slovakia on 1 May 2004 meant subordination of the civil law to EU law.

In the historical context, it is obvious that the Slovakia of the 21st century has difficulties on account of prior disruptions of its development. European legislation was developed in Western Europe in continuity with the integration process from the end of World War II and was always economically based on private property.^{*6}

3. The present state of civil law harmonisation

Given the prior discontinuity and instability of societal development and civil law, it is not realistic to consider systematic harmonisation.^{*7}

The dual model of the law of obligations in civil and commercial relations established in 1991 itself causes problems in practice; consumer contracts included in the Civil Code in 2004 deepened the state of disintegration of the contract system. There are now 20 specific contract types regulated in the Civil Code and 26 in the Commercial Code. Some of them are identical, and the scope of their application is dependent on the nature of their subjects. On the other hand, several contract types in these codes are applicable generally, irrespective

³ Civil Code from 1964 in its "purported progressivism" has exceeded also Soviet Civil Code, see J. Dvořák. Kodifikace občanského práva v České republice (včera, dnes, zítra) (Codification of Civil Law in the Czech Republic (Yesterday, Today, Tomorrow)). – P. Blaho, J. Švidroň (eds.). Kodifikácia, europeizácia a harmonizácia súkromného práva – Kodifikation, Europäisierung und Harmonisierung des Privatrechts. Dies Luby Iurisprudentiae No. 8. Bratislava: Iura Edition 2005, p. 242.

⁴ J. Švidroň. Hodnotové zakotvenie slovenského občianskeho práva (The Fundamental Moral Principles of Slovak Civil Law). – N. Štefanková (ed.). Vzťahy a interakcia vnútroštátneho práva, medzinárodného práva a európskeho práva z hľadiska krajín Vyšehradskej štvorky po ich vstupe do Európskej únie (Relationship and Interaction of Domestic, International and European Law in the View of "Visegrad Four Countries" after Their Accession in the EU). Žilina: PP Poradca podnikateľa, spol. s r.o. 2007, p. 71 (in Slovak).

⁵ Updated summary in J. Hurdík. Institucionální pilíře soukromého práva v dynamice vývoje společnosti (The institutional poles of private law in the dynamics of the historical development). Praha: C.H.Beck 2007, pp. 1–7 (in Czech).

⁶ J. Dvořák (Note 3), p. 242.

⁷ In the field of civil law, harmonisation of family law and intellectual property law is not taken into consideration here. Civil law, commercial law, labour law and international private law are traditionally included in private law in the Slovak republic.

of the nature of subjects. Specific contracts regulated in both codes may fall under the category of consumer protection and may be qualified as consumer contracts, provided that they satisfy legal requirements.^{*8} Although the civil law has been codified in the Civil Code, many other separate acts are included in its sources at the same time. The structure of the Civil Code itself has been broken by the amendment in 1991.

Lack of a systematic approach to implementation of EU directives has become evident in the manner of their integration into various acts:

- a) The package travel directive^{*9}, unfair contract terms directive^{*10}, consumer guarantees directive^{*11}, and timeshare directive^{*12}, as well as relevant parts of the financial collateral directive^{*13}, direct life assurance directive^{*14}, and legal expenses insurance directive^{*15}, were implemented in the Civil Code. How directives are integrated into the Civil Code is in itself problematic. Their transposition was not systematic or consistent.^{*16} Given the incoherent structure of the Civil Code, whether it was possible to do it much better is a matter for heated debate.^{*17}
- b) The unfair commercial practices directive, the injunctions directive, the general product safety directive, and the dangerous products directive were implemented in the Consumer Protection Act.^{*18}
- c) Transposition of some directives has been realised through specific acts: the doorstep selling directive^{*19} and distance selling directive^{*20} were implemented by a special act of the identical name (Act 108/2000 Coll. on consumer protection on the doorstep and distance selling). In connection with this example, it can be stated that the purpose of the implementation has not been actualised. According to my experience, in this case, rights conferred by the directive are not effective enough, on account of exclusion of the sales contract from the Civil Code.

⁸ Subsection 3 (3) of Consumers Protection Act (Act No. 250/2007 Collection of Laws of the Slovak Republic (hereinafter Coll.)): "Every consumer has a right to be protected against unfair terms in consumer contracts. Consumer contracts are contracts governed by Civil Code or by Commercial Code and all other contracts provided that they are concluded in multiple cases, and it is usual that the consumer does not have a substantial influence on the terms of contract. Provisions of Civil Code regarding consumer contracts shall be applied as appropriate to consumer contracts not governed by Civil Code." Subsection 52 (1) of Civil Code (Act No. 40/1964 Coll. as amended): "Consumer contract is every contract regardless of its form concluded between supplier and consumer."

⁹ Council directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours. – OJ L 158, 23.06.1990, p. 59. This directive has been implemented partly in Civil Code and partly in the Act No. 281/2001 Coll. on package tours, terms of running travel offices and agencies.

¹⁰ Council directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. – OJ L 95, 21.04.1993, p. 29.

¹¹ Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees. – OJ L 171, 7.07.1999, p. 12.

¹² Directive 94/47/EC of the European Parliament and of the Council of 26 October 1994 on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis. – OJ L 280, 29.10.1994, p. 83.

¹³ Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements. – OJ L 168, 27.06.2002, pp. 43–50.

¹⁴ Council directive 92/96/EEC of 10 November 1992 on the coordination of laws, regulations and administrative provisions relating to direct life assurance and amending directives 79/267/EEC and 90/619/EEC (Third life assurance directive). – OJ L 360, 9.12.1992, pp. 1–27.

¹⁵ Council directive 87/344/EEC of 22 June 1987 on the coordination of laws, regulations and administrative provisions relating to legal expenses insurance. – OJ L 185, 4.07.1987, pp. 77–80.

¹⁶ See J. Drgonec. Spotřebitelské zmluvy v právnom poriadku Slovenskej republiky (Consumer Contracts in the Legal Order of the Slovak Republic). – *Justičná revue* 2007 (3), pp. 295–317 (in Slovak); D. Dulaková-Jakúbeková. K novele Občianskeho zákonníka o spotrebiteľských zmluvách (On the Amendment of the Civil Code about the Consumer Contracts). – *Justičná revue* 2004 (8–9), p. 907 (in Slovak).

¹⁷ The present-day structure of Slovak Civil Code: Part One. General Part, Part Two Rights in Rem, Parts Three-Five repelled, Part Six Liability for Damages and Unjustified Enrichment, Part Seven Law of Succession, Part Eight Law of Obligations, Part Nine Final and Temporary Provisions.

¹⁸ Directive 98/27/EC of 19 May 1998 on injunctions for the protection of consumers' interests (OJ L 166, 11.06.1998, p. 51), amended by directive 1999/44/EC of 25 May 1999 (OJ L 171, 7.07.1999, pp. 12–16), directive 2000/31/EC of 8 June 2000 (OJ L 178, 17.07.2000, pp. 1–16), directive 2002/65/EC of 23 September 2002 (OJ L 271, 9.10.2002, pp. 16–24), directive 2005/29/EC of 11 May 2005 (OJ L 149, 11.06.2005, p. 22–39). Directive 87/357/EEC of 25 June 1987 on the approximation of the laws of the Member States concerning products which, appearing to be other than they are, endanger the health or safety of consumers. – OJ L 192, 11.07.1987, pp. 49–50; Directive 2001/95/EC of the European Parliament and of the Council of 3 December 2001 on general product safety. – OJ L 11, 15.01.2002, pp. 4–17; Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council directive 84/450/EEC, directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No. 2006/2004 of the European Parliament and of the Council.

¹⁹ Council directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises. – OJ L 372, 31.12.1985, p. 31.

²⁰ Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts (OJ L 144, 4.06.1997, p. 19), as last amended by directive 2005/29/EC (OJ L 149, 11.06.2005, p. 22).

The distance selling directive for financial services^{*21}, consumer credit directive^{*22}, and product liability directive^{*23}, as well as the directive on electronic commerce^{*24}, have been implemented via the enactment of specific acts.

Realisation of the purpose of **harmonisation is greatly affected by the legislative process of transposition itself**. Transposition carried out via drafts by various ministries (the Ministry of Justice, the Ministry of Economy, etc.) are subject to criticism stemming from lack of clear conception.^{*25} The reasons for this situation are also pointed out: ignorance of this issue by politicians and that public authorities align themselves with the stronger side.^{*26}

The Consumer Protection Act of 2007 itself shows signs of instability and misconception. The earlier Consumer Protection Act of 1992 was replaced this year by a new act to guarantee 'greater stability' than the previous one, which was modified several times in the course of its life.^{*27} The opposite is indicated by a new source available at the Ministry of Economy's Web site as the responsible authority, where another extensive modification of the act is suggested.^{*28} If the intention of the legislators was to reach a certain degree of stability, it would have been appropriate to wait for several years, until EU action achieves unity of *acquis communautaire* at the acceptable level. There are two other problematic elements in the Slovak Consumer Protection Act. Firstly, the name of the act itself is misleading, as it covers only a certain proportion of the target issue, which is evident in this outline. Second is the fact that this act combines rules of different character (civil, administrative, and procedural character, etc.).^{*29}

To sum up, all the defects of consumer *acquis* having been mentioned and criticised in the Green Paper on the Review of the Consumer *Acquis*^{*30} go directly to the heart of fractured Slovak civil law and are often even redundant. It is important to apply these experiences in the process of civil law re-codification.

It will be essential in the area of consumer protection to embody directly in the Civil Code material addressing information disclosure, the right to cancel a contract (withdrawal right), unfair terms, and in particular cases a requirement of written form. Today, the protection measures for the benefit of the weaker party — i.e., the consumer — are scattered throughout the code and specific acts in a way that suppresses their effectiveness. It has also to be considered whether the actual notion of consumer should be restricted. Nowadays, 'consumer' is repeatedly defined^{*31} in the Civil Code and the Consumer Protection Act, with this definition including not only natural persons but also legal persons if they meet other legal conditions.^{*32} Consumer contracts are also double-defined in private law.^{*33}

²¹ Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council directive 90/619/EEC and Directives 97/7/EC and 98/27/EC (OJ L 271, 9.10.2002, p. 16), as amended by directive 2005/29/EC (OJ L 149, 11.06.2005, p. 22) has been transposed by Act No. 266/2005 Coll. on consumer protection on distance financial services.

²² Council directive 87/102/EEC of 22 December 1986 for the approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit (OJ L 42, 12.02.1987, p. 48), as last amended by directive 98/7/EC of the European Parliament and of the Council (OJ L 101, 1.04.1998, p. 17) has been transposed by Act No. 258/2001 Coll. on consumer credits.

²³ Council directive 85/374/EEC of 25 July 1985 on the approximation of the laws, regulations and administrative provisions of the Member States concerning liability for defective products (OJ L 210, 7.08.1985, pp. 29–33) transposed by Act No. 294/1999 Coll. on liability for damage caused by defective products.

²⁴ Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects on information society services, in particular electronic commerce, in the internal market. – OJ L 178, 17.07.2000, p. 1.

²⁵ I. Fekete. Komentár k zmenám v úprave spotrebiteľského práva a k ďalším zmenám Občianskeho zákonníka od roku 2002 (The Comments on the Changes of Consumer Law and on the Other Changes of the Civil Code). Bratislava: Obchodné právo 2005 (6–7), p. 55 (in Slovak).

²⁶ J. Drgonec (Note 16), p. 306.

²⁷ The extract from the explanatory report to the newly enacted act: "(Former) Consumer Protection Act was enacted in 1992 and it has been 10 times amended until now. His application has been too complicated for the broad variety of consumers as well as for the responsible public authorities. Another reason for enacting of the new act is the new policy of this act. The proposed act is general and the particularities are regulated by the governmental orders. These approximation governmental orders will transpose EU Directives into the structure of Slovak law order in the compliance with the Slovak Constitution. This policy has been more advantageous given the fact that the EU Directives have been frequently changed in order to secure more protection of the consumer and to provide better safety of products and services. In the future only these approximate governmental orders will be changed without the changes of the acts more times in the year." Available at <http://www.economy.gov.sk/pk/2052-2006-1000/ds.htm> (11.11.2007).

²⁸ Available at <http://www.economy.gov.sk/pk/1939-2007-1000/ds.htm> (12.12.2007).

²⁹ L. Vékás (Note 2), p. 126.

³⁰ Green paper on the Review of the Consumer Acquis. – OJ C 61, 15.03.2007, pp. 1–23.

³¹ Subsection 52 (4) of Civil Code, § 2 a) of Consumer Protection Act.

³² For similar solution enacted, e.g., in Austria see B. Lurger. Consumer Law – Forerunner for or Part of a European Contract Law Code? The Case of Austrian Consumer protection. – S. Grundmann, M. Schauer (eds.). The Architecture of European Codes and Contract Law. – Private Law in European Context Series 2006 (8), p. 207.

³³ See Note 8.

4. The civil law re-codification

The contemporary situation of civil law demands that one concentrate on the key issues of re-codification. In its background it is possible to harmonise all those often mechanically realised responsibilities resulting from our membership in the EU and start harmonisation as the important positive factor in the development of the civil law, and not only in the field of consumer protection.

In January 2007, the Minister of Justice appointed the Codification Commission, whose objective is to prepare the new Civil Code by the end of 2010. Considering the fact that this is not the first effort (in 1998, the Civil Code Draft already containing wording of articles^{*34} was issued, with the Legislative Objectives of the Civil Code following in 2002)^{*35}, one may also draw something from the discussion of previous attempts. By following the professional and academic discussions, one can divide the key re-codification issues into two groups:

- a) issues repeatedly arising in discussions: the significance of national codification against the background of harmonisation processes in the EU, use of a monistic or dualistic model, degree of continuity, and the question of following suitable models^{*36} and
- b) other important issues that have not been paid appropriate attention, ones that have been arising recently: moral and political values of re-codification^{*37}, protection of the weaker side, and the manner of integration of consumer protection into the Civil Code.

The primary question is whether it is appropriate to make all efforts to perform the national codification in the contemporary integration process in Europe. Analogous to the situation in Hungary^{*38}, the Czech Republic^{*39}, and Poland^{*40}, which are close to our country geographically and are similarly situated in other terms, the solution is clear. Processes of developing unification propositions in Europe are highly promising; academic proposals and EU activities^{*41} have greatly affected work on re-codification and will continue to do so. However, their time frame is, unfortunately, uncertain. Slovakia needs to consolidate the civil law; therefore, the country is trying to enter the second wave of re-codification.^{*42}

Values of re-codification: The principles of a socially and ecologically oriented market economy are guaranteed by article 55 of the Slovak Constitution. An important basis for property law codification is given in article 20, particularly subsection 3: "Ownership is binding. It must not be misused to the detriment of others or at variance with general interests protected by law." Moral and political values in Slovak civil law have been almost completely neglected since significant social changes have occurred.^{*43} The direction of Slovak society after the rejection of socialism is to move toward broad liberalism; newly acquired freedom of contract is practically in a position of inviolability. I would incline toward the conclusion that traditional Continental countries are more willing to seriously debate ideas of social justice than is Slovakia.^{*44}

Monistic versus dualistic model: The nineteenth century is generally considered to have been a time of dualistic codification. In Slovakia, a dualistic model has been applied again since 1 January 1992. The present

³⁴ As a special addition of a journal *Mzdy a financie* (MaF Extra) (1, 2). Bratislava: EPOS 1998 (in Slovak).

³⁵ Legislatívny zámer Občianskeho zákonníka (Legislative Objectives of the Civil Code). – In addition to *Justičná revue* 2002 (8–9) (in Slovak).

³⁶ See the composite book P. Blaho, J. Švidroň (eds.) (Note 3); J. Lazar. *Otázky kodifikácie súkromného práva* (The Questions about the Civil Law Codification). Bratislava: IURA Edition 2006 (in Slovak); L. Fogaš, J. Mazák. *Rekodifikácia súkromného práva* (Stav, perspektívy, východiská) (Re-codification of Private Law (Position, Perspectives, Resources)). – *Právny obzor* 1999 (3), p. 193 (in Slovak); J. Lazar (ed.). *K návrhu slovenského Občianskeho zákonníka* (On the Slovak Civil Code Draft). – *Dies Luby Iurisprudentiae* 1999 (5) 1999 (in Slovak); P. Kubiček. *Aktuálne otázky reformy súkromného práva v SR* (The Current Questions of Private Law Reform in the Slovak Republic). – K. Eliáš (ed.). *Súkromné právo v pohybu*. Plzeň: Vydavatelství a nakladatelství Aleš Čeněk, s.r.o. 2005, p. 114 (in Slovak).

³⁷ J. Švidroň (Note 4), pp. 70–81.

³⁸ L. Vékás. *O návrhu nového maďarského občianskeho zákonníka* (About the New Hungarian Civil Code Draft). – J. Švestka, J. Dvořák, L. Tichý (eds.). *Sborník statí z diskusních fór o rekodifikaci občanského práva*. Praha: ASPI 2006, p. 104.

³⁹ L. Tichý. *Kodifikace českého soukromého práva v evropských souvislostech* (The Codification of the Czech Private Law in the European Context). – J. Švestka, J. Dvořák, L. Tichý (eds.). *Sborník statí z diskusních fór o rekodifikaci občanského práva*. Praha: ASPI 2006, p. 47; K. Eliáš. *Charakteristika návrhu nového občanského zákonníku* (The Characteristics of New Civil Code Draft). *Ibidem*, p. 28.

⁴⁰ Z. Radwanski. *Kodifikationsprobleme des Zivilrechts in Polen*. – P. Blaho, J. Švidroň (eds.). *Kodifikácia, europeizácia a harmonizácia súkromného práva – Kodifikation, Europäisierung und Harmonisierung des Privatrechts*. *Dies Luby Iurisprudentiae* No. 8. Bratislava: Iura Edition 2005, p. 173.

⁴¹ Available at <http://www.copec1.org> (16.02.2008).

⁴² C. von Bar. *O celoevropské odpovědnosti národní kodifikační politiky* (On All-European Responsibility of National Codification Policy). – J. Švestka, J. Dvořák, L. Tichý (eds.). *Sborník statí z diskusních fór o rekodifikaci občanského práva*. Praha: ASPI 2006, p. 11.

⁴³ For an exemption refer to Note 4.

⁴⁴ B. Lurger. *The Future of European Contract Law between Freedom of Contract, Social Justice and Market Rationality*. – *European Review of Contract Law* 2005 (4), pp. 442–468.

re-codification commission prefers a monistic model, although it is criticised by commercial lawyers.^{*45} The Commercial Code of 1991 was undeniably positive, enabling the development of market relations. The practice revealed opacity and functional inadequacy. It is more or less clear now that the future will be directed toward the monistic model, but details of this integration often have been overlooked or underestimated. Difficulties will occur not only in the integration of the general part of the law of obligations but in specific types of contracts as well. Breach of contractual obligations in civil law disintegrates into matters of defective performance, creditor's delay, and debtor's delay. In commercial law, this model of breach has been changed, becoming more unified, or is shifting toward the system of the uniform model of breach in the regulation of sales contracts based on the Vienna Convention (CISG). The unification of liability for damages is also problematic because in the Civil Code it is based on the principle of subjectivity, whereas in the Commercial Code it is addressed in the framework of the principle of objectivity. In the view of the European harmonisation scheme and the function of the liability system, the Slovak scheme of liability for damages, which unifies contractual and non-contractual liability, sometimes seems to be incompatible with the European solutions.

Consumer protection and the question of the enshrining of consumer contracts in the Civil Code: The purpose of consumer protection requires including consumer contracts under the Civil Code, so the commission has a serious task ahead of it in creating a unified contract system. This issue has not been very stable thus far, but now the EU is on its way toward consolidation via the Green Paper on the Review of the Consumer Acquis. It is hoped that Slovakia will be able to consider several results of this review and the Common Frame of Reference with regard to consumer protection in the future process of civil law re-codification.^{*46} In any case, unification of the present 'triple' system (civil, commercial, and consumer contracts) requires detailed analyses. A minimum of special provisions is preferable; protection provisions probably should differ from others only in their mandatory nature. The manner of incorporation of the results of the Acquis Group's work on the Draft Common Frame of Reference may serve as a model for dealing with this task.

The degree of influence of and inspiration by foreign patterns and academic models: The issue of influence is connected with the previous items and with the idea of continuity of the legal order, which would be pushed into the background if re-codification were widely inspired by patterns found in foreign legislation. There are several foreign patterns, among them traditional codification (as seen in the ABGB; the *Code Civil*; and the *Bürgerliches Gesetzbuch*, or BGB) and modern codification (as manifested in the Netherlands, Quebec, and reform of the law of obligations in the BGB). It is definitely unwise, and would prove impossible in the long term, to fall into mechanical copying. The history of Slovakia has shown attempts to 'artificially' implant the ABGB in the time of the Austro-Hungarian Empire and the pre-war Czechoslovakia. Both attempts were unsuccessful. The correct extraction of positive features of the individual national codifications requires demanding continual work in comparative law. Unfortunately, the fact remains that there is a lack of competent experts in Slovakia even after 18 years of transformation. I would rather turn to the results of academic efforts^{*47} that compare national legal systems on a scientific basis. It is important to involve experts who together bring a wide breadth of knowledge in the preparatory work, mainly the academic community in the initial stage. At the Faculty of Law of Trnava University, we have been working on the grant project European Civil Code (ECC) — Participation of Basic Legal Research in the Slovak Republic by Its Creation and Utilization of Its Solutions by Further Europeanization of Slovak Private Law.^{*48} The outcome of this research may contribute to the achievement of the task.

Degree of abstraction in law: The abstraction issue has come to attention through the spread of European legislation. Directives, implemented in the national law, are often inconsistent with other parts of our acts from the standpoint of degree of generalisation. It is true that socialist pieces of legislation often were short, sometimes even excessively so, but with the EU we are going in the opposite direction. This is another reason it will be difficult to find boundaries for the level of integration of *acquis communautaire* within a future code.

⁴⁵ Previous re-codification attempts came out of monistic conception.

⁴⁶ See also Principles of the Existing EC Contract Law (Acquis Principles). Contract I: Pre-contractual Obligations. Conclusion of Contract. Unfair Terms. Prepared by Research Group on the Existing EC Private Law (Acquis Group). Sellier 2007.

⁴⁷ See O. Lando, H. Beale (eds.). Principles of European Contract Law. Parts I and II. The Hague 2000; O. Lando, E. Clive, A. Prüm, R. Zimmermann (eds.). Principles of European Contract Law. Part III. The Hague 2003; Principles of European Law prepared by Study Group on a European Civil Code, see http://www.sellier.de/pages/de/buecher_s_elp/europarecht/454.htm (16.02.2008); Common Frame of Reference see <http://www.copecl.org/> (16.02.2008); UNIDROIT Principles of International Commercial Contracts see <http://www.unilex.info/dynasite.cfm?dssid=2375&dsmid=14276> (16.02.2008).

UNIDROIT Principles have been translated into the Slovak language. See J. Švidron. UNIDROIT – Zásady medzinárodných obchodných zmlúv. Bratislava: Iura Edition 1996. Revised translation J. Švidroň. Zásady UNIDROIT pre medzinárodné obchodné zmluvy 1994. In Vzorová zmluva MOK o medzinárodnom obchodnom zastúpení -príloha, Bratislava: SOPK 2003, pp. 45–66.

⁴⁸ As the first stage, researchers of this grant project assisted in the creation and compilation of the National Notes for the Draft Common Frame of Reference on a European Contract Law and related matters being produced by the Study Group on a European Civil Code and the Acquis Group within the context of the Joint network on European Private Law.

5. Conclusions

Despite the complicated history outlined here, or perhaps because of it, it is not possible to reform Slovak private law and create a new Civil Code without considering the approved legislation and judicial decisions of the last 50 years, on account of the adaptation of progressive reforms. According to Švidroň, “our history between 1948 and 1989 cannot be simply ‘thrown over a precipice’ [...] in the development of our civil law of this period, certain positive features can also be academically recognised”⁴⁹; thus, re-codification based on discontinuity would help neither experts nor the general public.

The economic aspect of integration into and within the European Union probably benefits Slovakia. Following from the ideas expressed in the work of Jerzy Rajski, intra-European harmonisation and progressive unification is of great importance for the future of European integration.⁵⁰ Perhaps ambiguous Slovak civil law has a more complicated task in its consolidation via re-codification. On the other hand, without being burdened with the traditional code as part of the country’s cultural heritage; Slovakia might succeed in forming high-quality legislative work.

⁴⁹ J. Švidroň, *Mravné dimenzie občianskeho práva* (Moral Dimensions of Civil Law). The lecture was addressed at the international conference “Tradition and Innovation in the Civil Law” organised by the Department of Civil Law of Masaryk University Brno on 25 September 2007 in Brno, available in Slovak, also with English summary at <http://www.jsn.sk> (16.02.2008).

⁵⁰ J. Rajski, *On the Need for a Progressive Harmonisation of Private Law in the European Union: The Role of Legal Science and Education*. – *Juridica International* 2006 (XI), pp. 20–24.



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Harmonisation of Private Law in Europe and the Development of Private Law in Slovenia

1. Introduction: Status of private law reform in Slovenia

The Republic of Slovenia, a member of the EU since 1 May 2004, is a former republic of the Socialist Federal Republic of Yugoslavia. It gained independence in 1991¹, following a referendum² after the first free and democratic parliamentary election in 1990. As in other former socialist countries, the official ideology has strongly influenced the legal system. The Communist revolution during and after WWII fundamentally changed the role of the law and of the judicial system. The tradition and development of pre-war private law were interrupted by the introduction of some new concepts, the most important ones concerning private property and free entrepreneurship. Private property was severely restricted. Private owners of immovable property in urban areas as well as owners of rural land exceeding a certain limit were expropriated by way of nationalisation. Another example is the introduction of so-called 'social' ownership (property of the society), mostly superseding state ownership. Private companies were nationalised and private entrepreneurship largely prohibited. Whereas there was an official monopoly of state (later 'social') capital, the management of companies was, at least declaratively, entrusted to the workers by way of an all-embracing system of 'self-management'. However, not all areas of private law were equally affected by these political and legal experiments. A good example is the law of obligations: apart from a few exceptions the Act on Obligations (1978) is certainly comparable to some Western civil (obligations) codes.³ Neither 'old' (from 1918 to WWII⁴) nor 'new' (after WWII) Yugoslavia succeeded in adopting a comprehensive civil code.⁵ The 'old' Yugoslavia wasn't even a unified legal territory; courts continued to apply pre-WWI civil codes: the Austrian Civil Code (in Slovenia and Croatia), the Serbian Civil Code, and the Montenegrin Civil Code. In the 'new' Yugoslavia, private legal matters were regulated by singular laws rather than a code, also due to division of legislative power between the federation and the republics.

¹ Declaration of independence: 26 June 1991.

² The referendum on 23 December 1990 was a success: 92.2% of voters took part and 88.2% of all voted for independence.

³ See V. Trstenjak. *Zivilrecht in Slowenien: Entwicklung und Stand der Dinge heute.* – *Zeitschrift für Europäisches Privatrecht (ZeuP)* 2000, p. 77.

⁴ From 1918: The Kingdom of Serbs, Croats and Slovenians; from 1929: The Kingdom of Yugoslavia.

⁵ See D. Nikolic. *International Encyclopaedia of Laws, Tort Law – Serbia and Montenegro.* Kluwer 2007, p. 37.

The process of private law reform began in the last years of ('new') Yugoslavia with the 1988 Companies Act⁶ and continued in the republics after their independence. In Slovenia, priority was given to key areas where socialist legislation was most incompatible with the new social and legal order based on the new Constitution (1991).⁷ Among the first important steps in the context for this were the (not yet finished) process of denationalisation⁸, the privatisation of companies⁹, and the adoption of the new Companies Act¹⁰ — the latter very clearly under the influence of the German *GmbH-Gesetz* and *Aktiengesetz*). The majority of private law, however, continued to be in force. A new property law code was adopted in 2002.¹¹ Family law¹² and law of succession¹³ have remained basically unchanged thus far. The same is true for most of the law of obligations. This shows that a considerable part of the private law regulation was considered satisfactory and unproblematic from the viewpoint of the new social and legal system.

2. Law of obligations: The Yugoslav Obligations Act, Slovenian Obligations Code, and Consumer Protection Act

For decades following WWII, Yugoslavia did not comprehensively regulate the law of obligations. In 1946, the revolutionary authorities annulled all pre-war (i.e., 'bourgeois') legislation, including civil and commercial codes.¹⁴ However, since the adoption of comprehensive new legislation was not expected to occur soon after, it was allowed to apply the old rules in so far as they didn't contravene any rules and principles of the new political and legal order.¹⁵ An important quasi-legislative role in commercial contract law (B-to-B) was played by the so-called 'General usances for trade with goods' — adopted in 1954 by the plenum of 'state trade arbitration'. The 'usances' brought about not only a collection of existing trade usages but also new regulation of some key issues of general contract law, effectively becoming a predecessor to the Obligations Act (1978). The leading role in the development of the law of obligations in the years prior to adoption of this act was played by the courts, which applied the old rules creatively and accepted some modern trends, especially in tort law.

The preparation of the Obligations Act was based on a draft (so-called 'Sketch') prepared by Professor Mihailo Konstantinović.¹⁶ In the later stages of the preparation, the draft was modified considerably, causing its author to decline further co-operation in the project. Regretfully, almost no *travaux préparatoires* for the Obligations Act are publicly available; thus, the reasons for adoption of specific solutions are unclear. The act on 'obligational relations' (the Obligations Act), adopted in 1978 as a Yugoslav federal act¹⁷, comprises a wide range of influences from different European codes — the Swiss *Obligationenrecht*, Italian *Codice Civile*, German BGB, and Austrian ABGB — with none of them prevailing. Following the Italian and Swiss example of a monistic approach, commercial and non-commercial ('civil') contracts are regulated uniformly. Characteristic of the act is a very distinct influence of uniform sales law, the Hague Conventions on Uniform

⁶ Zakon o podjetjih. — OJ SFRJ (Yugoslavia) 77/1988, 31.12.1988.

⁷ Ustava Republike Slovenije (The Constitution of the Republic of Slovenia). — OJ 33/1991, 28.12.1991 (subsequent changes: OJ 42/1997, 66/2000, 24/2003, 69/2004, 69/2004, 68/2006). English translation available at http://www.us-rs.si/en/index.php?sv_path=3583,3519 (21.08.2008).

⁸ Zakon o denacionalizaciji (Denationalisation Act). — OJ 271/91, 29.11.1991; with numerous subsequent changes and decisions of the Constitutional Court, see unofficial consolidated version available at http://www.mop.gov.si/fileadmin/mop.gov.si/pageuploads/zakonodaja/prostor/denacionalnizacija/denacionalizacija_zakon.pdf (21.08.2008) (in Slovenian).

⁹ Zakon o lastninskem preoblikovanju podjetij (Ownership Transformation of Companies Act). — OJ 95/92 (*et seq.*) (in Slovenian).

¹⁰ Zakon o gospodarskih družbah (ZGD). — OJ 30/1993, 10.06.1993 (*et seq.*). The Companies Act in force now: ZGD-1. — OJ 42/2006, 19.04.2006, with changes in OJ 26/2007, 33/2007, 10/2008, 68/2008 (in Slovenian).

¹¹ Stvarnopravni zakonik. — OJ 87/2002, 17.10.2002 (in Slovenian).

¹² Zakon o zakonski zvezi in družinskih razmerjih (Marriage and Family Relations Act). — OJ 15/1976, 4.06.1976, see official consolidated version in OJ 69/2004, 24.06.2004 (in Slovenian).

¹³ Zakon o dedovanju (Inheritance Act). — OJ 15/1976, 4.06.1976, with subsequent changes in OJ 23/1978, 117/2000, 67/2001, 83/2001 (in Slovenian).

¹⁴ The annulment was retroactive: as from 6 April 1941 — Zakon o razveljavitvi pravnih predpisov, izdanih pred 6.4.1941 in med sovražno okupacijo (The Act on Annulment of Legislation, adopted before 6.04.1941 and during occupation). — Federal OJ 86/46, 105/46, 96/47 (in Slovenian).

¹⁵ M. Ilešič. *Obligacijski zakonik* (Introduction to Obligations Code). Ljubljana: Uradni list 2003, p. 24 (in Slovenian).

¹⁶ M. Konstantinović. *Obligacije i ugovori, Skica za zakonik o obligacijama i ugovorima* (Obligations and Contracts — a Sketch for a Code). Belgrade 1969 (in Serbian).

¹⁷ Zakon o obligacijskih razmerjih (The Act on Obligational Relations). — Federal OJ 29/1978, 39/1985, 57/1989 (in Slovenian).

Sales Law, predecessors of the United Nations Convention on Contracts for the International Sale of Goods (CISG); therefore, the accordance of many provisions with the CISG is not surprising.^{*18} Apart from the chapter on conclusion of contracts and provisions on sales contracts, the most prominent example is the general exemption clause for damages resulting from breach of contract (the Obligations Act, or OA, article 263), which is very close to article 79 of the CISG. On the other hand, the OA also includes some outdated solutions and approaches, examples being the absence of a uniform notion of breach of contract and a very different treatment of non-performance (delay), defective performance (material and legal defects), and impossibility of performance. The prevailing views upon the OA among legal scholars also show that, despite the new act, the understanding and interpretation of the law of obligations were still much influenced by the traditions of old civil codes, above all the Austrian ABGB.^{*19}

Interestingly, the Yugoslav Obligations Act (1978) was an attempt to achieve some of the goals of consumer protection, later pursued by the European consumer protection directives, by using very similar mechanisms, albeit without the concept of consumer. Apart from the regulation of unfair contract terms in OA articles 142–144, the most important examples are producer's liability (OA article 179) and the system of a one-year obligatory 'guarantee for proper functioning' for a wide range of 'technical' goods (OA articles 501–507) — a liability of producer and seller, in addition to (non-mandatory) liability of the seller for material defects.^{*20}

After Slovenian independence, it was only natural that the Yugoslav Obligations Act, having been well accepted by Slovenian lawyers and having stood the test of practice, continued to be in force. In 2001 Slovenia adopted a new code of obligations (in force since 1.01.2002)^{*21}, but it can hardly be called new — apart from regulation of some contract types that were previously unregulated in the Yugoslav Obligations Act^{*22} and some minor and no conceptual changes, the modifications were mostly of 'cosmetic' nature: in fact, it is the Yugoslav Obligations Act with new numbering of articles. Ironically, the expert group preparing the reform decided that there was no need for reform.^{*23} Among the sources for such a decision were discussions with experienced judges. It seems that the aim of adopting the Slovenian Obligations Code was more a formal "Slovenisation" than an actual modernisation of Law of Obligations.

In 1998, the Consumer Protection Act was adopted^{*24}, creating a new branch of law of obligations by providing some special rules on limitations of party autonomy in relations between sellers and consumers regarding unfair contract terms, guarantee for proper functioning of goods, contract of sale, instalment sale, door-to-door sale, distance contracts, time-share contracts, and producer's liability. However, the relation between party autonomy and interventionism did not fundamentally change, since, as already indicated, already the Yugoslav Obligations Act contained several mandatory regulations (e.g., mandatory guarantee for proper functioning of the goods sold).

Another issue needs to be addressed in brief: Gaining independence from Yugoslavia was certainly beneficial for Slovenia in very many respects. On the other hand, Slovenia ceased to be a part of a relatively large system of (*inter alia*) private law. The same Obligations Act was used and developed by many courts in a much (about 12 times) bigger country, a great number of legal scholars discussed the same questions; there were several commentaries and books, etc. The law of obligations is, in spite of the reforms in Slovenia and Croatia, still the same or very similar in all of the former Yugoslav republics, but discussion between judges and academics from different republics has almost vanished. Setting aside political issues, 'nationalisation' of private law within the borders of tiny new national states is not beneficial to the quality and development of private law. Therefore a very open approach towards (European) unification projects is advisable.

¹⁸ See P. Schlechtriem, D. Možina. *Pravo mednarodne prodaje* (International Sales Law). Ljubljana: Uradni list 2006, p. 4 (in Slovenian).

¹⁹ For a discussion from a viewpoint of Croatian law, see N. Gavella. *Die Rolle des ABGB in der Rechtsordnung Kroatiens*. – ZEuP 1994, p. 603. Slovenian courts continued to apply rules of the Austrian Civil Code on donation contract, (gratuitous) lending contract and contract of (civic) partnership. This was due to the fact that the regulation of these 'gratuitous' contracts was up to the republics, but the legislation in Slovenia has never been adopted.

²⁰ See also *Zakon o standardizaciji* (Standardisation Act). – OJ 38/77 and 11/80 (in Slovenian). Article 43 of the act refers to a regulation defining a wide range of 'technical' goods which can be sold only with a guarantee for proper functioning. In Slovenia, the respective content of the Standardisation Act was transposed into the Consumer Protection Act (article 15b, referring to a regulation defining goods, which may only be sold with a guarantee).

²¹ *Obligacijski zakonik* (Obligations Code). – OJ 83/2001, 25.10.2001 (in Slovenian). It applies to obligations arising after 1.01.2002.

²² They were contained in Inheritance Act and even in the Austrian act.

²³ M. Ilešič. *Obligacijski zakonik z uvodnimi pojasnili* (Obligations Code with Introduction). Ljubljana 2003, p. 28 (in Slovenian).

²⁴ *Zakon o varstvu potrošnikov* (Consumer Protection Act). – OJ 20/1998, 13.03.1998, with subsequent changes — see official consolidated version in OJ 98/2004, 9.09.2004 and last amendment in OJ 126/2007, 31.12.2007 (in Slovenian).

3. The role of the *acquis communautaire* in the reform process

In 1998, when the Slovenian Consumer Protection Act was adopted, some of its provisions were modelled after some (but not all) European directives on consumer protection at the time (e.g., directives 85/374/EEC on producer's liability, 93/13/EEC on unfair terms, and 85/577/EEC on doorstep selling).^{*25} Another example of following the *acquis communautaire* before the beginning of the negotiation process for accession to the EU is the adoption of the Private International Law and Procedure Act (1999)^{*26}, implementing the Rome^{*27} and Brussels conventions.^{*28}

In 2002, when Slovenia was already well on the way to becoming part of the EU, the majority of the European consumer protection directives were implemented by amending the Consumer Protection Act.^{*29} The accession activities were at their height, and the main concern and focus was to ensure that the negotiation chapters be closed. It seemed logical that the directives would be implemented by merely transferring their contents into the Consumer Protection Act, which already contained some elements of consumer *acquis*.^{*30} Therefore the decision was made not to integrate the consumer legislation into the Obligations Code. The aim of the legislator was to ensure that minimal standards of consumer protection are met with as little change of existing contract law as possible. With regard to issues in relation to which there was no or very little regulation prior to implementation of the consumer *acquis* (e.g., consumer protection in distance contracts), such implementation is effective: the content of the directive is simply added to the existing legislation. However, with regard to areas where a complex regulation existed before implementation (e.g., seller's liability for non-conformity with a sales contract, unfair contract terms, and producer's liability), a hasty and ill-conceived implementation can create a mess. With regard to the principle mentioned for implementation of consumer *acquis*, it can be argued that the latter had as little influence on Slovenian private law as possible under the circumstances.

4. An example of implementation: The Consumer Sales Directive

Prior to the implementation, Slovenian (Yugoslav) sales law contained not only a complex system of buyer's remedies for material and legal defects (OA articles 478–500) but also a special parallel system of mandatory 'guarantee for proper functioning' of the goods with liability of sellers and producers (OA articles 501–507 and related legislation^{*31}). As already mentioned the latter was aimed at protection of buyers and bears some striking resemblances to the approach of the directive, despite the lack of the concept of consumer.

Regrettably, the Slovenian legislature did not take the opportunity for revision and modernisation of general contract and sales law, as offered by the implementation of the Consumer Sales Directive. If we consider that the 'reformed' draft Obligations Code and draft Consumer Protection Act (with implementation of consumer *acquis*) were both in parliamentary procedure at the same time, this is even more unfortunate. The Consumer Sales Directive was implemented by adding (some of) its contents to the Consumer Protection Act, without any adjustment of general contract and sales law. As a consequence, the picture of Slovenian sales law is fragmented and incoherent. There are also some shortcomings in the implementation. The following selected features of sales law can illustrate this.

While the directive, as does the CISG, proceeds from a uniform concept of breach of contract, Slovenian (Yugoslav) law still follows the traditional Continental approach and treats delay (so-called non-performance), defective performance (performance with material and legal defects), and subsequent impossibility of performance differently. The consumer sales regime specified in the Consumer Protection Act applies only to

²⁵ See Zakon o varstvu potrošnikov, articles 4–11 (producer's liability), articles 22–27 (unfair terms) and articles 42–47 of the Consumer Protection Act. – OJ 20/1998, 13.03.1998 (in Slovenian).

²⁶ Zakon o mednarodnem zasebnem pravu in postopku (Act on Private International Law and Procedure). – OJ 56/1999, 13.07.1999 (in Slovenian).

²⁷ Convention on the law applicable to the contractual obligations (80/934/EEC). – OJ L 266, 9.10.1980, pp. 1–19.

²⁸ Convention of 27 September 1968 on jurisdiction and enforcement of judgments in civil and commercial matters, Brussels. – OJ L 299/1972.

²⁹ Zakon o spremembah in dopolnitvah Zakona o varstvu potrošnikov (Act on Amendment of the Consumer Protection Act). – OJ 110/2002, 18.12.2002 (in Slovenian).

³⁰ With the exception of consumer credit, which is regulated in a separate act — Zakon o potrošniških kreditih (Consumer Credit Act). – OJ 70/2000, 41/2004, 111/2007 (in Slovenian).

³¹ See Note 19.

material defects (Consumer Protection Act article 37, paragraph 2). In itself, this does not mean a lower level of consumer protection, since the position of the buyer with regard to legal defects and delivery of an *aliud* is not worse, but it does demonstrate a different basic approach.

A material defect (non-conformity) is defined in the Consumer Protection Act (article 37, paragraph 2) as the lack of characteristics for agreed or normal use and is a concept taken from the Obligations Code (article 459). The seller is bound by public statements (by him or by the producer) but does not have the possibility of exemption provided for in the directive (article 2, paragraph 4). Moreover, article 2, paragraph 5 (the 'IKEA clause') of the directive was not implemented at all.

In general sales law, all remedies of the buyer depend on notice of material defects to the seller.^{*32} An unnecessarily complicated system of time limits for notification is established by OC articles 460–462, distinguishing 'apparent' and latent defects as well as commercial and non-commercial contracts. If both parties are present at the examination, apparent defects have to be reported immediately. If not, the seller must be notified of apparent defects within eight days (for non-commercial contracts) or 'without any delay' (in cases of commercial contracts) upon examination. Latent defects (not ascertainable by customary examination) have to be reported within the same time limits, starting from discovery. Slovenia has made use of the option in article 5 of the directive: in consumer contracts, the buyer must notify the seller about a material defect within two months upon discovery (article 37a). There are no persuasive reasons for the existence of so many different time limits for notification. Furthermore, the Obligations Code and Consumer Protection Act both provide that notification must be 'substantiated' (i.e., the defect described) and that the buyer must 'invite' the seller to examine the goods. Notwithstanding the question of whether such a demand is sensible, it constitutes an extra prerequisite for remedies, which, in consumer sales, is contrary to the directive.

According to article 462, paragraph 2 of the Obligations Code, in all non-consumer sales contracts the seller is liable for material defects only within six months of delivery, if not otherwise agreed. Moreover, the buyer may exercise his remedies only within a further one-year cut-off period, running from notification of the seller (OC article 480). A combination of these two extremely short time limits is one of the central deficiencies of Slovenian (Yugoslav) contract law. Article 37b of the Consumer Protection Act prescribes a two-year time limit (one year for used goods), with remedies available in a further two years from notification. The time limit of six months in general sales law is far too short. Such a discrepancy between consumer and non-consumer contracts is questionable.

As in general sales law, the buyer may choose freely from among the remedies of supplementary performance (repair or replacement), price reduction, and termination, all in combination with damages, but prior to termination the seller has to be given appropriate additional time to effect performance. The Slovenian legislator has not implemented the hierarchy of remedies from article 3, paragraph 3 of the directive. General contract law does not regulate limits of specific performance. However, according to case law, it would constitute an abuse of rights if the buyer were to choose a disproportionate remedy^{*33}; the same conclusion can be drawn by way of analogy with regulation of breach of contract for work (OC article 637).

The system of a mandatory one-year 'guarantee for proper functioning' for a wide range of 'technical' goods is parallel to the seller's liability for non-conformity.^{*34} In the light of mandatory two-year liability for non-conformity as brought about by the directive, the existence of a parallel mandatory system of protection for the buyer doesn't make much sense and creates confusion. There is also a regulation of 'voluntary' (so-called commercial) guarantee, but one of the elements of the principle of transparency set forth in article 6 of the directive is missing: the demand that the guarantee document both state that the consumer has legal rights under applicable national legislation governing the sale of consumer goods and make clear that those rights are not affected by the guarantee. In the absence of this rule, which is a starting point in the European regulation of (commercial) consumer guarantees, a guarantee cannot properly perform its functions.^{*35}

Although it is not directly connected to substantive law, another issue needs to be addressed: in Slovenia, as well as in other post-socialist countries, there is a big difference between law in legislation and law in action.^{*36} This is especially true for consumer law. In the ten years in which the Consumer Protection Act has been in force, not more than a handful of court decisions on the act are available.^{*37} Indeed, matters of consumer

³² With the exception of consequential damages — Obligations Code article 468, paragraph 3 (Yugoslav Obligations Act article 488, paragraph 3).

³³ Supreme Court of Slovenia, Case No. II Ips 968/93 of 6.04.1995.

³⁴ Consumer Protection Act article 15b. In Obligations Code articles 481–484, the guarantee-remedies of the buyer are defined: repair, replacement, termination, price reduction, and damages. The hierarchy is similar to the directive: the buyer can firstly demand repair or replacement, if the seller does not effect it within reasonable time, the buyer may terminate the contract or reduce the price. Interestingly, CO article 482, paragraph 2 explicitly states that the buyer has the right to claim damages for the deprived use of the goods from the moment the buyer claimed repair/replacement.

³⁵ See F. Gomez. — M. C. Bianca, S. Grundmann (eds.). EU Sales Directive Commentary. Intersentia 2002, p. 54, ff.

³⁶ See N. Reich. Transformation of Contract Law and Civil Justice in the New EU Member Countries: The Example of the Baltic States, Hungary and Poland. — F. Cafaggi (ed.). The Institutional Framework of European Private Law. Oxford University Press 2006, p. 300.

³⁷ Source: IUS-INFO, Slovenian legal information system, a collection of Appellate Courts and Supreme Court decisions.

protection are also under the jurisdiction of the special administrative body — ‘market inspectors’ — who can impose a penalty (a fine) on sellers not in compliance with the Consumer Protection Act. However, also decisions of market inspectors are scarce. One of the reasons is probably related to the problematic functioning of the judicial procedures in Slovenia. Another relates to the knowledge about and importance given to consumer protection law, which is illustrated by the fact that the programme for the state bar exam does not include the Consumer Protection Act, let alone the European consumer *acquis*.^{*38}

5. The role of the Principles of European Contract Law and similar instruments in the reform process

As already mentioned, the Hague Conventions on Uniform Sales Law (1964) had played a significant role in the making of the Yugoslav Obligations Act (1978), predecessor to the Slovenian Obligations Code. The uniform sales law from The Hague inspired not only some Obligations Act provisions on sales contracts but also the core of general contract law: the chapter on conclusion of contracts (OA articles 26–43), the concept of liability for breach of contract with exemptions for damages (OA article 262, OC article 240), and the foreseeability rule (OA article 266, OC article 243). The Obligations Act was transformed into the Slovenian Obligations Code in 2002 with only minor changes. Modifications in the chapter on conclusion of a contract were aimed at further harmonisation with the CISG.^{*39} Unfortunately, this was not sought with regard to other issues of contract law, with regard to which a range of outdated and incoherent solutions of the Yugoslav Obligations Act were preserved in the Slovenian Obligations Code, such as the very different treatment of delay (non-performance) and material defects (defective performance), far too short time limits for liability of the seller for material defects, invalidity of contract because of initial impossibility. The expert group preparing the reform proceeded from the assumption that the basic concept of the Yugoslav Obligations Act was in accordance with modern trends in comparative law. On the grounds that it stood the test of practice and Slovenes accepted it, a conservative approach to change was chosen.^{*40} An opportunity for modernisation as well as “Europeanisation” of contract law was missed.

6. Views on the ongoing harmonisation process in Europe and the coming Common Frame of Reference, from the perspective of Slovenia

The original aim of the European Community was not harmonisation of private law of the member states but market integration. The EC Treaty does not recognise a direct competence of the EC for private-law legislation. However, the EC is given a number of singular competencies to adopt private-law legislation, most importantly for measures of harmonisation aiming at the establishment and functioning of the internal market (EC article 95) and measures for achieving a high level of consumer protection (EC article 153).^{*41} On this basis, a number of consumer protection directives have been adopted since 1985, constituting the core of European contract law *acquis* and covering issues such as doorstep selling^{*42}, package tours^{*43}, unfair contract terms^{*44}, time-sharing^{*45}, distance contracts^{*46}, sale of consumer goods, and associated guarantees.^{*47} Characteristic of

^{*38} Available at the Ministry of Justice Internet site http://www.mp.gov.si/si/delovna_podrocja/cip/pravniiski_drzavni_izpiti/ (20.02.2008).

^{*39} So was OC article 22, paragraph 2 modelled entirely after CISG article 14, paragraph 2, OC article 26 after CISC article 20, paragraph 1, OC articles 29 and 31 after CISG article 19, paragraphs 2 and 3 and article 21.

^{*40} M. Ilešič. *Obligacijski zakonik* (Introduction to Obligations Act). Ljubljana 2003, p. 28 (in Slovenian).

^{*41} However, EC article 153, paragraph 3 refers back to EC article 95.

^{*42} Council directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises. – OJ L 372, 31.12.1985, pp. 31–33.

^{*43} Council directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours. – OJ L 158, 23.06.1990, pp. 59–64.

^{*44} Council directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. – OJ L 95, 21.04.1993, pp. 29–34.

^{*45} Directive 94/47/EC of the European Parliament and of the Council of 26 October 1994 on the protection of purchasers in respect of certain aspects of contracts relating to the purchase of the right to use immovable properties on a timeshare basis. – OJ L 280, 29.10.1994, pp. 83–87.

^{*46} Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts. – OJ L 144, 4.06.1997, pp. 19–27.

^{*47} Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees. – OJ L 171, 7.07.1999, pp. 12–16.

the consumer *acquis* is a limitation of freedom of contract in favour of the inferior party, aimed at securing an equitable exchange of goods. The directives contain rules on conclusion of special types of consumer contracts, especially with regard to the information duties. Some of them seek to protect the consumer from light-headed contractual binding with a right to withdraw from the contract (so called cooling-off) within a certain time. The directives gradually penetrated the national law of the member states, sometimes creating new divergences between national laws due to the principle of minimal harmonisation. The legislation is incoherent and fragmented, also due to the absence of a comprehensive overall approach: the directives were, in principle, aimed at regulating singular and sector-specific issues; they were adopted without a complex and logical system of ideas of the sort typically distinctive of national bodies of contract law. However, recent years have seen the discussions about establishing such a system on European level intensify, not only among scholars but also within institutions of the EU.

The European Commission launched the debate about the creation of European contract law by issuing the Communication on European Contract Law in 2001.⁴⁸ A non-exhaustive list of four options was set out describing possible solutions for problems resulting from divergences between national contract laws and incoherent consumer *acquis*.⁴⁹ In 2003, it issued another Communication (Action Plan)⁵⁰ document; it noted that the majority of stakeholders supported the option that legislation already in place should be improved by modernising, extending, and simplifying the existing directives, whereas the option related to promotion of the development of common contract law principles leading to greater convergence of national laws by way of restatements also received a lot of support. The Action Plan suggested a mix of non-regulatory and regulatory measures. In addition to a sector-specific approach, measures should be taken to increase the coherence of the contract law *acquis*, promote the elaboration of EU-wide general contract terms, and examine the possibility of introducing an 'optional instrument' in the future. The central project for improving the quality of the *acquis* is the elaboration of a common frame of reference (CFR) for European contract law. Common fundamental principles, terminology, and model rules should be developed on a basis of broad scientific research — in particular, a comparison and analysis of laws of the member states, with substantial participation by all stakeholders.

The CFR is intended to be used primarily by a European Community legislator in reviewing the existing *acquis* and proposing new measures, but it could also serve as a source of inspiration for national legislators, indirectly contributing to convergence between national laws. In the future, it should also serve as a basis for a possible optional instrument, a set of rules which the parties could choose to govern their contract. The European Commission emphasised that it did not plan to propose a 'European Civil Code'. In 2004 the commission issued a further Communication document on European contract law and the revision of the *acquis*: 'The Way Forward'.⁵¹ The commission stated that it wants to further pursue the elaboration of the CFR with the intention of making it the most important tool in the development of European contract law. Also, the European Council has expressly mentioned the CFR in the Hague Programme, a follow-up action from the council in Tampere.⁵²

According to the European Commission, the CFR would constitute a new kind of legal source — principally a non-binding instrument, but still an authoritative text, intended as a 'toolbox', primarily aimed at the Community legislator for improving existing and proposing new legislation. It could also play other roles. Most importantly, the CFR could serve national legislators as a kind of model law or source of inspiration, especially with regard to a coherent implementation of contract-law directives in national contract law and thus be a sort of soft-law tool for 'spontaneous' harmonisation of contract law. It could also help the European Court of Justice in interpreting contract law *acquis* and be applied by arbitration tribunals. The content of the CFR should contain a set of definitions, fundamental principles of contract law, and model rules — a structure that is very reminiscent of the Principles of European Contract Law. With regard to the scope, the CFR should cover not only consumer contract law but also other areas of the EU contract law *acquis* and related relevant issues of general contract law.⁵³ According to the Action Plan, it could include rules on the conclusion, validity, and interpretation of contracts; performance; non-performance; and remedies, as well as rules on credit securities on movable goods and the law of unjust enrichment.

⁴⁸ Communication from the Commission to the Council and the European Parliament on European Contract Law from 11.07.2001, COM(2001) 398 final. — OJ C 225, 13.09.2001, p. 1.

⁴⁹ In short: Option I: no EC action; Option II: promote the development of common contract law principles leading to more convergence of national laws; Option III: improve the quality of the existing legislation; Option IV: new comprehensive legislation at EC level.

⁵⁰ Communication from the Commission to the European Parliament and the Council: "A more Coherent European Contract Law: An Action Plan", COM(2003) 68 final. — OJ C 63, 15.03.2003.

⁵¹ Communication from the Commission to the European Parliament and the Council: European Contract Law and the revision of the *acquis*: The Way Forward, COM(2004) 651 final.

⁵² Tampere Council, 5.11.2004, see Council document 14292/04, 5.01.2004. Available at http://www.europarl.europa.eu/summits/tam_en.htm (21.08.2008).

⁵³ See Second progress report from the Commission on the CFR from 25.07.2007, COM(2007) 447 final, p. 11, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0456:FIN:EN:HTML> (21.08.2008).

The intention of creating a CFR as a non-binding toolbox for Community legislators that is primarily aimed at improvement of the existing *acquis* is perhaps a step back from the 2001 communication and a far cry from very ambitious incentives from the European Parliament concerning codification of European private law.^{*54} However, though it sometimes seems that the enthusiasm is decreasing, the CFR is still envisaged as a basis for discussion of a possible optional instrument the parties could choose to govern their contract (sometimes also called the 28th regime).^{*55}

At the end of 2007, the international group of legal scholars, led by German professors von Bar and Schulte-Nölke (the so-called Network of Excellence, bringing together several existing research groups, above all the Study Group on a European Civil Code and the Acquis Group) and financed by the EU, will present the first results of their work — the draft black letter rules of the CFR.^{*56} The final results, including comments and comparative notes, should be ready by the end of 2008. The European Commission will use the “academic” CFR for the preparation of a so-called political CFR and might start another round of consultation by issuing a White Book. In the end, the decision on what the final CFR will be — its purpose, contents, scope, and legal nature — and in exactly what way will be a political one.

Slovenia is a very small country: it has two million people, its own language, and a legal system with an independent tradition of only 17 years. A general approach for such a country toward harmonisation or even partial unification of private law should be positive. Slovenia can only profit from big international scientific legal projects — such as the draft CFR. The amount of energy invested in such a project is simply not comparable to that available in Slovenia. In principle, the development of European private law can be very beneficial for small member states, especially those with a socialist history. Moreover, there is, in principle, less resistance on account of there being less sense of sacrificing an old national civil code and well-established case law.

With regard to the evolving CFR, particularly from a Slovenian point of view, the secondary purpose of the CFR is to be pointed out: the toolbox function for national legislators — a source of inspiration and guidance for improvement of national legislation, especially with regard to implementation of the consumer *acquis*, and harmonious integration of consumer law into general contract law. The CFR and also the Draft Common Frame of Reference (DCFR) also offer a possibility to compare the national law with modern trends in comparative and European law. In this respect, the incentive they provide for study and development of national as well as European contract law is to be embraced. The ‘informal’ effect of both CFR and DCFR may well prove to be very important for future harmonisation of private law. Legislators will have an opportunity to form their contract law in a way that is both compatible with the laws of other member states and coherent, thus promoting cross-border trade.^{*57} It is very important that the CFR (and also DCFR) be available in all languages of the EU.

A future optional instrument (on an opt-in basis) is a very good approach to the problem of diverging national contract laws, making cross-border trade on the common market more difficult. This is especially so with regard to consumer contracts (B-to-C). In the existing system, where mandatory rules of the consumer’s country are applicable regardless of choice of law, the seller has to pay regard to national laws of all member states or not sell to consumers in some countries.^{*58} With regard to existing differences in implementation of consumer *acquis*, especially the Directive on distance contracts^{*59}, a uniform market approach is almost impossible. An optional instrument would make it possible to test in practice whether parties to a contract would prefer the uniform European contract law over the existing complicated system of national laws interwoven with EC contract law *acquis*. If it turns into a success story it can change the climate about further “Europeanisation” of private law.

⁵⁴ See Resolution of 26 May 1989 on action to bring into line the private law of the Member States (OJ C 158, 26.06.1989, p. 400), Resolution of 6 May 1994 on the harmonisation of certain sectors of the private law of the Member States (OJ C 205, 25.07.1994, p. 518), Resolution of 15 November 2001 on the approximation of the civil and commercial law of the Member States and (OJ C 140 E, 13.06.2002, p. 538), Resolution of 2 September 2003 on the Communication from the Commission to the European Parliament and the Council — A more coherent European contract law — An action plan (OJ C 76 E, 25.03.2004, p. 95).

⁵⁵ See D. Staudenmayer. What Does European Contract Law Mean. — S. Vogenauer, S. Weatherill (eds.). The Harmonisation of European Contract Law. Oxford: Hart Publishing 2006, p. 235.

⁵⁶ See C. von Bar. Working together toward a Common Frame of Reference. — *Juridica International* 2005 (X), p. 17.

⁵⁷ G. Hirsch. Erwartungen der gerichtlichen Praxis an einen Gemeinsamen Referenzrahmen für ein europäisches Vertragsrecht, Vortrag zum 3. Europäischen Diskussionsforums im Vertragsrecht am 1. März 2007 in Stuttgart, p. 11. Available at http://ec.europa.eu/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/conference01032007_en.htm (21.08.2008).

⁵⁸ See Rome Convention article 5 (Note 27).

⁵⁹ See H. Schulte-Nölke, C. Twigg-Flesner, M. Ebers (eds.). EC Consumer Law Compendium. Available at http://ec.europa.eu/consumers/cons_int/safe_shop/acquis/comp_analysis_en.pdf (5.09.2008).



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Reform of the Hungarian Law of Security Rights in Movable Property

1. Introduction

The Hungarian law of proprietary security rights — contained in the Civil Code^{*2} — has undergone two major reforms since the transition to a market economy, the first taking place in 1996 and the second in 2000.^{*3} A third, minor revision of the Civil Code's provisions on security rights was undertaken in 2004, due to the transposition of the European directive on financial collateral arrangements.^{*4}

A third — or fourth, depending on one's view — reform is forthcoming, as Hungary is on the way to adopting a new civil code in the very near future. It was in 1998 that the Government decided to undertake a comprehensive re-codification of Hungarian civil law and set up a commission with the mandate of drafting a new code.^{*5} In co-operation with the Ministry of Justice, the commission, chaired by Professor Lajos Vékás, produced its draft in 2006 (known as the Commission Draft).^{*6} The commission was about to finalise a second, revised draft, on the basis of the comments received, when the Ministry of Justice unexpectedly terminated its mandate in September 2007. The Ministry of Justice published a revised draft in October 2007 (referred to as the First Ministry Draft). Professor Vékás and a group of experts — many of whom also contributed to the Commission Draft from 2006 — published a draft in March 2008 (called the Expert Draft).^{*7} Almost simul-

¹ From 2002 to 2008, the author served as legal counsel at the Department for the Codification of Civil Law of the Hungarian Ministry of Justice. Together with István Gárdos, he was responsible for the drafting of the provisions on the law of charges in the successive drafts of the new Hungarian civil code. The views expressed in this article, however, are those of the author alone and do not reflect the views of the Hungarian Ministry of Justice.

² Act IV of 1959 on the Civil Code (CC). Complementary rules can be found in subordinate legislation: Government decree No. 12/2003. (I. 30.) on the extrajudicial sale of charged property and decree of the Minister of Justice No. 11/2001. (IX. 1.) on the detailed rules of the register of charges. The rules on the judicial enforcement of charges can be found in Act LIII of 1994 on judicial enforcement, the effects of insolvency on the rights of secured creditors are laid out in Act XLIX of 1991 on bankruptcy and winding-up proceedings (hereinafter: Insolvency Act). The legislation is available at government website: <http://www.magyarorszag.hu/kereses/jogszabalykereso> (in Hungarian).

³ The statutes amending the Civil Code were: Act XXXVI of 1996 and Act CXXXVII of 2000.

⁴ Directive 2002/47/EC on financial collateral arrangements was implemented by §§ 41–60 of Act XXVII of 2004, which amended the Civil Code, the Insolvency Act and Law-Decree No. 13 of 1979 on private international law.

⁵ Government decision No. 1050/1998. (IV. 24.).

⁶ For an account of the codification process until 2006 see P. Gárdos. Re-codification of the Hungarian Civil Law. – *European Review of Private Law* 2007 (15), pp. 707–722.

⁷ L. Vékás (ed.). *Szakértői Javaslat az új Polgári Törvénykönyv tervezetéhez* (Draft of a New Civil Code for Hungary: An Expert Proposal). Budapest 2008 (in Hungarian).

taneously, the Ministry of Justice published a new draft (the Second Ministry Draft).^{*8} The Second Ministry Draft was again revised, and, on 28 May 2008, the Cabinet approved the final version of the draft, which was introduced to Parliament as the bill on the new civil code on 5 June 2008.^{*9} The Government expects the bill to receive the approval of Parliament by the end of 2008 and enter into force in 2010, a full 50 years after the entry into force of the current Civil Code.

This article presents and evaluates the post-transition reform of Hungarian secured transactions law and examines the impact that the wholesale reform of Hungarian civil law will have on this body of law.

Two preliminary remarks need to be made:

First, the regime of proprietary security rights as regulated in the Civil Code applies without regard to the status of the debtor and the creditor; i.e., there is no separate set of rules for company security interests and security interests created by unincorporated businesses or individuals. Likewise, the transposition of the financial collateral directive into Hungarian law made the rules of the directive applicable to all financial collateral arrangements, without regard to the status of the debtor and the creditor. There is only one form of security right that is not available to all debtors: the enterprise charge, which can only be taken over the patrimony of a company or other legal person.

Second, it is important to note that, although this article focuses on security rights in movables, the division between the law relating to immovables (real property) and the law governing personal property is not as deep as in some other jurisdictions. The rules on real and personal property law can be found in the same book of the Civil Code (although there is a separate statute on the land register), with the rules on security rights in immovables and movables under the same title. Both the current Civil Code and the bill on the new civil code contain a considerable number of common rules applicable to all security rights, regardless of the movable or immovable nature of the collateral. Differentiation, where necessary, is made on the level of particular provisions.

2. The reforms of 1996 and 2000

The pre-transition Hungarian law of proprietary security rights focused on immovables.^{*10} The primary aim of the 1996 and 2000 reforms was to provide a legal framework by which movables can be utilised efficiently as collateral. The main source of inspiration for the reform was the Model Law of Secured Transactions (1994) elaborated by the European Bank for Reconstruction and Development (EBRD).^{*11} It was on the basis of this Model Law that a charges register was established and two new types of charge were introduced into Hungarian law: the registered non-possessory charge over tangible (corporeal) movables and the ‘enterprise charge’.^{*12} By introducing these forms of security interests, the Hungarian legislator borrowed concepts and ideas from North American and English law, albeit only indirectly, through the filter of the EBRD Model Law.^{*13}

Prior to the reforms, two types of charge were available in respect of tangible movables: the pledge and the so-called ‘charge securing a bank loan’. The pledge requires transfer of possession to the creditor; therefore, it does not allow enterprises to raise financing against their equipment or inventory. The ‘charge securing a bank

^{*8} Both the First and the Second Ministry Drafts are available only on the website of the Ministry of Justice (in Hungarian) at <http://irm.gov.hu/?katid=1&id=104&cikkid=4413> (20.06.2008).

^{*9} Bill No. T/5949 on the new Civil Code.

^{*10} This branch of law was already highly developed before the Second World War, as evidenced by Act XXXV of 1927 on Hypothecs.

^{*11} In fact, one of the three Central European lawyers “requesting that the EBRD propose a basis for uniform or similar regulation of secured transactions across the region” was Professor Attila Harmathy of Hungary. See F. Dahan, J. Simpson. The European Bank for Reconstruction and Development’s Secured Transactions Project: a model law and ten core principles for a modern secured transactions law in countries of Central and Eastern Europe (and elsewhere!) – E.-M. Kieninger (ed.). *Security Rights in Movable Property in European Private Law*. Cambridge: Cambridge University Press 2004, p. 99. Professor Harmathy was also member of the Advisory Board that assisted the EBRD in the drafting of the Model Law.

^{*12} The reforms also introduced a third new type of charge, the so-called ‘independent charge’, which is a non-accessory charge, modelled upon the German non-accessory mortgage, the *Grundschuld*, but with a scope extended to movables. Also enterprise charges may be created in an independent, non-accessory form. However, this type of charge has not gained any significance in respect of movables. According to the data of the Hungarian Chamber of Notaries, only 210 ‘independent charges’ over movables and only 98 ‘independent enterprise charges’ have been created in the period between 1997–2006. The Bill on the new Civil Code restricts the scope of application of the independent charge to immovables, therefore this article does not deal with this type of charge.

^{*13} This is similar to what happened in Slovakia, where the EBRD Model Law had a significant impact on the reform of secured transactions law in 2002. In other countries of the region, US or Canadian law (in its Québec version) had a direct impact on law reform. For Romania see N. de la Peña, H. W. Fleisig. *Romania: Law on Security Interests in Personal Property and Commentaries*. – Review of Central and East European Law 2004 (29), p. 133 ff. For Ukraine see R. A. Macdonald. *Commentaries on the Law of Ukraine on Securing Creditors’ Claims and Encumbrances on Moveables*. Kiev: World Bank Office 2004. In some countries of South-Eastern Europe, e.g., Slovenia and Croatia, German and Dutch law were relied upon in the reform of secured transactions law.

loan' was free from this disadvantage. This special device was created by the socialist Civil Code of 1959.^{*14} It could be created over tangible movables without transfer of possession to the creditor or any alternative form of publicity, but only to secure a bank loan. According to the Official Commentary to the 1959 Civil Code, the drafters' intention was to allow for the extension of bank credit against a shifting pool of assets, particularly against inventory.^{*15} With the development of the credit market and the switch to a two-tier banking system in 1987, this special form of charge became untenable: it amounted to positive discrimination in favour of the banks, and, more importantly, the lack of publicity discouraged even lending by banks as soon as commercial banks appeared on the playing field.^{*16}

Similarly, prior to the reforms, a charge over a receivable^{*17} required notification of the debtor and transfer of any document relating to the encumbered receivable to the creditor. Thus, future receivables were incapable of being used as collateral and the creation of a charge over a multitude of receivables was also cumbersome.

The pre-reform Hungarian law of secured transactions resembled very much the German law on pledges and hypothecs as codified in the German Civil Code of 1900. Apart from the exceptional 'charge securing a bank loan', non-possessory security interest could be granted exclusively over immovables.

There were two ways to overcome the rigidity of the system: to validate hidden security rights (i.e., fiduciary transfer of ownership and fiduciary assignment for purposes of security^{*18}) or to introduce an alternative technique of publicity replacing dispossession (in case of tangibles) and notification of the debtor (in case of intangibles). German case law and practice went down the first road, thereby circumventing and displacing the rules of codified law. North American law illustrates the second option: the establishment of a public register of security rights in movables that fulfils the needs of both the debtor and the creditor. The creditor can file a record of the security right in the public register, thereby achieving third-party effectiveness and priority, whereas the debtor does not have to surrender possession of the encumbered assets to the creditor; that is, the encumbered assets are not withdrawn from the business of the debtor but continue to produce income from which the secured loan can be repaid. The great advantage of the North American approach is that it results in transparency and predictability: third parties (potential creditors) can discover any existing security rights through a search of the public register.

2.1. Validation of non-possessory charge over tangibles and establishment of a charges register

In 1996, the Hungarian legislator opted for the North American model: a grantor-indexed register of charges was established and non-possessory charge over tangibles — perfected^{*19} by registration instead of dispossession — validated.

In case of the non-possessory charge, the chargor (grantor) remains entitled to the possession, use, and enjoyment of the encumbered assets. The Civil Code does not expressly confer upon the chargor the power to dispose of the charged property in the ordinary course of business, but such power is to be inferred from the provision according to which the non-possessory charge is extinguished by a disposition to a *bona fide* purchaser for value in the ordinary course of business.^{*20} Purchasers in the ordinary course of business are not expected to

¹⁴ See CC (1959) § 262.

¹⁵ A Magyar Népköztársaság Polgári Törvénykönyve. Az 1959. évi IV. törvény és a törvény javaslatának miniszteri indokolása (Civil Code of the People's Republic of Hungary. Act IV of 1959 and the Official Commentary to the Bill of the Act). Budapest 1963, p. 284 (in Hungarian).

¹⁶ Prior to the introduction of the two-tier banking system, the central bank performed also the functions of a commercial bank. Besides the central bank, there existed three specialised state-owned banks: a national savings bank providing services to households, a national development bank providing services to state enterprises and a foreign trade bank. The foreign trade bank was not active in the field of lending, the savings bank and the development bank were engaged only in the business of lending on the security of immovables. The only bank that provided inventory financing and used the 'charge securing a bank loan' was the central bank.

¹⁷ In this article, the term 'receivable' is used with a much broader meaning than in North American or English terminology. It simply refers to any right to the performance of an obligation (including monetary and non-monetary obligations). Obviously, the subcategories known in UCC terminology as accounts receivable and payment intangibles are the most suitable to be used as collateral.

¹⁸ Under Hungarian law, transfer of ownership does not necessarily require actual physical transfer of possession to the transferee, assignment is not subject to the requirement of notification. See CC §§ 117, 328.

¹⁹ The term 'perfected' is not used in its technical meaning here, it merely denotes the element additional to the charge contract. It will be explained later that Hungarian law does not know the distinction between creation and perfection and does not recognise unperfected security rights. See 3.2 *infra*.

²⁰ See CC § 262 (6). The language of the CC, according to which the charge is **extinguished** upon a disposition to a *bona fide* purchaser for value in the ordinary course of business, is unfortunate from more aspects. First, it creates the false impression that the non-possessory charge is altogether extinguished under these circumstances, whereas upon proper construction this provision only means that the charge is terminated in respect of the specific asset subject to the disposition, in other words: the transferee obtains an overriding title. Second, the CC should provide that the *bona fide* purchaser for value **takes free of the charge**, so as not to preclude the extension of the charge to the proceeds of disposition.

search the charges register in order to qualify as *bona fide* purchasers.^{*21} Although these provisions lack the accuracy and the precision of the corresponding rules of the Uniform Commercial Code^{*22}, the aim of the legislator was the same: to enable goods to move freely from inventory.

Also enterprise charges were brought under the system of registration. Unfortunately, the legislator did not extend the scope of the charges register to receivables and other intangibles; i.e., charges over intangibles are perfected by the mere conclusion of a charge agreement, without any need for publicity.^{*23} (Only charges over registered intangibles, such as patent rights and trademarks, are subject to a publicity requirement: registration of the charge in the appropriate specialist register.)

2.2. Abolition of the notification requirement in case of a charge over receivables

In order to facilitate the use of receivables as collateral, the reforms abolished the obligation of notifying the debtor of the receivable as a precondition to creating a security right in the receivable. Notice to the debtor is necessary only if the chargee wants to prevent the debtor from making payment to the grantor — as long as there is no notification, the debtor of the receivable is discharged by paying to the grantor. As notification is not a requirement for the creation of a charge over the receivable, it is also irrelevant for purposes of priority between competing chargees. It is the first chargee and not the first notifying chargee who obtains priority.

These rules are parallel to the rules on assignment: a notice to the debtor is not required for the assignment to take place, the notification plays a role in the protection of the debtor^{*24}, and it is the first assignee and not the first notifying assignee who has priority in case of successive assignments by the same assignor.

In spite of the similarity of the legal regimes applicable to assignment and the charge over receivables, creditors preferred assignment by way of security to the creation of a charge, because of the unsatisfactory treatment of secured claims (i.e., claims secured by a charge) in insolvency until 2007.^{*25} By using security assignment, creditors expected to remain unaffected by the insolvency of the debtor (i.e., assignor). From 2001, when the Supreme Court held that the receivables not collected by the security assignee until the commencement of winding-up fall into the insolvency estate of the security assignor, creditors began to use charge and security assignment at the same time — in respect of the same receivables, to secure the same obligation. Outside insolvency, the creditor would act upon the security assignment, inside insolvency he would still enjoy the limited priority conferred on secured creditors. It remains to be seen whether the new insolvency rules favourable to secured creditors are going to change this practice.

2.3. Departure from the principle of specificity

The reforms also departed from the traditional principle of specificity^{*26}, according to which a proprietary right (or right *in rem*) can only subsist over a specific item of property to secure a specific obligation. It would flow from this principle that the encumbered assets and the secured obligations need to be specified individually in the charge contract and in the record in the relevant register.

Instead of adhering to this principle, the reforms allowed for a generic description of the encumbered assets (including after-acquired or future assets) in the case of the non-possessory (registered) charge over tangible movables and the charge over intangibles. In other words, there is no requirement that the encumbered assets be identified individually or that the borrower have rights in the assets at the time it grants the non-possessory charge.^{*27} To use the terminology of US law, the reforms validated the ‘floating lien’ on shifting collateral.

However, this mistake is not one of drafting but of substance: the CC does not extend the charge to the proceeds of disposition. For this problem see the explanation under 3.7 *infra*.

²¹ Law-decree No. 11 of 1960 on the introduction of the Civil Code § 47 (2).

²² UCC § 9-320 and § 1-201 (b) (9). The language of § 4:154 of the Bill on the new CC is much closer to these provisions of UCC: it protects persons who buy tangible movables in the ordinary course of business from a person in the business of selling tangible movables of that kind, without knowledge that the person is not entitled to a disposition of the tangible movables free of the charge.

²³ See CC § 267 (1).

²⁴ I.e., the debtor may discharge his obligation by paying the assignor until he receives a notification of the assignment.

²⁵ See the explanation under 2.6 *infra*.

²⁶ Generally referred to as *Spezialitätsprinzip* or *Bestimmtheitsprinzip* in German legal terminology.

²⁷ For tangibles see CC § 262 (2), § 262 (5), for intangibles CC § 267 (1).

But the legislator did not stop here. The new species of the ‘enterprise charge’ was created.^{*28} This is an all-asset security right that can be granted only by a company or other legal person^{*29}; the individual assets comprising the fund do not need to be specified, the object of the charge is a shifting fund of assets. On the one hand, the range of assets that can be subject to an enterprise charge is broader than the range of assets susceptible to a ‘simple’ registered charge: the enterprise charge also covers the immovables and the registered movables of the debtor, whereas a ‘simple’ registered charge cannot be taken over these assets. On the other hand, as from the 2000 reform, an enterprise charge may be granted only over the whole or ‘an economically independent unit’ of the patrimony of a legal person.^{*30} Whether it was useful to introduce the enterprise charge as a distinct security right, in addition to the validation of floating liens, will be discussed later.

In respect of the secured obligation, the reforms maintained the possibility — already present in the Act on Hypothecs of 1927 and the Civil Code of 1959 — of creating a ‘maximal charge’^{*31}, which secures all obligations arising from a certain legal relationship between the debtor and the creditor, to a maximum amount. (Security rights may be created to secure future or conditional obligations; this was already permitted by the Civil Code of 1959.) Unfortunately, the legislator placed the article on maximal charge not among the common rules applicable to all types of charge but in the sub-chapter on non-possessory charges over tangibles, which created doubts as to the availability of this type of charge in cases of charges over intangibles or financial collateral.

2.4. Introduction of the enterprise charge

As has been mentioned above, one of the major innovations of the 1996–2000 reforms was the introduction of the enterprise charge.^{*32} This device is often compared to the floating charge of English law, but there are important differences between the two.

Under English law, it is a distinctive feature of the floating charge — as opposed to a fixed charge — that the debtor company remains free to dispose of the charged assets in the ordinary course of business. Hungarian law does not know this distinction between fixed and floating charges: the non-possessory registered charge over tangibles also confers continued dealing power on the debtor. This follows from the rule that buyers in the ordinary course of business take free of a registered charge without having to search the charges register.^{*33} All non-possessory charges registered in the charges register (non-possessory charges over tangibles and enterprise charges alike) leave the debtor free to deal with the charged assets in the ordinary course of business, free from the charge.

In fact, there is some difference between the dealing powers of the chargor under a registered charge over tangibles and an enterprise charge. Under the latter, the chargor retains an unlimited right to dispose of the assets of the enterprise. According to the Civil Code, transferees acquire an overriding title, even if the disposition was not in the ordinary course of business and even if the transferee acquired in bad faith or at an undervalue.^{*34} Of course, the chargee can bring an action under § 203 of the Civil Code or § 40 of the Insolvency Act on the avoidance of transactions defrauding creditors, and thereby reverse fraudulent or gratuitous transfers. Still, this unlimited dealing power conferred upon the grantor of an enterprise charge does not seem to be justifiable.

Under English law, a floating charge does not attach to the specific assets comprising the security until crystallisation. Under Hungarian law, crystallisation is not a necessary precondition to the enforcement of an enterprise charge. Upon default, the creditor is entitled to transform the enterprise charge — by unilateral declaration — into charges over individual pieces of property, but he can also, at least theoretically, enforce the charge “with the preservation of the unity of the patrimony”, through the sale of the enterprise as a whole (as a going concern), without first having to transform the enterprise charge into charges over specific assets.^{*35}

²⁸ See CC § 266.

²⁹ But a mortgage (hypothec) registered in the land register or a charge registered in the appropriate specialist register has priority even if it was registered subsequently to the registration of the enterprise charge. See CC § 266 (3).

³⁰ In practice, there are doubts as to what constitutes ‘an economically independent unit’ of a company. The 1996 reform allowed an enterprise charge to be granted over the whole or **any part** of the patrimony of the enterprise.

³¹ This form of charge is similar to the *Höchstbetragshypothek* of German and Austrian law or the *hipoteca global* of Spanish law.

³² The exact, word-to-word translation of the Hungarian term *vagyont terhelő zálogjog* would be ‘charge over a patrimony’.

³³ See CC § 262 (6).

³⁴ According to CC § 266 (1), the enterprise charge automatically extends [attaches] to any asset acquired by the chargor after the conclusion of the charge contract, while any asset that ceases to be part of the chargor’s patrimony automatically becomes free of the enterprise charge.

³⁵ See CC § 266 (2). However, this remedy remained ‘law in the books’, since no procedure comparable to the ‘enterprise charge administration’ of the EBRD Model Law or the receivership of English law has ever been devised by the Hungarian legislator. In fact, a consultation of the Ministry of Justice in 2004 revealed that the widespread opinion among legal scholars and practitioners was that the holder of the enterprise charge should not be allowed to enforce the charge against the whole of the debtor’s patrimony outside of a collective (insolvency) proceeding, with the exclusion of other creditors.

Under English law, since crystallisation of the floating charge is not retrospective, subsequent fixed charges (arising prior to crystallisation) rank ahead of a floating charge. Under Hungarian law, crystallisation is in principle retrospective^{*36} and only subsequent mortgages^{*37} registered in the land register and subsequent charges registered in specialist registers (e.g., charges over ships and aircraft) have priority over the enterprise charge. Apart from these exceptions, the priority of the enterprise charge (and the charges over the specific assets created upon crystallisation) depends upon the time of registration. Therefore, an enterprise charge (and a charge over a specific asset created upon crystallisation) has priority over charges subsequently registered in the charges register.

Finally, the enterprise charge does not give its holder the power to appoint an administrative receiver as the English floating charge does.

2.5. Introduction of extrajudicial enforcement mechanisms

The reforms not only created new forms of proprietary security rights with a new system of publicity but also provided for speedier and more cost-efficient enforcement of security rights. Previously, enforcement was possible only by means of costly and time-consuming judicial procedures. The reforms allowed for an agreement between the debtor and the creditor that enforcement would take place by out-of-court sale of the encumbered assets. The agreement needs to be in written form and has to fix the lowest price for which the encumbered asset may be sold and the deadline before which the sale has to be effected.

According to § 257 CC, there are three forms of extrajudicial disposition of the encumbered asset: i) joint sale by the debtor and the creditor, ii) sale by the creditor alone, and iii) sale by a mandatary of the secured creditor. An agreement on extrajudicial sale by the secured creditor alone is permitted only if the encumbered asset has an official market price or the chargee is in the business of providing secured loans. If neither of these requirements is fulfilled, the debtor and the creditor may agree that, in the event of default, the encumbered asset will be sold by a mandatary of the creditor who is engaged in the business of providing secured loans or organising auctions.^{*38}

2.6. Gradual return to the principle of full (absolute) priority of secured claims in insolvency

In addition to the revisions of the Civil Code rules on security rights, legislative measures in the field of insolvency law also significantly improved the conditions of secured lending. Insolvency is the ‘acid test’ of security rights, and it is widely held that an essential feature of proprietary security rights is that in insolvency the secured creditor is entitled to payment in full out of the proceeds of sale of the encumbered assets before general unsecured creditors. The Hungarian Insolvency Act did not grant this right to secured creditors until recently.

In winding-up proceedings opened before 1 September 2001, an extensive list of privileged claims was granted absolute preference over secured claims. These preferential claims included not only the expenses of the proceeding and the remuneration of the liquidator but — *inter alia* — also the debts due to employees, the claims of the Wage Guarantee Fund^{*39}, and the costs of remedying any damage caused by the debtor company to the environment.

A 2000 amendment to the Insolvency Act introduced partial priority of the secured creditor: 50 per cent of the proceeds of the sale of the encumbered asset — less the costs of the sale — had to be paid directly to the secured creditor, with the other 50 per cent reserved for the preferential claims. Only the surplus — if any — could be paid to the secured creditor. This 50 per cent priority was restricted to the holders of charges created at least one year before the commencement of the winding-up.

A further amendment, made in 2006 and taking effect on 1 January 2007, granted absolute priority to secured creditors in respect of the proceeds of encumbered assets, provided that the charge was created before the commencement of the winding-up proceeding.^{*40} Thus, the rule that excluded the holders of ‘late charges’ (i.e., charges created within one year of the commencement of the winding-up) from the scope of the priority

³⁶ It is not the date of crystallisation, but the date of the registration of the enterprise charge that determines the ranking of the charges over the specific assets (created by the crystallisation).

³⁷ In this article, the term ‘mortgage’ simply refers to a security right in immovable property in the form of a limited real right (hypothec), without transfer of title to the creditor.

³⁸ Government decree No. 12/2003. (I. 30.) contains further rules of detail on the extrajudicial sale.

³⁹ This Fund pays the outstanding wages of the employees and is subrogated to their rights against the employer in insolvency.

⁴⁰ Act VI of 2006 on the amendment of Act XLIX of 1991 on bankruptcy, winding-up and voluntary winding-up proceedings. The present rule on the treatment of secured creditors in insolvency (§ 49/D of the Insolvency Act) is comparable to the German *Absonderungsrecht* or the Spanish *privilegio especial*.

rule was abolished as well. Only the costs of the preservation and the sale of the encumbered assets and a proportionate amount of the liquidator's fees may be deducted from the proceeds of the sale of the encumbered assets before applying the proceeds to the satisfaction of the secured claim. However, the limitation of priority (to 50 per cent of the proceeds) was retained for enterprise charges.^{*41}

The secured creditor is not a 'separatist'; he cannot simply remove his security from the insolvency estate. He is required to submit a formal claim to the liquidator and rely on the latter to complete the realisation (disposition) of the encumbered assets. It is only in the case of possessory charge over financial collateral^{*42} that the chargee remains unaffected by the winding-up: he retains his rights to enforce the charge by appropriation or sale in accordance with the rules of the Civil Code, as if no insolvency proceedings had been commenced.

3. The deficiencies of the current legal framework

Without doubt, the reforms proved beneficial for the Hungarian economy. They enhanced the availability of lower-cost secured credit by validating non-possessory security rights in movables, facilitating the enforcement of a security right, and providing for the priority of secured claims in insolvency. However, the current legal framework is far from optimal.

3.1. Incomprehensiveness and formalistic approach — no functional concept of a security right

The present statutory regime is not comprehensive; it does not cover all rights that are created to secure the performance of an obligation. The rules applicable to charges do not apply to *quasi*-securities (functional security interests), such as retention of title, financial lease, transfer of ownership or assignment by way of security. The case law is ambiguous, it fails to provide *ex ante* legal certainty.

In 2002 and 2003, the Supreme Court held that parties are free to secure a loan by a sale under suspensive condition or a sale with an option of repurchase (right of redemption) granted to the seller/debtor and that such sales contracts concluded to secure an obligation are not sham transactions but reflect the true and lawful intention of the parties.^{*43} In decisions from 2006, the same court held that contracts of sale with a right of redemption granted to the seller (debtor) are simulated and therefore void contracts, since the parties' true agreement was to create a hypothec in favour of the buyer (creditor).^{*44} However, there is nothing in the decisions from 2006 that could serve as an explanation for the change in the attitude of the court.^{*45} Quite the contrary — one of the 2006 decisions refers, *en passant*, to the 2003 decision with approval. The incompatibility of the 2002–2003 decisions with those from 2006 seems to reflect a disagreement between different chambers of the Supreme Court.^{*46}

Another, frequently used title-based security device is the option to purchase, used both independently and in combination with a charge. The creditor is thereby granted the power to create a contract of sale in respect of an asset of the debtor by a unilateral act, a simple declaration.^{*47} The grant of an option to purchase is

⁴¹ This is very similar to what happened in the Czech Republic, where a 2000 amendment of the old Insolvency Act (dating from 1991) introduced the limited priority of secured creditors in insolvency (70 per cent of the proceeds of the sale of collateral). The new Czech Insolvency Act that entered into force on 1 January 2008 reintroduced full priority of secured creditors in insolvency (subject only to capped costs of the preservation and the sale of the collateral, and to the remuneration of the insolvency administrator). See T. Richter. One Flight over Czech Security Interests: Priorities and other Monsters of Post-transformation Debtor/Creditor Law. – IES Occasional Paper 2006/3, Institute of Economic Studies, Charles University of Prague. Available at <http://ies.fsv.cuni.cz/sci/publication/show/id/1915/lang/en> (20.06.2008).

⁴² Also transfer to the creditor's account or to a blocked account in the name of the debtor or a third party amounts to possession. Possession includes also what is called 'control' in UCC, except for control agreement which is not a recognised form of dispossession under current Hungarian law.

⁴³ Legf. Bir. Pfv. VI. 20.398/2001. BH 2002. 182. and Legf. Bir. Pfv. VI. 22.404/2001. EBH 2003. 857. The 2002 case concerned a sales contract subject to the condition precedent of failure to repay the loan (sale under suspensive condition). When the debtors defaulted under the loan, the sales contract came into effect. The 2003 case concerned the sale of three flats with a right granted to the sellers to rescind the sales contracts upon repayment of the purchase price equivalent to the loan. The right of rescission (right of redemption) had the same effect as a condition subsequent (resolutive condition).

⁴⁴ Legf. Bir. Pfv. IX. 21.703/2005. BH 2006. 118. and Legf. Bir. Gfv. IX. 30.118/2005. BH 2006. 17.

⁴⁵ All these cases concerned immovables, but the reasoning of the judgments is not confined to the law of immovables. Apart from the different regimes of publicity (land register vs charges register), security rights over immovables and movables follow, in many respects, the same rules.

⁴⁶ The decisions from 2002–2003 were handed down by the Sixth Civil Law Chamber (Pf. VI.), whereas the 2006 judgments were delivered by the Ninth Commercial Law Chamber (Gf. IX.).

⁴⁷ See CC § 375.

sometimes additional to a charge created over the same asset, in which case the creditor's option to purchase amounts to a circumvention of the prohibition of the so-called *lex commissoria*.^{*48} This notwithstanding, the Supreme Court considers the use of the option to purchase with a security function to be perfectly legitimate, provided that the purchase price reflects the real market value of the collateral and the creditor accounts to the debtor for any surplus. Only those agreements are held void that entitle the holder of the option to purchase to exercise the option at a price equivalent to the outstanding obligation of the debtor, irrespective of the real market value of the asset.^{*49} There is a dispute between two chambers of the Supreme Court as to whether the grant of the option to purchase (the option contract) or only the contract of sale that is formed upon the exercise of the option can be avoided on the ground of inadequacy of consideration (*laesio enormis*).^{*50}

The assignment by way of security has also been held valid by the courts^{*51}, but the receivables not collected by the assignee until the commencement of winding-up proceedings are held to fall into the insolvency estate of the assignor.^{*52}

Retention of title and finance lease are treated as if they had no connection with security rights. The retention-of-title seller and the finance lessor are considered to be owners, unaffected by the insolvency of the buyer/lessee, with a right to rescind the sale and reclaim the sold/leased property. There is no registration requirement in either case. However, retention of title is not such a powerful security device as, for example, under German law, since Hungarian law permits only simple retention of title agreements. Only the outstanding purchase price can be secured by a retention of title: 'all sums' or 'all monies' clauses in which the seller retains title until all debts owed by the buyer to the seller have been discharged are not valid. Neither can the seller retain title to the proceeds or products of the goods supplied under retention of title.

3.2. No distinction between effectiveness as between the parties and effectiveness against third parties

Many jurisdictions draw a distinction between the creation of a security right *inter partes* and the perfection (opposability) of the security right *erga omnes*. These jurisdictions admit the notion of a right *in rem* enforceable only against the debtor: even in the absence of transfer of possession or registration of the security right, the secured creditor is entitled to exercise various pre-default rights (e.g., in the case of deterioration in value of the encumbered assets) and may also be entitled to realise the collateral upon the debtor's default. Beyond being enforceable between the parties, an unperfected security right may also be good against unsecured non-insolvency creditors.^{*53}

Hungarian law does not make such a distinction: the charge (pledge, mortgage) is by definition a right *in rem*, created by the charge contract and the additional element of publicity (transfer of possession or registration in the appropriate register). The first is sometimes referred to as the legal ground (*causa* or *titulus*), the latter as the mode (*modus*) of the acquisition of the charge. A charge (a right *in rem*) effective only against the grantor is considered to be a contradiction in terms. Thereby transfer of possession or registration is required for the creation of the security right even as between the grantor and secured creditor. A security agreement alone creates at best an obligation to transfer possession to the creditor or to give consent to the registration of the security right.

This approach is based on dogmatic rather than practical considerations and attaches more importance to the element of publicity than what can be justified by the underlying policies. Publicity is required to safeguard the interests of third parties, particularly those of prospective creditors, by providing them with an objective source of information about security rights that may already exist. Therefore, it seems to be unreasonable to deny the unperfected secured creditor the rights and remedies of a secured creditor even in the absence of competing creditors.

⁴⁸ Also called *pactum commissorium*. According to CC § 255 (2), a pre-default agreement, according to which the chargee acquires the ownership of the charged asset upon default, is null and void.

⁴⁹ Legf. Bír. Gf. I. 30.339/2000. BH 2001. 584., Legf. Bír. Gfv. X. 32.615/1997. BH 1998. 350. The same reasoning is followed by the Court of Appeal of Szeged: Szegedi Ítéltábla Gf. I. 30.578/2003. BH 2005. 73.

⁵⁰ According to a decision of the Supreme Court from 2007 (Legf. Bír. Pfv. VI. 21.674/2006. BH 2007. 293.) only the contract of sale can be avoided. According to a decision of the Supreme Court from 2008 (Legf. Bír. Gfv. IX. 30.406/2006. BH 2008. 48.) the option contract itself can be avoided.

⁵¹ Fővárosi Ítéltábla (Metropolitan Court of Appeal, i.e., Court of Appeal of Budapest) 6. Pf. 20.5562004. BH 2005. 16.

⁵² Legf. Bír. Gfv. X. 31.608/1999. BH 2001. 489.

⁵³ See, e.g., R. Goode. *Legal Problems of Credit and Security*. London 2003, pp. 59–60; J. J. White, R. S. Summers. *Uniform Commercial Code*. 5th ed. St. Paul 2000, p. 748. Québec law adopts a more restricted view on the unperfected secured creditor's rights, denying the holder of an *hypothèque non publiée* the right to enforce the security right upon the debtor's default. See L. Payette. *Les sûretés réelles dans le Code civil du Québec*. 3rd ed. Éditions Yvonne Blais 2006, p. 157.

3.3. Complexity

The system of the traditional security rights is overcomplicated: there are too many sub-types with special rules instead of a simple, 'user-friendly' regulation with as many general rules as possible and a minimal number of special requirements for the individual types.

3.4. Lack of publicity of security rights in receivables

As already mentioned, there is no publicity of security rights in receivables, in spite of the existence of a charges register. Only charges over tangible movables and enterprise charges have to be registered; charges over receivables are exempt from the registration requirement. Thereby, in the context of receivables financing, prospective creditors have to rely on the statements of prospective debtors and their contractual liability in case of fraud.

3.5. Excessive costs of creation

The formal requirements in respect of the creation of non-possessory registered charges are too burdensome. The registration requires the notarisation of the charge agreement, for which an *ad valorem* fee is charged. This notary fee is made up of at least two components: the 'fee for the notary's services' and a lump sum for the notary's expenses. The first component is calculated on a degressive scale according to the amount of the secured obligation. The second component is 40 per cent of the first.^{*54} The registration fee is additional to this notary fee.^{*55}

The extremely high notary costs make the creation of a charge considerably more expensive than anywhere else in the region.^{*56} It also seems to be disproportionate to apply the same notary fees for the notarisation of a mortgage contract (i.e., a contract creating a security right in immovable property) and a charge contract (i.e., a contract creating a security right in movable property). Expensive notarisation as a mandatory precondition to registration results in relatively low usage of non-possessory charges when compared to other countries (e.g., Slovakia, Romania, and Bulgaria).^{*57} To take a striking example, whereas approximately 65–75 per cent of registrations in a Canadian secured transactions register relate to motor vehicles^{*58}, the Hungarian charges register is not used at all to create charges over motor vehicles, except for fleet financing. Because of the high costs of the mandatory notarisation, automobile financiers use a title-based security device, the option to purchase, which is surrounded by much uncertainty and risk. If the vehicle is seized by a judgment creditor (often the tax authority), the option to purchase is of no value, since the financier obtains merely contractual rights by exercising the option to purchase. (To acquire ownership, the financier should also take possession, obviously impossible after seizure of the vehicle by the bailiff.) The finance and leasing industry claims to suffer a yearly loss of five billion HUF because of the expensive and cumbersome registration of charges forcing the industry to use alternative devices.^{*59}

⁵⁴ See decree No. 14/1991. (XI. 26.) of the Justice Minister on the remuneration of notaries. For instance, if the credit secured is an amount higher than HUF 5,000,000 (≈ € 21,000), but not higher than HUF 10,000,000 (≈ € 42,000), the notary is entitled to charge a fee of HUF 56,700 (≈ € 235) plus 0.5 per cent of the amount of the credit exceeding HUF 5,000,000. This is the 'fee for the notary's services' (*közjegyzői munkadíj*). 40 per cent of this is added as a lump sum for the notary's expenses. Thus the notarisation of a charge agreement securing a credit of HUF 10,000,000 (≈ € 42,000) costs HUF 114,380 (≈ € 474). These calculations are based on the exchange rates on 20 June 2008. The 'fee for the notary's services' can be doubled if the deed is drawn up in a foreign language, it can be halved if the notary prepares the deed on the basis of a draft provided by the parties without altering the draft.

⁵⁵ At present, the fee for registration is HUF 5000 (≈ € 19), the fee for search is HUF 1000 (≈ € 4).

⁵⁶ Hungary is the only country that is given a negative grading in respect of the costs of the creation of a mortgage as a result of the high notarial fees in the recent EBRD survey: *Mortgages in transition economies. The legal framework for mortgages and mortgage securities, 2007*. See <http://ebrd.com/pubs/legal/mit.pdf> (20.06.2008). Although this survey investigated the legal framework for security rights in immovables, the negative grading holds equally in respect of the costs of creation of security rights in movables.

⁵⁷ Since 2003, the number of new registrations has been declining year by year: 12,129 (2002), 10,760 (2003), 9,481 (2004), 9,085 (2005), 7,430 (2006).

⁵⁸ R. C. C. Cuming, *Should Canadian Jurisdictions Implement Certificate of Title Systems for Motor Vehicles?* Uniform Law Conference of Canada, Civil Law Section 2006, p. 11. Available at http://www.ulcc.ca/en/poam2/Certificate_of_Title_for_Motor_Vehicles_En.pdf (20.06.2008).

⁵⁹ The Hungarian Leasing Association has been urging the Ministry of Justice since 2006 to amend the law and enable the automobile financiers to take a charge over motor vehicles in a simple and inexpensive way. The original suggestion of the industry was to provide for the registration of charges over motor vehicles in the specialist register operated by a government agency pursuant to traffic legislation. The author of this article proposed instead a reform along the lines of Canadian law and the recommendations of the English Law Commission: registration in the charges register without mandatory notarisation of the charge contract, inclusion of the unique identification number of the vehicle in the record, possibility to search the register according to this identification number and disapplication of the rule according to which buyers in the ordinary course of business take free of a registered charge without having to search the register. The Leasing Association welcomed this alternative proposal and the Chamber of Notaries also seems to be prepared to make the online search of the register possible in the near future. For a brief summary of the Law Commission proposals see H. Beale, *Reform of the Law of Security Interests over Personal Property*. – J. Lowry, L. Mistelis (eds.). *Commercial Law: Perspectives and Practice (Essays in Honour of Sir Roy Goode)*. London 2006, 3.50.

It could be argued that the excessive notary costs are justified or at least counterbalanced by the ‘executory force’ of a notarised deed: upon default by the debtor, the notarised deed allows the creditor to proceed immediately to judicial enforcement, without first having to reduce the secured claim to judgment. While this argument has its merits, it does not justify the mandatory requirement of a notarial deed as a precondition to registration. Secured creditors should be free to decide whether, under the circumstances of the particular transaction, a notarial deed is indispensable or not.^{*60}

During the consultations, the Chamber of Notaries argued that the mandatory notarisation also serves to protect the debtor against exploitative terms imposed upon the debtor by a rapacious creditor. However, according to the data collected by the Chamber of Notaries, about 95 per cent of the debtors against whose property charges are registered are legal persons, usually companies obtaining professional legal advice when preparing contracts and making decisions. Consultations also revealed that the notarial deeds are usually drawn up on the basis of carefully prepared draft agreements negotiated by the parties’ legal representatives and it is highly unlikely for a notary to require the alteration of the parties’ agreement. As far as natural persons granting charges are concerned, the provisions of the Civil Code on the avoidance of unfair contract terms provide adequate protection.

Finally, notaries also argued that the mandatory notarisation serves the purpose of verification of the contracting parties’ identity, since notaries have access to the state databases and are obliged to check the identification documents against the contents of these databases. First, this service does not justify the excessive costs of notarisation, and, second, modern technology (such as the electronic ID card already introduced in some European jurisdictions, such as Estonia) could provide an alternative to personal identification by a notary.

3.6. Paper-based document-filing instead of on-line notice-filing

The charges register is kept in electronic form by the Chamber of Notaries, but neither registration nor search is possible on-line. Both are possible only by going personally to the office of a notary. The registration can only take place on the basis of a notarised charge contract. The register is not publicly searchable via the website of the Chamber of Notaries,^{*61} but it is possible to conclude a contract with the Chamber of Notaries for direct electronic access for the purpose of making searches, provided that the necessary technical requirements are met and the fees for having access to the register are paid.

In summary, the current system of publicity does not allow for simple, fast, and inexpensive registration or access to the registered information. This is to a great extent because the Hungarian legislator of 1996–2000 misunderstood the nature and role of the charges register. This misunderstanding is still present among both lawyers and market participants, most of whom think of the charges register as if it were the equivalent of the land register for movables and disregard the basic differences between a title register and a secured transactions register. For instance, the ‘Concept Paper’ for the new civil code (2002) stated that “the authenticity^{*62} of the charges register has to be increased”.^{*63} The speakers at a conference organised by the Chamber of Notaries in February 2007 argued that the rules on the charges register should be brought into line with the rules of the land register. It may be hard to believe, but the leading lawyer of the Chamber of Notaries recommended abolition of the rule according to which transferees in the ordinary course of business obtain an overriding title, free of the non-possessory charge, without having to search the register. Even 11 years after the establishment of the charges register, it is still not commonly accepted that the charges register operates on the principle of negative publicity (or negative authenticity) and that the record in the register is not intended to

⁶⁰ The costs of obtaining a notarial deed with executory force seem to be high also in other countries of the region, but the notarisation of the charge contract is usually not a mandatory precondition to registration. See, e.g., K. Andova. *Das Mobiliarpfandrecht in Österreich, Ungarn, Tschechien und in der Slowakei*. Wien 2004, p. 221; B. Schönfelder. *Courts, Credit and Debt Collection in Post-communist Slovakia*. Notes about some understudied ingredients of a successful transition. – *Economic Annals* No. 167, October–December 2005, p. 7 ff.

⁶¹ In other countries of Central and Eastern Europe, where a register for security rights in movables has been established, on-line search is possible, and in many countries also registration can take place on-line, at least for a limited group of registered users such as banks. The charges register operated by the Slovakian Chamber of Notaries permits free, electronic on-line search. See <http://www.notar.sk/dotnetnuke/aj/Liens/tabid/346/Default.aspx>. Also the database of the Romanian Archive of Security Interests in Movables can be searched by anyone for free via the Internet at <http://www.mj.romarhiva.ro>. In Montenegro, searches can be made through the Internet at <http://www.rzcg.cg.yu> and registered users (currently only lawyers of the Montenegro Bar and commercial banks) can also register charges on-line.

⁶² ‘Authenticity’ (‘public faith’) means that public reliance on the contents of the land register is protected. The first reform of the CC provisions on the law of charge (1996) introduced the rule that the charges register is ‘authentic’, i.e., public reliance on the contents of the register is protected. The second reform (2000) limited the ‘authenticity’ of the charges register to the conclusion of the charge agreement, i.e., the register provides authentic evidence that a charge agreement was entered into by the parties. Of course, even this rule is pointless, because third parties are not interested in the existence of the charge agreement, but in the existence of the charge as a proprietary right.

⁶³ Az új Polgári Törvénykönyv koncepciója és szabályozási tematikája (Concept Paper of the new Civil Code). – *Magyar Közlöny, Különszám* (Official Gazette, Special Issue) 2003, p. 101 (in Hungarian).

provide positive proof of the existence of the charge. Even if these are recognised, they are often considered to be the result of bad legislation. Astonishingly, even banks consider the charges register to be a repository of authentic documents with the notaries as gatekeepers who should scrutinise the information submitted by the parties.⁶⁴ It must be admitted that Hungarian legal scholarship did a very bad job in educating the public about the role of the charges register and the nature of the non-possessory charge over movables.

3.7. Lack of a general extension of charge to proceeds of disposition

The right of the chargee to follow the charged asset in the hands of a transferee is considerably limited by the rule according to which buyers in the ordinary course of business acquire an overriding title to tangible movable assets free of a non-possessory charge. Also to counterbalance this limitation, the charge should extend to whatever proceeds are received by the grantor upon disposition of the charged assets. However, Hungarian law takes a narrow view of the proceeds that take the place of the original collateral: the charge extends to a payment under an insurance policy, damages recovered from a third party, or other value received for the depreciation in value or destruction of the charged asset, but not to proceeds of disposition. Of course, the parties may agree that a charge is to carry through to any proceeds of disposition, but problems may arise in practice (e.g., upon the commingling of money), as Hungarian law does not have tracing rules to identify the proceeds of the original collateral.

3.8. Enforcement: The creditor's remedies upon the debtor's default

The enforcement methods should be made less formalistic and more flexible in order to reduce costs and delay. The remedy of acceptance of the collateral in full or partial satisfaction of the secured claim should be introduced with appropriate safeguards for the debtor and third parties.

3.9. Lack of consumer protection rules

Finally, greater flexibility should be counterbalanced by consumer protection rules whenever necessary, such as by restricting the consumers' ability to encumber their future property or by a mandatory requirement of public sale as a method of enforcement.

4. The virtues and vices of the bill on the new civil code

The structure of the provisions on charge is essentially the same in the Expert Draft and the bill on the new civil code. In both of them, the rules are divided into 10 chapters, covering the following:

- I. Creation of the charge
- II. The secured obligation
- III. The object of the charge
- IV. Pre-default rights and obligations of the parties
- V. Charge granted by a third party (i.e., by a person different from the debtor of the secured obligation)
- VI. Security trustee
- VII. Charges register
- VIII. Priority of charges
- IX. Enforcement of the charge
- X. Termination of the charge

⁶⁴ In the consultation process, the Banking Federation preferred retaining the present system of document-filing — coupled with the lowering of notary fees — to the introduction of on-line notice-filing. To understand this position, one should know that Hungarian banks do not trust the agreements on extrajudicial enforcement, because they fear that uncooperative debtors might prevent the creditor from taking possession of the encumbered assets. Therefore they regularly require the chargor to sign a notarial deed that enables the creditor to initiate judicial enforcement proceeding without previous judgment. To put it briefly, banks do not consider document-filing to be a particular burden, since notarisation of the charge contract requires appearance before a notary anyway.

In addition to these chapters, comprising the title on charge, the bill contains two further titles, one on enterprise charge and another on the so-called independent (non-accessory) charge. The Expert Draft recommends restricting the scope of an all-asset security right to movables and abolishing the independent charge altogether.

A significant portion of the provisions on charge is identical in the academic and the official draft. Still, there are considerable differences, most notably in respect of the treatment of title-based security devices and the system of registration of security rights in movables. This part of the paper provides a comparison of the solutions adopted by the various drafts, focusing on the Expert Draft and the final Ministry of Justice draft, which became the Bill on the new civil code.^{*65}

4.1. Effectiveness as between the parties

The Expert Draft contains a provision on the *inter partes* effectiveness of a charge contract.^{*66} According to this provision, the legal effects of a charge contract are twofold: On the one hand, the contract creates an obligation on the part of the grantor to transfer possession of the asset to the creditor or to give a declaration of consent to the registration of the charge. On the other hand, the parties to a charge contract have the same rights and duties between themselves as the chargor and the chargee, but these rights and duties cannot be enforced against third parties in the absence of dispossession or registration.

Thereby the Expert Draft recognises the *inter partes* enforceability of unperfected security rights. However, a clear distinction between creation and perfection (third-party effectiveness) throughout the draft would have been preferable. In contrast, the Ministry of Justice's drafts — including the Bill — do not clarify the legal effects of a charge contract not accompanied by dispossession or registration.

4.2. Quasi-securities

The proper treatment of title finance has been one of the most debated issues of the re-codification. The Commission Draft included a prohibition of title-based (or fiduciary) security agreements^{*67}, whereas the Expert Draft and the First Ministry Draft opted for a statutory re-characterisation of *quasi*-securities as charge agreements.^{*68} This approach resembles the device of a 'presumption of hypothec' as had been recommended by the Civil Code Revision Office of Québec in 1978.^{*69} For example, a transfer of ownership or an assignment for purposes of security would not be void, but would be given the effect of a charge contract. Similarly, the grant of an option to purchase by way of security would be converted into a charge contract. Without dispossession or registration, the charge contract would not create any right *in rem*, yet the creditor may still be able to enforce the charge and realise the collateral in the absence of competing third parties.

The Expert Draft extended the scope of re-characterisation to cover also retention of title agreements to secure the purchase price and those lease transactions that are economically indistinguishable from conditional sales ('disguised sales'). The title retained by the lessor is re-characterised as a security right if a) the lessee acquires or has an option to acquire the ownership of the leased goods for no additional consideration or for nominal additional consideration at the end of the lease or b) the term of the lease is equal to or longer than the remaining useful life of the goods.^{*70}

The Expert Draft also provides for the superpriority of acquisition financiers' charges (purchase money security rights): title-retaining sellers and finance lessors — whose retained title is given the effect of a charge — have priority over other chargees if they register their charge prior to the buyer's/lessee's taking possession of the goods and notify other creditors with a registered charge over the same goods. The Expert Draft extends this superpriority also to lenders who advance credit to enable buyers to acquire goods.^{*71}

The Second Ministry Draft, of February 2008, reversed the policy decision to treat all transactions performing a security function equally. The re-characterisation rule was dropped. The Bill neither prohibits nor re-

⁶⁵ Hereinafter: the Bill.

⁶⁶ Expert Draft § 4:104.

⁶⁷ Commission Draft § 5:383: "A contract for the transfer or retention of title, the transfer or retention of a claim or a right by way of security is null and void, unless there is an express statutory provision to the contrary." This is similar to, although broader in scope than the approach of the Dutch Civil Code in article 3:84 (3).

⁶⁸ Expert Draft §§ 4:106–107, First Ministry Draft § 4:100. The First Ministry Draft applied the recharacterisation rule only to transfer of ownership by way of security, assignment by way of security and the grant of an option to purchase by way of security, but not to retention of title and finance lease.

⁶⁹ See, e.g., M. Boodman, R. Macdonald. How Far is Article 9 of the Uniform Commercial Code Exportable? A Return to Sources? – Canadian Business Law Journal 1996 (27), pp. 249, 256.

⁷⁰ Expert Draft § 4:107.

⁷¹ Expert Draft § 4:144.

characterises title-based security devices. It is silent on some *quasi*-securities, such as security transfer of ownership and security assignment. The rights of title-retaining sellers and finance lessors are regulated, but they are not considered to be security rights at all.^{*72}

However, one title-based security device received express recognition in the Bill: the option to purchase granted by way of security. According to the Bill, the grant of an option to purchase for security purposes is valid only if a) granted in a notarial deed or in a deed countersigned by an attorney, b) registered in the land register or the charges register, and c) containing statement of the value of the asset according to expert opinion given not earlier than six months from the date of the grant of the option. The option to purchase entitles its holder to create a contract of sale by unilateral declaration, subject to a duty to account to the debtor ('seller') for any surplus calculated on the basis of an expert opinion given at the time of the exercise of the option to purchase.^{*73} These rules are unsound from a dogmatic point of view (e.g., the registration requirement as a condition for the validity of the contract) and do not clarify a number of essential issues (what kind of obligations may be secured; what the requirements are in respect of the identification of the secured obligation and the encumbered assets in the contract; what the pre-default rights and obligations of the parties are, if any; whether it is an accessory right that is terminated, for example, by the discharge of the secured obligation, etc.). Nor will the holder of the option to purchase be able to follow the asset into the hands of third parties. At least there is no provision to that effect in the Bill.^{*74}

An alternative to full-fledged functionalism could have been to apply only the publicity requirement to *quasi*-securities (i.e., to include them within the registration scheme) while leaving their contractual and proprietary nature otherwise unaltered.^{*75} However, this solution was rejected as well, for no apparent reason (although the system of document-filing would be unsuitable for at least some forms of *quasi*-security and — as shall be explained later — the Ministry of Justice refused to adopt a system of notice-filing).

4.3. Receivables financing

Both the Expert Draft and the Bill propose extension of the registration requirement to charges over receivables. In fact, all of the drafts contained this proposal, and this was one of the few issues on which all consultees agreed.

It was the understanding of the Hungarian Banking Federation that the publicity of security rights in receivables is also a requirement from the viewpoint of the new European capital adequacy regime applicable to credit institutions. Under the new regulatory framework based on the Basel II Accord, collateralised transactions have to fulfil a number of criteria in order to qualify as a credit risk mitigation technique. One of these criteria is the legal certainty of the collateral, since collateral can effectively mitigate risk only if the relevant legal mechanisms ensure that the lender has clear rights to the collateral. As the registration system permits prospective creditors to discover already existing security rights and enables the secured party to obtain priority over third parties, publicity has been considered to be an element of legal certainty by all stakeholders in the consultation process.

By contrast, none of the drafts recommends extending the scope of registration to outright assignments — i.e., transfers of receivables. The Expert Draft recommended the re-characterisation of security assignments as charge agreements, with registration required to achieve third-party effectiveness. The Bill does not require the publication of either security or outright assignments. Rather, it turns a blind eye to the facts that security assignments perform the same economic function as charges and that it is often very difficult to distinguish between outright transfers, on the one hand, and security transfers and charges, on the other. The Bill fails to recognise that the publicity of all three types of transactions could improve the ability to obtain credit on the security of receivables.

To promote receivables financing transactions and thereby to increase the availability of credit, both the Expert Draft and the Bill provide for the override of contractual anti-assignment clauses: contractual restrictions on the transferability of receivables are null and void.^{*76} The Bill also expressly provides that contract clauses

^{*72} The provisions on sale and leasing treat the title-retaining seller and the finance lessor as owner.

^{*73} Bill § 5:373. This article is contained in the Book on the Law of Obligations (Book V), following the rules on suretyship and independent guarantee.

^{*74} The option to purchase is opposable against third party acquirers only if the option relates to immovables or registered tangibles and the option is registered in the land register or the appropriate specialist register. See Bill § 5:190 and § 5:195 (5).

^{*75} Louise Gullifer draws attention to this possibility in her article *Quasi-security Interests: Functionalism and the Incidents of Security* — I. Davies (ed.), *Issues in International Commercial Law*. Ashgate 2005, pp. 3, 10. This approach has been followed in the second stage of secured transactions law reform in Lithuania. See A. Smaliukas, *Reform of Laws on Security Interests in Lithuania: Convergence of Legal Concepts*. — I. Davies (ed.), *Issues in International Commercial Law*. Ashgate 2005, p. 31 ff. and A. Smaliukas, *Reform of security over movable property in Lithuania: the second stage*. Available at <http://www.ebrd.com/pubs/legal/lit041d.pdf> (20.06.2008).

^{*76} Expert Draft § 5:177 (3), Bill § 5:168 (4).

prohibiting or limiting the creation of a charge over the receivables shall be of no effect.^{*77} Under these rules, the assignment of the receivable or the creation of a charge over the receivable — despite a contractual restriction — does not even constitute a breach of contract as between the debtor and the assignor/chargor. The Commission Draft of 2006 provided only for the ineffectiveness of such clauses as against the assignee, but not as between the assignor and the debtor of the receivable. However, this solution was not considered to be sufficient to stop the widespread practice on the part of large customers of inserting in their purchase orders a clause prohibiting the supplier from assigning his right to payment under the supply contract.^{*78} Creditors would still be deterred from assigning or charging the receivable for fear of liability in damages for breach of contract.

4.4. Charges register

One of the main differences between the Expert Draft and the Bill is the approach taken with respect to the charges register. Whereas both the Commission Draft of 2006 and the Expert Draft of 2008 propose to modernise the charges register by switching to on-line notice-filing, the drafts of the Ministry of Justice — including the Bill — retain the status quo: document-filing by personal appearance in the office of a notary.

The Expert Draft contains detailed rules on on-line registration. Instead of the present system of document-filing with extensive particulars of the charge to be registered, it recommends that only the essential data (the name and details of the chargor and the chargee, along with description of the encumbered assets) should be filed by completing a form on-screen (on a government website). The parties may also include in the notice the maximum amount of the secured obligation, but this is not mandatory.

In response to concerns about wrongful filings ('bogus filings'), the Expert Draft requires also the consent of the grantor to be given on-line. Only enrolled users would be able to register a charge or give consent to a registration. Both natural and legal persons could enrol as users, and legal persons could also submit the particulars of natural persons entitled to register charges or consent to registrations on their behalf. In addition to prior enrolment as a user, the draft envisages personal identification before each registration or consent to registration. This could take place by various techniques, such as by implementing an electronic ID card scheme as can be found in Estonia.^{*79}

4.5. Security trustee

Both the Expert Draft and the Bill empower the chargee(s) to appoint a person (the security trustee or charge manager) to exercise all the rights of the chargee(s) arising under the charge except for the right to transfer the secured obligation. This new role is intended to facilitate syndicated lending, where the loan is extended by a group of creditors and the charge is granted for the benefit of all of them. The rules are inspired by those laid down in article 16 of the EBRD Model Law on Secured Transactions. The charge manager may be one of the chargees or a third party. The appointment is effective against third parties from the date of registration in the appropriate register. If a security trustee is registered, the chargees themselves do not need to be registered. Upon any transfer by a chargee of the secured obligation extending to the charge, the powers and obligations of the security trustee continue and the security trustee acts also for the benefit of the new chargeholder.^{*80}

4.6. Extension of the charge over a receivable to any personal or property rights securing the receivable

The current Civil Code provides that the assignee of a receivable automatically has the benefit of a suretyship or a charge that secures the payment of the receivable, but no similar rule can be found among the provisions on charge. The Expert Draft and the Bill apply the same rule to a charge over a receivable: the chargee automatically has the benefit of a suretyship or a charge that secures the payment of the receivable.^{*81}

⁷⁷ Bill § 4:105 (6).

⁷⁸ As the suppliers often depend upon the orders from these large customers, non-assignment clauses are usually imposed upon the weaker party by the party with the stronger bargaining power.

⁷⁹ See <http://www.id.ee> (20.06.2008).

⁸⁰ In 2007, a new provision has been added to the French Civil Code with the same purpose. Article 2328-1 CC enables the secured creditors to appoint a person to hold the security interest for their benefit, particularly to act for their benefit in the course of the registration and the enforcement of the security interest: "Toute sûreté réelle peut être inscrite, gérée et réalisée pour le compte des créanciers de l'obligation garantie par une personne qu'ils désignent à cette fin dans l'acte qui constate cette obligation."

⁸¹ Expert Draft § 4:165 (1), Bill § 4:152 (1).

The drafts also clarify that where the receivable is secured by an independent guarantee, the charge does not extend to the right to draw under the independent guarantee. It extends only to the proceeds under the independent guarantee.*⁸²

4.7. Enforcement: The creditor's remedies upon the debtor's default

Under current Hungarian law, a chargee is entitled *ex lege* (without the need for an express agreement with the chargor) only to judicial enforcement. Out-of-court disposition of the collateral is possible only if the debtor expressly agreed to this prior to the default, in written form.

Both the Expert Draft and the Bill give the following out-of-court remedies to the chargee without requiring a pre-default agreement: a) disposition of the collateral by the chargee, b) acquisition of title to the charged asset (in other words, acceptance of the charged asset) in full or partial satisfaction of the secured claim, and c) collection or enforcement of the charged claim. The rules are fairly similar to those in Part 6 ('Default') of article 9 UCC.

The secured creditor is required to act according to the standards of commercial reasonableness when disposing of the collateral extrajudicially, taking into account the interests of the debtor, the chargor (if different from the debtor), and any other chargees with a right vested in the same asset. The extension of the requirement of commercial reasonableness to all aspects of all out-of-court dispositions is an innovation; the current Civil Code refers to this standard only in the case of charges over financial collateral. The Expert Draft and the Bill also provide for a rebuttable presumption that the disposition was made in a commercially reasonable manner if the disposition was made a) at a price current in any regulated market (such as stock exchanges) at the time of disposition or b) in conformity with the usual commercial practices among dealers in the type of property that was the subject of the disposition.

Appropriation as a special remedy in the case of possessory charges over financial collateral is, of course, retained. This remedy is regulated as an exceptional form of acquisition of title to the charged asset in full or partial satisfaction of the secured claim, where the creditor does not have to present a proposal and the consent of the debtor or third parties is not required. The creditor is, in essence, only required to account for any surplus, taking into account the value of the collateral at the time of enforcement.*⁸³

4.8. Consumer protection

Both the Expert Draft and the Bill recommend introduction of consumer protection rules into the law of charge — in the context of the creation and the enforcement of the charge. The relevant provisions are identical in the two drafts.*⁸⁴

A charge contract will qualify as a consumer charge contract if a) the chargor is a natural person, b) the object of the charge is an asset primarily used for purposes outside the scope of the chargor's business or professional activity, and c) the secured obligation arises from a contract that the chargor concluded outside the scope of its business or professional activity.

In the context of creation, the drafts seek to prevent excessive consumer borrowing by requiring the consumer charge contract a) to contain a specific description of the encumbered asset(s) and b) to stipulate the maximum amount of the secured obligation. A consumer charge contract that fails to meet these requirements is null and void. To protect consumers from overindebtedness, the drafts also provide that consumers cannot charge their future property, except when it is the secured loan that enables the consumer to acquire the future asset.

In the context of enforcement, the restrictions are twofold: a) the chargee is not entitled to accept the collateral in full or partial satisfaction of the secured obligation (he is required to dispose of the encumbered asset),

⁸² Expert Draft § 4:165 (2) and § 4:117 (7), Bill § 4:152 (2) and § 4:108 (7).

⁸³ 'Appropriation' (within the meaning of the financial collateral directive) is defined by Professor George L. Gretton as a method "whereby the creditor enforces by taking absolute title to the collateral". See G. L. Gretton, *Financial Collateral and the Fundamentals of Secured Transactions*. – *Edinburgh Law Review* 2006 (10) 2, pp. 209, 231. In fact, the creditor may have acquired absolute title well before the enforcement, through the commingling of fungible goods. As Professor Alfons Bürge explains: "beim *pignus irregulare* bei der Pfandverwertung immer nur um ein Aufrechnen oder Abrechnen gehen kann, da das Eigentum bereits früher übergegangen ist und sich die Schuld auf die Leistung von Sachen gleicher Art, Güte und Menge beschränkt". See A. Bürge, *Das römische Recht und das Drama der Umsetzung der Richtlinie über die Finanzsicherheiten in das deutsche BGB*. – R. Waldburger, Ch. M. Baer, U. Nobel, B. Bernet (eds.), *Wirtschaftsrecht zu Beginn des 21. Jahrhunderts*, FS Peter Nobel, Bern 2005, pp. 495, 512. The essence of *pignus irregulare* is very clearly formulated in article 1851 of the Italian Civil Code.

⁸⁴ Bill § 4:97, § 4:138, Expert Draft § 4:103, § 4:151.

and b) the disposition may take place only by a public sale, except as otherwise provided by the parties in a written agreement entered into after default.

4.9. Charge over financial collateral

Ever since its adoption in 1959, the Civil Code has contained rules on a special security right with two distinctive features: it can subsist only over money (tangible or intangible)^{*85} and securities (certificated or uncertificated), and it confers on the creditor a right of appropriation upon the debtor's default. Although it is created by a security agreement and transfer of possession to the creditor, it is regulated separately from the provisions on possessory charge (pledge). It even has its own distinct name (*óvadék*). These rules were amended in 2004 by the statute implementing the EC financial collateral directive.

The Bill integrates the rules on this special form of security right into the general scheme of the law of charge, with special rules whenever necessary. Special rules have been added in the chapters on creation, pre-default rights, priority, and enforcement.

The chapter on creation provides a special definition of transfer of possession in respect of intangible money and book-entry securities.^{*86} This means that the concept of possession is broadened, instead of the introduction of a new concept, such as 'control'.^{*87} The methods by which a creditor can obtain possession of bank money or book-entry securities are the following: a) transfer to the creditor's account; b) transfer to an account (sub-account) in the name of the debtor, blocked in favour of the creditor; c) control agreement; and d) automatically upon conclusion of the charge contract, if the secured creditor is the depositary bank or the intermediary. All of these mechanisms are deemed to effect a transfer of possession for the purposes of creating a charge over bank money or securities. The control agreement is defined as a tripartite agreement between the account holder, the creditor, and the depositary bank (in respect of bank money) or the intermediary (in respect of securities), pursuant to which a) the depositary bank or the intermediary is not permitted to comply with any instructions given by the account holder without having received the consent of the creditor and/or b) the depositary bank or the intermediary is obliged to comply with any instructions given by the creditor without any further consent of the account holder.^{*88}

The chapter on pre-default rights contains a provision on irregular pledge, which implements the rules of the financial collateral directive on the creditor's right of use and disposition.

The chapter on priorities includes a rule according to which a possessory charge (pledge) over money or securities credited to an account has priority over a non-possessory, registered charge over the same assets. This is the 'Hungarian translation' of the UCC rule that gives priority to the secured creditor who has control over another secured creditor who perfects by other means.

The chapter on enforcement empowers the creditor to enforce a possessory charge over money or securities by appropriation — i.e., without sale — by retaining as much of the collateral as is necessary to discharge the secured obligation.^{*89} The creditor is, of course, under an obligation to account for any surplus.

The Expert Draft adopts substantially identical rules, with only minor differences, stemming from a different conceptualisation of the transfer of incorporeal money.

⁸⁵ The term used to refer to intangible money (in both the CC in force and the drafts of the new CC) is 'claim based on a bank account'. This is similar to the term of the UNCITRAL Legislative Guide on Secured Transactions: 'right to payment of funds credited to a bank account'. In the course of the re-codification, there has been some discussion about the appropriate legal characterisation of intangible money. It has been proposed to characterize incorporeal bank money as a 'chose in possession' instead of a 'chose in action' (First Ministry Draft § 4:13), but this proposal was eventually rejected.

⁸⁶ Bill § 4:101.

⁸⁷ The concept of 'control' originates from article 8 of the UCC. It is used by the EC financial collateral directive in article 2, paragraph 2 and in recital No. 9, the directive defines the concept of 'provision' by reference to possession and control. The concept will probably be used as an equivalent of 'possession' for intangibles by the Principles of European Law – Proprietary Security Rights in Movable Assets, prepared by the Study Group on a European Civil Code. According to the Official Commentary to § 8-106 of the Uniform Commercial Code: "A principal purpose of the 'control' concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices." None of the drafts of the new civil code attempted to introduce a similar new concept into Hungarian law.

⁸⁸ This definition of 'control agreement' is modelled upon the definition of the UNIDROIT Draft Convention on Substantive Rules regarding Intermediated Securities. The second part of the definition is identical to the definition in the UNCITRAL Legislative Guide on Secured Transactions.

⁸⁹ If the securities do not have an objective market value, the chargee is not entitled to enforce the charge by appropriation.

4.10. Enterprise charge

The Commission Draft and the Expert Draft proposed to abolish the enterprise charge as a distinct security right. Two arguments were put forward to support this proposal: 1) A charge created by registration in the charges register may cover all the movable assets of the debtor (except those for which a specialist title register exists), including after-acquired assets. The only advantage of retaining the enterprise charge as a distinct security right would be that it could also cover — present and after-acquired — immovables and registered movables of the debtor. However, immovables and registered movables in the patrimony of the debtor are not safely ‘allocated’ to the secured creditor by an enterprise charge, since holders of subsequent mortgages and charges registered in specialist registers have priority over the holder of the enterprise charge. Therefore secured creditors always take separate mortgages and charges over immovables and registered movables in addition to an enterprise charge. This practice suggests that there would be no harm in restricting the scope of charges created by registration in the charges register to non-registered movables.^{*90} 2) The special enforcement method provided for in § 266 of the Civil Code — i.e., the sale of the enterprise as a whole (as a going concern) — should lead to a collective proceeding involving all the creditors of the debtor, and any difference from an insolvency proceeding would be hardly justifiable.^{*91}

In fact, there was no significant opposition among consultees to the abolition of the enterprise charge. It was only the Chamber of Notaries that insisted on retaining this institution, arguing that, although a creditor regularly takes separate mortgages over immovables and separate charges over registered movables that are already present in the debtor’s patrimony at the time of the creation of the enterprise charge, the enterprise charge captures also after-acquired immovables and registered movables (although priority may be obtained by another creditor). The Ministry of Justice accepted this argument, and the Bill contains a separate title on the enterprise charge. However, the rules depart from the existing law on two points: i) they permit an enterprise charge to be granted over the whole or **any part** of the patrimony of the enterprise — i.e., the requirement that the object of an enterprise charge be either the whole or **an economically independent unit** of the enterprise is to be abolished — and ii) the provision on enforcement “with the preservation of the unity of the enterprise” is omitted.^{*92}

5. Conclusions

Undoubtedly, the wholesale review of Hungarian civil law has yielded some fruits for the law of charges. If the Bill on the new civil code is enacted, this branch of the law will be better structured, conceptually clearer, and more streamlined than the provisions of the current Civil Code. The Bill also innovates in several important respects. It proposes introduction of a number of useful new legal concepts and techniques, such as the consumer charge contract, the control agreement, the merely consensual creation (in UCC parlance, automatic perfection) of a charge over financial collateral in favour of the depositary bank or the intermediary, the right of the chargee(s) to appoint a security trustee, the availability of extrajudicial remedies by virtue of law (*ex lege*), commercial reasonableness as a general post-default standard of conduct, and the new remedy of acceptance of the collateral in full or partial satisfaction of the secured obligation.

However, the Bill also suffers from major flaws. The most important shortcoming of the Bill is its failure to implement an integrated and functional approach to replace the current fragmented and formalistic approach. Further, the Bill misses the opportunity to substitute a scheme of on-line notice-filing for the current system of paper-based document-filing.

The failure to handle the issue of *quasi*-securities in a consistent way means that the current situation of legal uncertainty will persist and the existing practice of creating a charge and a title-based security device at the same time over the same assets to secure the same obligation will continue. Neither transaction costs nor the amount of litigation will be reduced thereby.

The failure to modernise the charges register does not contribute to the competitiveness of the Hungarian legal framework in view of the advanced Internet-based registers operating in other countries of the region. The Bill,

⁹⁰ In its consultative report of 2004, the Law Commission for England and Wales also suggested that charges over assets for which there is a specialist mortgage register, for example land, registered ships, aircraft and certain types of intellectual property, should be outside the notice-filing scheme. See Company Security Interests. A consultative report. Law Commission Consultation Paper No. 176, p. 25 *ff*. Available at http://www.lawcom.gov.uk/docs/cp176_final_version.pdf (18.08.2008).

⁹¹ For some time, subordinate legislation was planned to enact detailed rules along the lines of the EBRD Model Law for Secured Transactions (see article 25 on enterprise charge administration). Subsequent to a consultation in 2004, this plan was abandoned, as the conclusion was reached that an enforcement by the sale of the enterprise as a whole should take into account the interests of all the creditors and that can be achieved in a collective insolvency proceeding. The Drafts also referred to the Enterprise Act 2002 of the United Kingdom, which restricted the institution of administrative receivership to certain exceptional situations.

⁹² These amendments represent a return to the first reform of secured transactions law in 1996.

if enacted in its present form, is going to compel the Chamber of Notaries to enable free on-line search of the register and will also abolish notarisation as a mandatory precondition to registration. However, registration will continue to take place by personal appearance before a notary instead of by filing a simple notice on-line. In fact, the more substantial issue of *quasi*-securities and the more technical matter of registration are closely linked: a cumbersome registration procedure precludes the extension of the registration scheme to title retention (at least if related to inventory supplied on short-term credit) and outright sales of receivables.

The Expert Draft offered solutions for both of these issues, in line with the recommendations of the latest international project aiming at the harmonisation of secured transactions law, the UNCITRAL Legislative Guide on Secured Transactions.^{*93} However, vigorous opposition was staged against the proposed solutions by the two stakeholders with the most significant influence over the drafting of this part of the Bill in the last phase of the codification, the Hungarian Chamber of Notaries and the Hungarian Banking Federation. The former asserted that notice-filing would disrupt public confidence in the reliability of the charges register, and the latter argued that the functional approach is an unnecessary restriction of freedom of contract.

To summarise, the Bill represents a significant simplification and an improvement of the current legislation, but it will achieve much more a fine-tuning than a radical change of the Hungarian law of proprietary security rights. Attachment to the status quo and particularist interests impeded the implementation of some of the core principles of a modern secured transactions law. Nevertheless, the codification exercise generated useful debate, and it brought forward new ideas and critical thoughts on the adequacy and efficacy of the existing legislative framework. Hungarian lawyers have been granted the opportunity to become familiar with the achievements of foreign law reforms and the recommendations of international projects aimed at the harmonisation of secured transactions law.^{*94} One can only hope that the unsettled debates and the divergences of the various drafts will provide food for further reflection and that the process will bear fruit in the coming years.

⁹³ In many respects, the proposed solutions were also similar to the reform proposals of the English Law Commission. As far as it can be predicted, the Study Group on a European Civil Code will also come to similar conclusions in its Principles of Proprietary Security Rights in Movable Assets to be published in 2009.

⁹⁴ On the invitation of the Ministry of Justice, Harry C. Sigman, member of the Drafting Committee that revised article 9 UCC held two lectures in Budapest, where he presented the US law of secured transactions. In late 2006, a three-day international seminar was hosted by the Ministry, where internationally renowned experts (Spiros Bazinas, Hugh Beale, Angel Carrasco Perera, Neil B. Cohen, Eric Dirix, Ulrich Drobnig, Dimitri Houtcieff, Eva-Maria Kieninger, Roderick A. Macdonald, Harry C. Sigman, Catherine Walsh) expressed their views on the draft provisions on the law of charges as contained in the Commission Draft. The author is indebted to all the participants of this seminar for their useful remarks and suggestions.



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Draft Common Frame of Reference and Estonian Law of Obligations Act: Similarities and Differences in the System of Contractual Liability

1. Introduction

The debate on a further and greater harmonisation of civil law has been going on in the European Union for years. The Principles of European Contract Law (PECL)¹ have been developed and published. This work has been continued by the Study Group on a European Civil Code under the leadership of Professor Christian von Bar.² As the so-called Draft Common Frame of Reference (DCFR), an integral draft model law recently has been published³ and is being further elaborated, with the promise of publication in full in December 2008. The future of the latter project, however, is a bit unclear. The role of the DCFR presumably may be to serve as a model law used as an example in preparing national and EU legislation, and in theory it may be applied similarly to *lex mercatoria* subject to agreement of the parties.⁴ It should not be likely to become, in the

¹ First version: The Principles of European Contract Law. Part I: Performance, Non-performance and Remedies. Dordrecht, Boston, London: Martinus Nijhoff Publishers 1995. Second version: Principles of European Contract Law. Parts I and II. Combined and revised. Prepared by the Commission on European Contract Law (chaired by Professor Ole Lando) and edited by Ole Lando and Hugh Beale. The Hague, London, Boston: Kluwer Law International, 2000.

² See <http://www.sgecc.net/>.

³ Principles, Definitions and Model Rules of European Private Law Draft Common Frame of Reference (DCFR). Interim Outline Edition. Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) and based in part on a revised version of the Principles of European Contract Law, edited by Christian von Bar, Eric Clive, Hans Schulte-Nölke, and Hugh Beale, Johnny Herre, Jérôme Huet, Peter Schlechtriem, Matthias Storme, Stephen Swann, Paul Varul, Anna Veneziano, and Fryderyk Zoll. Munich: Sellier, 2008, 396 pages.

⁴ For details about the CFR and its prospects for the future, see, for example, H. Beale. The Development of European Private Law and the European Commission's Action Plan on Contract Law. – *Juridica International* 2005, pp. 4–16; C. von Bar. Working Together Toward a Common Frame of Reference. – *Juridica International* 2005, pp. 17–26; C. Castronovo. Common Frame of Reference: Conciliation or Clash? – *Juridica International* 2006, pp. 25–29; Dirk Staudenmayer's piece in *Zeitschrift für Europäisches Privatrecht* (4/2003), pp. 828–846; Jürgen Basedow's piece in *Zeitschrift für Europäisches Privatrecht* (4/2003), pp. 828–846; the work of Brigitte Zypries in *Zeitschrift für Europäisches Privatrecht* (2/2004), pp. 225–233; and DCFR pp. 3–49.

foreseeable future, a legal instrument in its own right (such as a unified European civil code).⁵ In all likelihood, the DCFR cannot be capable of harmonising European private law, even on the assumption that a need exists for such a common frame of reference. Nevertheless, the DCFR signifies an important achievement of synthesising European law and employing a modern approach, first and foremost, to contract law.⁶

Six years have passed since the Estonian Law of Obligations Act (LOA)⁷ and the new General Part of the Civil Code Act (GPCCA)⁸ entered into force. This is long enough to allow for drawing initial conclusions. As the general part of the LOA and also, in part, the GPCCA make use of several solutions based on the PECL (and by extension the DCFR), it is possible to evaluate, albeit indirectly, the functioning of PECL and DCFR solutions as real and effective law in combination with other acts and regulations. The author shall concentrate in this article on the breach of contract (non-performance) and related liability provisions under the LOA and the new DCFR as these provisions represent a central array of issues in modern contract law. Although the new version of the DCFR also regulates non-contractual obligations, for the sake of brevity and in order to maintain its focus, the paper deals just with the problems related to contracts.

2. The general system of the contractual liability provisions of DCFR Book III and the LOA

Book III, Chapter 3 of the DCFR regulates remedies for non-performance. Chapter 3 is composed of material on the following: general matters (Section 1), cure by debtor of non-conforming performance (Section 2), the right to enforce performance (Section 3), withholding performance (Section 4), termination (Section 5), price reduction (Section 6), and damages and interest (Section 6).

The general system of debtor's liability under the Law of Obligations Act is similar to that of the DCFR. Breach of obligation is regulated by LOA Chapter 5, while general provisions (including liability for breach of obligation) (Division 1) and legal remedies (Division 2) are regulated separately. The legal remedies applicable to breach of obligation are also similar in the DCFR and LOA. The author believes that the LOA is structured somewhat conditionally (e.g., as regards the position of § 105⁹ in the LOA), but this has not caused any particular problems in applying the law.

3. Breach of obligation as a precondition for liability

In the LOA, breach of obligation (in Estonian, *kohustuse rikkumine*) represents the central category of contractual liability; under § 100 of the LOA, breach of obligation may be failure to perform or defective performance of a prestation, including a delay in performance, but also substandard performance. In the DCFR, the same institute is expressed with the term 'non-performance' (*täitmatajätmine*) (in DCFR article III.-1:101 (3)); however, different terms should not carry a substantial difference. Just as does the DCFR, the LOA recognises a universal category of non-performance and does not separate substandard performance from general liability.¹⁰ Such an approach should first and foremost prevent differentiation between, for example, substandard performance and non-performance, although this might remain an issue with contracts of sale. The author believes that such an approach is reasonable.¹¹

⁵ On the developments in harmonising EU civil law and on its possibilities, see P. Schlechtriem. 'Europäisierung des Privatrechts – vom Beruf unserer Zeit für ein Europäisches Privatrecht. – Juridica International 2004, pp. 27–31; Wolfgang Wurmnest's work in Zeitschrift für Europäisches Privatrecht (4/2003), pp. 714–744; Kadner Graziano's piece in Zeitschrift für Europäisches Privatrecht (3/2005), pp. 523–540; and the work of Dieter Martiny in Zeitschrift für Europäisches Privatrecht (1/2006), pp. 60–95.

⁶ For details on the preparation and system of the PECL, see O. Lando. The Structure and the Salient Features of the Principles of European Contract Law. – Juridica International 2001, pp. 4–15.

⁷ Võlaõigusseadus (adopted on 26 September 2001 and entered into force on 1 July 2002). – RT I 2001, 81, 487; 2007, 56, 375 (in Estonian).

⁸ Tsiviilseadustiku üldosa seadus (adopted on 27 March 2002 and entered into force on 1 July 2002). – RT I 2002, 35, 216; 2007, 24, 128 (in Estonian).

⁹ LOA § 105 (legal remedies independent of liability of the creditor) is located in the Division, which establishes general provisions on the breach of contract.

¹⁰ See also P. Varul, I. Kull, V. Kõve, M. Käerdi. Võlaõigusseadus I. Üldosa (§§ 1–207). Kommenteeritud väljaanne (Law of Obligations Act I. General Part. (§§ 1–207). Commented edition). Tallinn 2006 (hereinafter LOA Comm.), p. 312 (in Estonian).

¹¹ About fundamental breach of contract, see Section 8 of this article.

4. Lack of excusability or culpability, and agreements related to restriction of liability

Under the LOA, general liability for breach of contract is similar to that under the DCFR. Subsection 101 (1) of the LOA lists the important legal remedies regulated by law to which the creditor may resort if the debtor does not perform an obligation.

Subsection 103 (1) of the LOA ties liability generally to lack of excusability; i.e., if the conduct of the party who failed to perform an obligation is not excusable, the other party may apply legal remedies against the non-performing party. Thus, the general regulation is essentially the same as under article III.–3:101 (1) of the DCFR. Even if the non-performance is excusable, the other party has under § 105 of the LOA (similarly to article III.–3:101 (2) of the DCFR) the right to resort to such legal remedies as withholding of performance of the obligation, unilateral termination of the contract and reduction of the price, and (in cases of economic transactions) also demanding of a penalty for late payment. Pursuant to § 115 (1) of the LOA, the demanding of compensation for damage is clearly tied to lack of excusability. What is somewhat unclear concerns matters tied to the real performance of an obligation. One can conclude from § 105 of the LOA that, similarly to the situation under article III.–3:101 (2) of the DCFR, here lack of excusability is required in order for one to submit a claim. However, this is not laid down as a prerequisite for a claim in § 108 of the LOA, which regulates requirement of performance of an obligation; subsection 2 of that section sets forth the criteria for applicability of the requirement to perform, and in contracts of sale or for services, excusability should evidently not have any bearing, at least in cases where a substandard product was transferred to the other party. By contrast, the requirement to perform should not be tied to excusability and relief from the obligation to perform should be based not solely on excusability but strictly on the cases listed in § 108 (2) of the LOA (DCFR article III.–3:302 (2)).^{*12} The author believes that the DCFR also unnecessarily ties the requirement of real performance to lack of excusability, which causes only confusion. To date, the Supreme Court has held the position that in principle excusability should as a rule be essentially excluded in cases where the payment obligation is not performed.^{*13} Similarly to the terms of the DCFR's article III.–3:101 (3), the LOA's § 101 (3) provides that a creditor must not rely on non-performance by a debtor, nor resort to legal remedies arising therefrom insofar as said non-performance was caused by an act of the creditor or by circumstances dependent on the creditor or by an event the risk of which is borne by the creditor.

Article III.–3:102 of the DCFR's material on the possibility of cumulation of legal remedies is matched by § 101 (2) of the LOA; i.e., under Estonian law too, a creditor may simultaneously resort to different legal remedies. In particular, a creditor always has the right to demand compensation for damage. The Supreme Court of Estonia has ruled that, on the basis of that provision, for example, reduction of price and compensation for damage, which are similar in content, must not be used in parallel.^{*14} Such a solution concerning the cumulation of legal remedies is optimal and does not excessively restrict the parties. With the LOA, however, it is somewhat unclear whether cumulation also covers, for example, the option to cancel a contract because of error. This should be unambiguously regulated.

Article III.–3:104 of the DCFR, on excuse due to an impediment, is largely paralleled by § 103 of the LOA, under which the liability of a creditor for breach of contract is tied to lack of excusability. Article III.–3:104 (1) of the DCFR is essentially matched by §§ 103 (1) and (2) of the LOA, which provide a definition of *force majeure* (as the basis of excusability) analogous to that set forth in the DCFR. Both regulations have caused debates regarding how to 'furnish' the criterion of foreseeability in determining excusability and how to distinguish it from wrongful liability.^{*15} Probably it would be more reasonable for both instruments, the LOA and DCFR, to further extend liability and thus reduce the theoretical possibility of escaping liability — that is, for the two instruments to extend strict liability. This would make the system clearer. The first sentence of article III.–3:104 (5) of the DCFR is essentially parallel to § 102 of the LOA, under which a debtor must notify the creditor of any impediment to performance by the debtor and of the effect of the impediment on the performance of the obligation immediately after the debtor becomes aware of the impediment.

Unlike the DCFR, the LOA recognises, in addition to the general liability existing in cases not involving *force majeure*, an exception: wrongful liability. Pursuant to § 103 (4) of the LOA, in those cases specified by law or in the contract, a person shall be liable for the breach of the contract regardless of whether the breach is excused. For instance, providers of health care services are liable for their wrongful violations under § 770 (1) of the LOA. Section 104 of the LOA defines wrongful liability and the types of culpability. Under § 104 (2)

^{*12} Under § 108 (2) of the LOA, performance of the obligation shall not be required if performance is impossible, performance is unreasonably burdensome or expensive for the debtor, the creditor may reasonably achieve the desired result of the performance in another manner, or the performance involves provision of services of a personal nature. See also LOA Comm., p. 348 (in Estonian).

^{*13} See, e.g., the Supreme Court decision of 7 November 2005 in civil case 3-2-1-118-05 (RT III 2005, 39, 384), Sec. 16 (in Estonian).

^{*14} See the Supreme Court decision of 30 November 2005 in civil case 3-2-1-131-05 (RT III 2005, 43, 425), Sec. 18 (in Estonian).

^{*15} See, e.g., K. Sein. Mis on vääramatu jõud? (What Is *Force Majeure*?). – Juridica 2004/8, pp. 511–519 (in Estonian).

of the LOA, the types of culpability are carelessness, gross negligence, and intent. As an exception, the LOA also recognises liability for the level of care exercised by a person in his or her affairs (e.g., liability upon gratuitous deposit according to § 885 of the LOA). In cases involving such a duty related to the level of care, a person is nevertheless liable in the event of intent and in cases of gross negligence (LOA § 104 (6)). In view of the different relationships regulated by the LOA and the fact that the provisions cited are in part also applicable to delictual liability, the solution provided by the LOA is obviously reasonable, albeit not the only possible one.

The general provisions of the LOA do not contain a regulation comparable to article III.–3:107 of the DCFR, under which a creditor who is not a consumer may not rely on the lack of non-conformity of goods or services received, unless the creditor gives notice to the debtor within a reasonable time. However, a similar obligation of the purchaser can be found in the LOA's § 220 (pertaining to cases of contracts of sale) and of the customer in § 644 of the LOA (in relation to contracts for services). Not unlike the DCFR's article III.–3:107 (3), the LOA's § 221 (1) and § 645 (1) restrict the creditor's right to rely on failure to provide notification of non-conformity if the debtor was aware or ought to have been aware of the lack of conformity and did not disclose such information to the creditor. To sum up, the rules of the LOA and DCFR are similar and obviously reasonable.

The material in article III.–3:105 of the PECL on agreements restricting liability is reflected in § 106 of the LOA, whose subsection 1 specifies that a debtor and a creditor may agree in advance to preclude or restrict liability in the event of non-performance of an obligation. Despite the rather ambiguous wording, this provision should also cover the exclusion of resorting to different legal remedies.¹⁶ Under § 106 (2) of the LOA, agreements that allow the debtor to perform an obligation in a manner materially different from that which could be reasonably expected by the creditor or that unreasonably exclude or restrict liability in some other manner, and also agreements that preclude or restrict liability in the event of intentional non-performance, are void. Unlike the regulation provided in the LOA, article III.–3:105 (1) of the DCFR prohibits only agreements related to personal injury caused intentionally or through gross negligence. What is different in the LOA from the latter terms of the DCFR is the invalidity of all unreasonable agreements (LOA § 42) but not the prohibition to rely on them (in part) (as provided by the DCFR). Such regulation as that seen here in the DCFR would obviously be more rational, as it would allow more flexibility in application. Amending the LOA to reflect that would be desirable.

5. Cure of non-performance and deadlines for remedying lack of conformity

Articles III.–3:202 through III.–3:204 of the DCFR are resembled by § 107 of the LOA, which allows the party who fails to perform a contractual obligation to cure the non-performance; however, the LOA grants a slightly broader scope of cure for the debtor. Thus, under § 107 of the LOA, the party who fails to perform an obligation may in principle and within the limits of reason cure the non-performance (e.g., rectify or replace defective performance) until the other party has not terminated the contract or demanded compensation for damage in lieu of performing the obligation. Under § 107 (4) of the LOA, cure does not deprive the aggrieved party of the right to claim compensation for damage caused by a delay in performance or by attempted cure, including the right to claim payment of a penalty for late payment or a contractual penalty (similarly to the DCFR's article III.–3:204 (3)).

Section 114 of the LOA generally corresponds to the DCFR's article III.–3:103 on notice for fixing an additional period of performance. Granting of an additional term for performance is a general prerequisite for both withdrawal from a contract due to breach of contract (LOA § 116 (2) 5)) and cancellation, due to the same reason, of a contract entered into for an indefinite period (LOA § 196 (2)). Also, under § 115 (2) of the LOA it is a general prerequisite for demanding compensation for damage in lieu of performance. Differently from article III.–3:103 (2) of the DCFR, the LOA's § 114 (3) prescribes that the creditor may, during the additional term granted for performance, also claim a penalty for late payment. Subsection 114 (2) explains also that the granting of an additional term for performance does not release the debtor from liability for breach of contract. Clause 116 (2) 5) of the LOA, unlike article III.–3:503 (1) of the DCFR, obviously over-justifies a party's withdrawal from the contract if the other party fails to perform any obligation (not just delaying performance) during the additional term granted for performance or if said party gives notice that he will not perform the obligation during that term. Within the context of other provisions, § 116 (4) of the LOA is also a bit unclear, tying withdrawal from a contract to granting of an additional term for non-performance (see Section 8 of this article).

¹⁶ See LOA Comm., p. 338 (in Estonian).

6. Requirement of real performance

Article III.–3:301 (1) of the DCFR's regulation of monetary obligations is in essence matched by § 108 (1) of the LOA, which in principle grants the creditor an indefinite right to demand performance of a monetary obligation. The Supreme Court has found that non-performance of a monetary obligation is, as a rule, not excusable.^{*17} The LOA does not have a regulation corresponding to the rather 'heavy' article III.–3:301 (2) of the DCFR concerning unwillingness of the debtor to receive the creditor's performance. Subsection 109 (1) of the LOA includes a somewhat similar idea: In the case of a mutual contract, the party in breach of obligation may require the other party to perform its obligations even if performance by the party in breach cannot be required for reasons specified in § 108 (2) of the LOA and if the reason arises because of circumstances dependent on the other party or if the reason arises at the time when the other party delays acceptance. This ensures that the creditor still has a right of counterclaim. In addition, § 109 (2) of the LOA provides that the party in breach must nevertheless deduct from its claim whatever it saves as a result of non-performance or obtains as a result of applying its labour or other resources elsewhere or what it in bad faith fails to obtain, despite having a reasonable opportunity to obtain it. Additionally, for example, a seller has the right to withdraw from the contract and claim damages if the purchaser refuses to accept the goods. Also, under § 115 (2) of the LOA, the seller may demand compensation for damage in lieu of performance.

Section 108 of the LOA is similar to article III.–3:302 of the DCFR in its handling of non-monetary obligations; i.e., under Estonian law too it is possible to demand, in court, real performance of an obligation other than payment of money, albeit subject to restrictions arising from law.^{*18} Not unlike article III.–3:302 (3) of the DCFR, the second sentence of § 108 (2) of the LOA restricts the enforcement of a claim for real performance, and the specific restrictions listed in the LOA and DCFR overlap. However, the meaning of the restrictions is not always absolutely clear, as is the case with a claim to replace a defective item sold under a contract of sale. One should perhaps prefer the interpretation according to which such restrictions are not overly important, and § 222 of the LOA should be applied in the case of sale. Article III.–3:302 (4) of the DCFR is matched by § 108 (3) of the LOA. That is, under Estonian law too a creditor is required to decide as quickly as possible whether to continue to demand real performance of the obligation that was breached. In addition, § 108 (4) of the LOA stipulates that a debtor may determine beforehand a reasonable term within which the creditor may require performance and if the debtor specifies an unreasonably short term within which the creditor may require performance, the term is deemed to have been extended to a reasonable length. In practice, however, the reasonability of the temporal restriction on a claim of performance has been questioned, particularly in parallel with the existence of limitation periods. This causes somewhat unnecessary disputes, and it would be preferable to waive such a restriction.^{*19} Nevertheless, as far as is known, this particular regulation has not caused major court cases to date.

7. Withholding performance of a contract

Compared to article III.–3:401 of the DCFR, the LOA regulates withholding of performance more broadly and with greater detail (in its §§ 110 and 111). However, several inaccuracies can be found in the LOA.

Article III.–3:401 (1) of the DCFR is similar to § 111 (1) of the LOA, but, unlike the DCFR, the LOA does not clearly specify that it pertains to only the right to withdraw performance of the party who is required to perform after or simultaneously with the other party. Even so, one should come to this conclusion on the basis of the logic of the provision.^{*20} In addition, under § 111 (1) of the LOA, the right to withhold performance terminates also where the other party has performed or offered to perform (obviously without basis) and has secured or confirmed the performance. Subsection 111 (3) of the LOA is similar to article III.–3:401 (4) of the DCFR (although the LOA regulation is broader in scope), according to which a party shall not withhold performance if this would be unreasonable in the circumstances or contrary to the principle of good faith, in particular if the other party has performed the obligations thereof for the most part or without significant deficiencies.

The option of the creditor to withhold performance when he reasonably believes there will be non-performance by the debtor as set out in article III.–3:401 (2) of the DCFR is regulated in detail in §§ 111 (4)–(6) of the LOA.

In addition to regulating performance in cases of mutual contract, § 110 of the LOA grants a debtor a broader right to withhold performance of an obligation until the creditor has satisfied a claim that is due for the benefit of the debtor against the creditor (also, for example, a claim from another contract or other prestation) if the claim is not sufficiently secured and there is a sufficient link between the claim and the obligation of the debtor,

¹⁷ See CCSCd No. 3-2-1-118-05, Sec. 16 (in Estonian).

¹⁸ For discussion of the meaning of excusability in cases of a claim of real performance, see Section 4 of this article.

¹⁹ See LOA Comm., p. 351 (in Estonian).

²⁰ See LOA Comm., 365 (in Estonian).

and unless indicated otherwise by the law, the contract, or the nature of the obligation (LOA § 110 (1)). Section 110 of the LOA regulates that right in detail. The author believes that the general regulation of § 110 concerning the right to withdraw performance is reasonable, as it improves the position of the aggrieved party.

8. Unilateral termination of contract

Comparable regulation to article III.–3:502 (1) of the DCFR on unilateral termination of contract can be found in § 116 of the LOA. That is, also under Estonian law a party may unilaterally terminate a contract in the event of fundamental breach of contract (LOA § 116 (1)). The main instances of fundamental breach of contract are listed in § 116 (2). Provisions related to the granting of an additional term for performance can be found in subsections 4 and 5 of § 116 of the LOA. Under the LOA, the fundamental nature of the breach is also important if compensation for damages in lieu of performance is demanded (see its § 115 (2) and (3)), and also, in the case of contracts of sales and services, if upon the emergence of lack of conformity of an item the delivery of a substitute thing is demanded (see LOA § 222 (2) and § 646 (2)). That the alleged breach of contract is of a fundamental nature is also important if a party withdraws itself from performance (LOA § 111 (6)).

Article III.–3:502 (2) (a) of the DCFR is in essence matched by § 116 (2) 1) of the LOA, under which a breach of contract is fundamental if non-performance of an obligation substantially deprives the aggrieved party of what said party was entitled to expect under the contract, except in cases where the other party did not foresee such consequences of the non-performance and a reasonable person of the same kind as that second party could not have foreseen such consequences under the same circumstances. The DCFR does not have a separate provision with the effect of the LOA's § 116 (2) 2), under which a breach is fundamental if, pursuant to the contract, strict compliance with the obligation that has not been performed is the precondition for the other party's continued interest in the performance of the contract. Unlike article III.–3:502 (2) (b) of the DCFR, § 116 (2) 3) of the LOA prescribes that a breach may be deemed fundamental even simply if non-performance of some obligation was intentional or (additionally to the conditions set forth in the DCFR) due to gross negligence, and § 116 (2) 4) specifies that a breach is fundamental if non-performance of the obligation gives the aggrieved party reasonable reason to believe that it cannot rely on the other party's future performance. Thus, the important regulation of the DCFR provision has been divided in the LOA into two separate bases with, at the same time, addition of gross negligence to the list. Such a solution is obviously not the best, as it allows treating rather insignificant breaches of contract as fundamental. What is also not clear is differentiation of § 116 (2) 4) of the LOA from termination of contract, for example, on the basis of alleged breach of contract under § 117 (1) of the LOA.²¹ Differently from DCFR article III.–3:503 (1), § 116 (2) 5) of the LOA stipulates that any breach is fundamental if the other party fails to perform any obligation thereof during an additional term for performance or gives notice that it will not perform the obligation during this term (see also Section 5 of this article). Also, it is unclear how to apply the bases listed in the LOA's § 116 (2) 1), 3), and 4) in conjunction with § 116 (4) of the LOA, under which withdrawal from a contract without granting of an additional term for performance is prohibited if the damage suffered by the non-performing party in the case of withdrawal would be disproportionate to the expenses incurred in the performance or preparation for the performance of the obligation. Unlike the DCFR's article III.–3:502 (2), the list in § 116 (2) of the LOA is not exhaustive. Subsection 117 (1) of the LOA in essence corresponds to article III.–3:504 of the DCFR; i.e., under Estonian law as well it is possible to withdraw from a contract before a fundamental breach of the contract actually happens, if such a situation arising is evident.

Differently from the DCFR, the LOA makes a more detailed differentiation of contracts entered into for an indefinite period that are contracts for the performance of a continuing obligation or recurring obligations (LOA § 195 (3)). Under the LOA's § 116 (6), in the case of a fundamental breach of a contract entered into for an indefinite period, the aggrieved party may cancel the contract pursuant to the provisions of § 196 of the LOA. Unilateral termination of any other contract is called withdrawal. The difference lies in the existence of reversal of the contract (in the case of withdrawal) or the lack of it (in the case of cancellation). Nevertheless, the bases for unilateral termination in the case of fundamental breach of a contract are, pursuant to § 196 (2) of the LOA, still the same and are grounded in § 116 of the LOA. However, under § 196 (1) of the LOA, a contract entered into for an indefinite period may extraordinarily be cancelled with good reason without giving of advance notice, in particular if the party cancelling the contract cannot reasonably be expected to continue performing the contract until the due date agreed upon or until expiry of the term for advance notice, with all of the circumstances and the mutual interests of the parties taken into account. It is most likely that, in the LOA too, a unified approach to termination would have been possible, but with different types of contract there still remains the need to allow termination of a contract on account of circumstances arising from the party wishing to terminate the contract — and this is what § 196 of the LOA enables. Therefore, the solution provided by the LOA is not necessarily worse than that of the DCFR.

²¹ See LOA Comm., p. 404 (in Estonian).

Analogously to article III.–3:507 (1) of the DCFR, pursuant to § 188 (1) of the LOA withdrawal from a contract occurs by the withdrawing party's submitting a declaration of withdrawal to the other party. Under § 195 (1) of the LOA, contracts entered into for an indefinite time are also cancelled by a declaration to the other party. Accordingly, under Estonian law it is not necessary, for example, to file an action with a court in order to unilaterally terminate a contract. Similarly to article III.–3:508 (1) of the DCFR, § 118 (1) 1) of the LOA sets out that a party entitled to withdraw from a contract loses the right to withdraw if said party does not make a declaration of withdrawal within a reasonable time after it becomes or should have become aware of a fundamental breach of the contract. Clause § 118 (1) 2) of the LOA furthermore stipulates that withdrawal must also occur within reasonable time after expiry of the additional term for performance. The LOA's § 118 (2) provides for the, so to say, final deadline of withdrawal — withdrawal from a contract due to a breach of the contract is void if the claim for the performance of the obligation has expired and the debtor relies on such a claim or if the debtor legitimately refuses to perform the obligation.

Subsections 188 (2) and (3) of the LOA in essence correspond to article III.–3:509 of the DCFR. That is, also under Estonian law withdrawal from a contract does not have a retroactive effect *per se*; i.e., it does not affect the validity of rights and obligations that have arisen from the contract before the withdrawal but, rather, releases the parties from further performance of the contract. Under § 195 (2) of the LOA, the consequences of withdrawing from a contract entered into for an indefinite period are virtually the same. Withdrawal additionally has a significant consequence of reversal of contract under §§ 189–191 of the LOA; exceptionally this may also be a consequence of cancellation under § 195 (5) of the LOA. The LOA's regulation of return of property upon termination and compensation for its value is in principle similar to articles III.–3:511–III.–3:515 of the DCFR. According to those provisions, that which was delivered under the contract must mutually be returned, and, if this is not possible, the value of that which was received must be compensated for in money. There is also detailed regulation of the impossibility of the obligation to return, payment of compensation for use of that which was delivered, compensation for costs incurred through that which was delivered, etc. Compared to the earlier regulation of the PECL, the solution provided by the DCFR is much clearer and actually more similar to that of the LOA.

9. Reduction of price

Article 3:601 of the DCFR, on price reduction, is mostly matched by § 112 of the LOA; i.e., under Estonian law too, the general legal remedy of unilateral reduction of price upon acceptance of defective performance is possible. Only the breach of a contract through defective performance and not lack of excusability is a precondition for the reduction of price (§ 105 LOA). Reduction of price has acquired an important place in Estonian court practice.

The LOA does not have a provision matching article III.–3:601 (3) of the DCFR on delimiting price reduction from claiming of compensation for damages; however, the practical application should yield a similar result. On the basis of § 101 (2) of the LOA, price reduction and compensation for damages may be used in parallel but only to such an extent that they do not preclude each other. The Supreme Court has decided that parallel demanding of price reduction and compensation for damages is not allowed.²² This position, however, obviously covers demanding of compensation for damages that goes in the same direction as the reduction of price. The LOA's § 112 (2) further regulates the procedure for price reduction. According to that provision, price reduction is performed by making a corresponding declaration to the other party. The position of the Supreme Court is that such a declaration may be in any form.²³

Both the DCFR's article III.–3:601 and the LOA's § 112 are imperfect in that the period during which one may resort to price reduction is not clear.

10. Compensation for damage due to breach of contract

The LOA's regulation of compensation for damage is similar in essence to that of the DCFR, although it is structured a bit differently and is more detailed. Basically, the general requirement to compensate for damage due to breach of a contract is regulated, as a legal remedy, in § 115 of the LOA; the extent and calculation of compensation are, on the other hand, jointly regulated both for the purposes of the contract and for applica-

²² See CCSCd 3-2-1-131-05, Sec. 18 (in Estonian).

²³ See the Supreme Court decision of 14 June 2006 in civil case 3-2-1-59-06 (RT III 2006, 25, 229), Sec. 16 (in Estonian).

tion of delict law in §§ 127–140 of the LOA. The law of delict, together with the bases for the claim, can be found in §§ 1043–1067 of the LOA. Subsection 1044 (2) of the LOA contains an important stipulation that compensation for damage arising from the violation of contractual obligations may not be claimed on a delictual basis except in cases where the objective of the violated contractual obligation was other than to prevent the damage for which compensation is claimed. Under § 1044 (3) of the LOA, claims may be submitted both on a contractual and on a delictual basis in cases involving causing of death, bodily injury, or damage to the health of a person.

Similarly to article III.–3:701 (1) of the DCFR, § 115 (1) of the LOA provides that, in the case of non-performance of an obligation by a debtor, the creditor may along with or in lieu of performance claim compensation for that damage caused by the non-performance from the debtor, except in cases where the debtor is not liable for the non-performance (i.e., where the non-performance is excusable under § 103 of the LOA) or the damage is not subject to compensation for any other reason specified by law. The LOA's § 115 draws a clear distinction between a claim for compensation of damage together with performance of the obligation (the so-called 'small claim for compensation of damage') and a claim for compensation of damage in lieu of performance (the so-called 'big claim for compensation of damage'). The language in §§ 115 (2)–(4) provides, similarly to the provisions on withdrawal, more precise regulation of a claim for compensation of damage in lieu of performance (such a delimitation may cause problems, primarily in connection with extinguishment of a claim). Under §§ 146–148 of the General Part of the Civil Code Act, the limitation period of a claim for compensation for damage arising from a contract or pre-contractual negotiations (both including and in lieu of performance) is three years from its falling due — i.e., from the time at which one may start demanding compensation.

In essence, the LOA's regulation here is similar to that of articles III.–3:701 (2) and (3) and article III.–3:702 of the DCFR both as regards the extent of compensation and as concerns the types of damages subject to compensation. Under § 127 (1) of the LOA, the purpose of compensation for damage is to place the aggrieved person in a situation as near as possible to that in which said person would have been if the circumstances that form the basis for the compensation obligation had not occurred. In Estonian judicial practice, compensation for damage is known as expectation interest or positive damage as well as negative damage or reliance interest, for example, in the case of nullity of contract or upon breach of an obligation arising from pre-contractual negotiations.²⁴ Damage suffered by an aggrieved person is one of the preconditions for the arising of the obligation to compensate.²⁵ According to § 127 (5) of the LOA, any gain received by the aggrieved party as a result of the damage caused — in particular, the costs avoided by the aggrieved party — must be deducted from the compensation for damage, unless deduction is contrary to the purpose of the compensation. Under the LOA's § 128 (1), damage subject to compensation may be either patrimonial or non-patrimonial. Pursuant to § 128 (2), patrimonial damage includes, primarily, direct patrimonial damage and loss of profit. The special provisions of the LOA specify the extent of compensation in cases of violation of concrete legal rights: causing the death of a person (LOA § 129); causing harm to the health or causing bodily injury (LOA § 130 (1)); deprivation of liberty or violation of personality rights (LOA § 131); destruction, loss of, and/or damage to property (LOA § 132); and damage caused by activities that are hazardous to the environment (LOA § 133). According to § 128 (5) of the LOA, non-patrimonial damage involves primarily the physical and emotional distress and suffering caused to the aggrieved person. The extent of compensation for non-patrimonial damage is further specified primarily in § 134 of the LOA. Pursuant to § 134 (1) of the LOA, compensation for non-patrimonial damage arising from non-performance of a contractual obligation may be claimed only if the purpose of the obligation was to pursue a non-patrimonial interest and, under the circumstances relating to entry into the contract or to the non-performance, the debtor was aware or should have been aware that non-performance could cause non-patrimonial damage. With different prerequisites, non-patrimonial damage is subject to compensation also in cases of causing of either damage to the health or bodily injury to a person (LOA § 130 (2)), violation of personality rights (LOA § 134 (2)), causing of the death of a person (in which case compensation is payable to persons close to the deceased) (LOA § 134 (3)), and destruction or loss of a thing (LOA § 134 (4)). Under the LOA's § 127 (6), if damage has been established but the exact extent of that damage cannot be established, including in the event of non-patrimonial damage or future damage, the amount of compensation shall be determined by the court. The same regulation in essence arises from § 233 (1) of the Code of Civil Procedure²⁶. The LOA's § 135 (1), which allows substitute transaction as the basis for calculating the compensation, is similar to the DCFR's article III.–3:706; § 135 (2) of the LOA, allowing for using current prices as the basis in calculation of the compensation, is similar to article III.–3:706 of the DCFR.

Subsection 127 (3) of the LOA is basically the same as article III.–3:703 of the DCFR; that is, in the event of breach of a contract, the non-conforming party must compensate for only such damage as said party foresaw or should have foreseen as a possible consequence of non-performance at the time of entering into the contract,

²⁴ See, for instance, the Supreme Court 21 October 2003 decision in civil case 3-2-1-106-03 (RT III 2003, 33, 342), Sec. 14–17 (in Estonian).

²⁵ See the Supreme Court decision of 13 February 2002, in civil case 3-2-1-14-02. — RT III 2002, 8, 80 (in Estonian).

²⁶ Tsiviilkohtumenetluse seadustik. — RT 2005, 26, 197; 2007, 16, 77 (in Estonian).

unless the damage has been caused intentionally or through gross negligence.^{*27} In addition, according to § 127 (2) of the LOA, the damage is not to be compensated for to the extent that prevention of damage was not the purpose of the obligation or provision due to the non-performance of which the compensation obligation arose (that is, the so-called ‘theory of the purpose of the law’).^{*28} Pursuant to § 127 (4) of the LOA, a person must compensate for damage only if the circumstances on which the liability of that person is based and the damage caused are related in such a manner that the damage is a consequence of the circumstances (i.e., there is a causal relationship). To date, court practice has not provided an exhaustive answer concerning application of different elements of §§ 127 (2)–(4) in conjunction with each other.^{*29}

Under § 136 (1) of the LOA, damage is to be compensated for in a lump sum unless the nature of the damage makes it reasonable to pay the compensation in instalments. Pursuant to § 136 (5) of the LOA, in the cases specified by law or a contract and in other cases where this is reasonable under the circumstances, the aggrieved person may claim compensation for damage in a manner other than monetary compensation. The language in § 137 of the LOA further specifies the compensation for damage to be paid by several persons and stipulates, *inter alia*, solidary liability for payment of compensation (LOA § 137 (1)). Judicial practice provides an example of such a situation. The court decided that, under § 137 (1) of the LOA, an employee and a third party were solidarily liable for damage caused to an employer’s car, with the employee being held liable for breach of the employment contract and the third party found guilty on the basis of provisions regulating unlawful damage.^{*30} The LOA’s § 138 makes it simpler for the aggrieved party to claim compensation where several persons may be liable for the damage caused and it has been established that any of these persons could have caused the damage. In such a case, according to the LOA’s § 138 (1), compensation for the damage may be claimed from all such persons. Under § 138 (3) of the LOA, this compensation may be claimed only to an extent that is in proportion to the probability that the damage was caused by the person concerned. The Supreme Court has ruled that these principles may be applied, for example, to builder’s and designer’s liability for defective construction.^{*31}

The LOA’s regulation, although somewhat broader in scope, is similar in essence to article III.–3:705 of the DCFR in its handling of reduction of loss. Pursuant to § 139 (1) of the LOA, if the damage is caused in part by circumstances dependent on the aggrieved party or due to a risk borne by the aggrieved party, the amount of compensation for the damage shall be reduced to the extent that such circumstances or risk contributed to the damage. Under § 139 (2) of the LOA, this provision also applies if the aggrieved person failed to draw the attention of the person causing the damage to an unusually high risk of damage or to prevent the risk of damage, or failed to perform any act that would have reduced the damage caused if the aggrieved person could have reasonably been expected to do so. In § 139 (3) and (4), the LOA specifies the details of reduction of compensation in the case of damage to a person. The Supreme Court has expressed the position that, for instance, if the debtor failed to supply to a factory the quantity of raw materials prescribed by the contract, the factory, as the creditor, could be assumed to perform a substitute transaction — i.e., reduce their damage for the purposes of § 139 (2) of the LOA.^{*32} The LOA’s regulation corresponding to DCFR article III.–3:705 (2) can be found in § 128 (3), according to which direct patrimonial damage includes, *inter alia*, reasonable expenses related to prevention or reduction of damage. Pursuant to § 140 (1) of the LOA, the court may reduce the amount of compensation for damage if compensation in full would be grossly unfair with respect to the obligated person or for any other reason not be reasonably acceptable. In such cases, all circumstances — in particular, the nature of the liability, relationships between the persons, and their economic situations (including insurance coverage) — must be taken into account.

11. Penalty for late payment and contractual penalty

Similarly to article III.–3:708 of the DCFR, § 113 of the LOA provides for a general opportunity to require, upon a delay in the performance of a monetary obligation, payment of a penalty for late payment, although the LOA is much more detailed in its regulation. Under the LOA’s § 113 (1), interest on the delay (that is, a penalty for late payment) may be claimed for the period from the time the obligation falls due until conforming performance is rendered, at the interest rate specified in § 94 of the LOA^{*33} — the last interest rate applicable to the main refinancing operations of the European Central Bank before 1 January or 1 July of each

²⁷ See, for example, the Supreme Court 6 March 2003 decision in civil case 3-2-1-19-03 (RT III 2003, 7, 78), Sec. 12 (in Estonian).

²⁸ See LOA Comm., pp. 440–441 (in Estonian).

²⁹ See, for example, the Supreme Court 26 September 2006 decision in civil case 3-2-1-53-06 (RT III 2006, 33, 283), Sec. 13 (in Estonian).

³⁰ See the Supreme Court 7 December 2005 decision in civil case 3-2-1-149-05 (RT III 2005, 45, 441), Sec. 12 (in Estonian).

³¹ See the Supreme Court decision of 21 May 2002 in civil case 3-2-1-56-02 (RT III 2002, 16, 194), Sec. 24 (in Estonian).

³² See the Supreme Court 21 December 2005 decision in civil case 3-2-1-137-05 (RT III 2006, 3, 26), Sec. 12 (in Estonian).

³³ Directive 2000/35/EC of the European Parliament and of the Council of 29 June 2000, on combating late payment in commercial transactions.

year plus seven per cent per year. If a contract prescribes payment of interest exceeding the rate provided for by law, the interest rate prescribed by the contract is to be the rate of penalty for late payment. In the case of contracts entered into in economic or professional activities, the penalty for late payment is calculated on the basis of the second sentence of § 105, irrespective of the excusability of the non-performance; in other cases where non-performance is not excusable, § 103 of the LOA shall be taken as the basis. Analogously to article III.–3:708 (2) of the DCFR, subject to the existence of the other prerequisites, it is possible to claim under § 113 (5) of the LOA compensation for the sum in excess of the penalty for late payment if the damage caused by the delay in performance exceeds the amount of the fine specified for the delay. The LOA's § 113 (2) specifies further that if compensation for damage is required for reasons other than non-performance of an obligation to pay money, the penalty for late payment of the sum of the compensation shall be calculated as of the moment when the person required to compensate for the damage became or should have become aware of the damage caused.

What differs fundamentally from the DCFR's article III.–3:709 is the regulation of § 113 (6) of the LOA, which prohibits requirement of a penalty for late payment for a delay in payment of interest. Agreements that derogate from this requirement to the detriment of the debtor are void. Pursuant to § 113 (7) of the LOA, this does not, however, preclude or restrict the right of the creditor to claim compensation for damage caused by a delay in the payment of interest. A person required to pay a penalty for late payment may, under § 113 (8) of the LOA, make a claim for a reduction of the fine pursuant to the provisions of § 162 of the LOA. In the practice of the Supreme Court of Estonia, any reduction of the fine is granted at the discretion of the court and in consequence of weighing the interests of the debtor and the creditor, comparing the amount of the claim to the amount of the loss caused to the creditor, and estimating its proportionality.^{*34} Unreasonably high penalties foreseen in standard terms serve as an exception here. In such a case, the court should not reduce the penalty rate but, on the basis of § 42 (3) of the LOA, deem the agreement void. As a result, only the statutory penalty can be claimed in the latter case.^{*35}

The LOA's regulation of contractual penalty terms (in §§ 158–163) is similar to what is set forth in the DCFR's article III.–3:710, although the former is much more detailed. According to § 161 (1) of the LOA, in the case of non-performance of a contract, the aggrieved party may claim payment of a contractual penalty regardless of the actual damage. If an aggrieved party has the right to claim compensation for damage incurred because of non-performance of the contract, compensation under § 161 (2) of the LOA must be paid to the extent not covered by the contractual penalty; i.e., the aggrieved party may additionally require compensation for the amount exceeding the contractual penalty. The language of § 159 (1) of the LOA specifies that if a contractual penalty is agreed upon for the occasion of non-performance of an obligation, the aggrieved party may make claim for performance of the obligation in addition to payment of the contractual penalty. A claim cannot be made for performance of the obligation in addition to payment of a contractual penalty if the contractual penalty was agreed upon as a substituted performance and not as a means for achieving performance. Under the LOA's § 160, if non-performance is excusable, a contractual penalty cannot be claimed unless otherwise prescribed by the contract. According to § 159 (2) of the LOA, an aggrieved party loses the right to claim payment of a contractual penalty if the party fails to notify the other party within reasonable time after becoming aware of the non-performance that it is claiming payment of the contractual penalty. Similarly to the DCFR's article III.–3:701 (2), under § 162 of the LOA it is possible to ask the court to reduce the contractual penalty.

12. Conclusions

To sum up, we can say that the LOA is in principle similar to the DCFR in its regulation of consequences of breach of contract and in the applicable system of legal remedies. The LOA contains several inaccuracies in details concerning, for example, prerequisites to unilateral termination of contract and rights of withdrawal from performance. At the same time, some regulation provided in the LOA is much more precise and protects the interests of the parties better (e.g., that of compensation for damage). Compared to the PECL, the terms in the DCFR in several parts show significant improvements (e.g., the material on consequences of terminating a contract). However, there are still shortcomings suffered by both the LOA and the DCFR, such as the unclear connection between the requirement of real performance, questionable regulation of temporal restriction on the submission of a claim of performance, and the deadline for reduction of price. However, as a whole these do not affect this obviously modern and relevant system of contractual liability.

³⁴ See, for example, the Supreme Court 14 June 2005 decision in civil case 3-2-1-66-05 (RT III 2005, 23, 245), Sec. 16 (in Estonian).

³⁵ See CCSCd No. 3-2-1-66-05, Sec. 24 (in Estonian).



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The Development of the Concept of Pre-contractual Duties in Estonian Law

The knowledge that there are pre-contractual duties that could lead to a liability if breached is new to Estonian lawyers. The relevant regulation was introduced with the new Law of Obligations Act¹, which entered into force on 1 July 2002 and thoroughly altered the existing understanding and concepts of contract law, torts, and other obligations.

The Law of Obligations Act (LOA) contains specific regulation on pre-contractual duties (LOA § 14). As a general rule, LOA § 14 (1) requires the parties who have started negotiations over the conclusion of a contract to “take reasonable account of each other’s interests and rights”. This leads specifically to an obligation to negotiate in good faith, which in turn amounts to a prohibition to start or continue negotiations without willingness to conclude a contract and precludes the party from ending the negotiations in bad faith without concluding a contract (LOA § 14 (3)). The general principle of acting in good faith during the pre-contractual relations in LOA § 14 (1) is also a source of specific disclosure requirements. The negotiating parties are first required to ensure that the information provided by them to the other party in the pre-contractual phase is true and correct (LOA § 14 (2), first sentence). This leads to liability for any incorrect information submitted during the negotiations, provided that such information influenced the decision to enter into contract or to do so under the agreed terms. The pre-contractual duties related to disclosure of information are not limited to the liability for incorrect information. In addition, the law requires the negotiating parties to actively disclose to the other party all information the knowledge of which is evidently material to the other party in consideration of the purpose of the contract (§ 14 (2), second sentence). The source of the regulation of pre-contractual duties in LOA § 14 has mainly been the German concept of liability under *culpa in contrahendo*, as set out in § 241 (2) and § 311 (2) of the BGB², but the legislator was also influenced by the regulations of pre-contractual duties in the Principles of European Contract Law (articles 2:301 (4) and 2:302) and in the Principles of International Commercial Contracts (articles 2.1.15 and 2.1.16).³

The existence of specific duties between the parties prior to conclusion of the contract was to some extent acknowledged also before the new LOA. Such specific pre-contractual duties were mainly recognised with respect to the disclosure requirements in the pre-contractual phase. However, such duties were largely accepted only where the negotiations had led to conclusion of a contract. In such cases, the duties were conceived not as pre-contractual but, rather, as duties arising under the contract. That the duties in question ought to have been performed prior to the conclusion of the contract was not considered to be important. As the liability

¹ Võlaõigusseadus. – RT I 2001, 81, 487; 2007, 56, 375 (in Estonian). Available in English at <http://www.just.ee/23295> (30.06.2008).

² P. Varul et al. Võlaõigusseadus. Kommenteeritud väljaanne I. (Law of Obligations Act I. Commented edition). Tallinn: Juura 2006, commentary 2 to § 14, p. 58 (in Estonian).

³ *Ibid.*, commentary 2 to § 14, p. 58.

for a possible breach of such duties was contractual by its nature, no specific discussion existed regarding the pre-contractual duties or liability. A good example is a case decided by the Civil Chamber of the Supreme Court in 2001.⁴ A buyer of a house, which was still under construction at the time it was bought, claimed damages from the seller. The claim was mainly based on the fact that the constructive elements of floors and ceilings of the house were made of timber and not from concrete. The buyer claimed that prior to the conclusion of the contract the seller had shown her the project details and blueprints of the house, which provided for a concrete structure. The notarised sales agreement that the parties concluded later on made no reference to the blueprints or specific characteristics of the house, which was sold on an 'as is' basis. Nonetheless, the buyer based her claim on defective performance and argued that the house did not conform to the contract. The Supreme Court obviously did not accept this argument, as it concluded that the mere fact that the floors were constructed from timber and not from concrete did not amount to a defect of the house, as the floors conformed to the applicable construction standards. The Court was obviously of the opinion that the provision of the project providing for concrete floors did not become a part of the sales contract as a contractual promise regarding the quality characteristics of the house. This did not lead to dismissal of the claim, though, as the Court accepted the seller's liability on the basis of a different argument. The Supreme Court pointed out that, irrespective of whether there was an agreement on the nature of the floors, the seller, who had disclosed the blueprints, was under a duty to inform the buyer that the house was not constructed in accordance with these. The seller was hence found to be in breach of the contract. This conclusion seemed so evident that the court did not even bother to ponder on the existence of such disclosure requirements, nor did it reflect on their pre-contractual nature.

1. The nature of pre-contractual liability, between tort and contract

When the new LOA entered into force and introduced a thorough regulation of the duties arising in the pre-contractual phase, the practice had only limited understanding of the purpose of the pre-contractual duties, the cases wherein the breach of such duties would be relevant, and the nature of the liability arising thereunder.⁵ It took some time before the courts and practising lawyers discovered the concept and its practical applications. The constant stream of case law in the last few years has shown that the regulation has not remained a mere concept on paper. A number of decisions from the Supreme Court have developed the concept of pre-contractual liability and amount to a growing legal certainty in the field.

The first issue the courts had to settle with respect to pre-contractual duties was the nature of the pre-contractual liability. Two principal concepts were discussed in the literature. The first of them saw the pre-contractual liability as part of tort law.⁶ In accordance with this concept, the respective duties, listed in LOA § 14, were nothing more than a specific form of a general duty of care the breach of which leads to a liability under the general principles of tort law. A concurring concept entailed the opinion that the pre-contractual relationship and the specific duties arising under it between the negotiating parties leads to a specific legal relationship between the parties (an obligation, or *võlasuhe* in Estonian⁷) the nature of which lies between that of contract and tort.⁸ This is, of course, a concept that is apparently similar to the German understanding of pre-contractual liability (*culpa in contrahendo*), which, as noted above, also served as a basis for the Estonian regulation.

It has to be admitted that, as far as the practical outcome is concerned, there is little difference in whether the breach of pre-contractual duties leads to the liability under a tort or to a quasi-contractual liability. The main difference between these two concepts in Estonian law is that the tort liability is a liability for negligence whereas the quasi-contractual liability for the breach of an obligation is strict liability where any breach leads to a liability except where the breach was attributable to *force majeure* and hence excusable. However, there cannot be very many cases in practice where such a fine distinction is of importance. This is largely because most of the pre-contractual duties can be breached only out of negligence. With respect to such duties, the tort law concept would not lead to a less 'strict' liability than the concept of a quasi-contractual liability, which does not require negligence as a precondition for liability. Nonetheless, there are situations where the choice of concept is indeed relevant. The most important among such cases is the liability for incorrect information provided to the other party during the pre-contractual negotiations. Under a tort concept, the party who provided such information

⁴ CCSCd 30.112007, 3-2-1-131-05. – RT III 2005, 43, 425 (in Estonian).

⁵ A notable exception was an introductory article by I. Kull. *Sissejuhatus probleemide: lepingueelne vastutus (culpa in contrahendo)* (Introduction into a Problem: Pre-contractual Liability (*culpa in contrahendo*)). – *Juridica* 1994, pp. 214–215 (in Estonian).

⁶ J. Lahe. *Lepingueelsete kohustuste ning eellepingu rikkumisest tulenev tsiviilõiguslik vastutus* (Civil Liability arising from the Breach of Pre-contractual Obligations and Pre-contracts). – *Juridica* 2004/10, pp. 681–687 (in Estonian).

⁷ The Estonian institute of an obligation (*võlasuhe*) is very similar to the German *Schuldverhältnis*.

⁸ I. Kull, M. Käerdi, V. Kõve. *Võlaõigus I. Üldosa* (Law of Obligations I. General Part). Tallinn: Juura 2004, p. 80 (in Estonian).

could be held liable only if he knew or ought to have known that the information provided to the other party was incorrect or if it could at least be proved that the information provided was negligently left uncontrolled by that party. In the quasi-contractual strict liability regime, the risk of liability for incorrect information lies entirely with the party who provided the information, who would be liable irrespective of whether said party knew or could have known of the incorrectness or whether the incorrect information was provided negligently.

The nature of the pre-contractual liability was clarified by the Supreme Court in the decision regarding breach of the duty to negotiate in good faith (addressed in the following section of this paper). The Supreme Court supported the concept of the liability in pre-contractual relations being quasi-contractual and therefore not leading to a tort. Negotiations regarding the conclusion of a contract between the parties lead to creation of an obligation⁹ between the parties negotiating. Under Estonian law, the breach of duties arising under an obligation created under the law entitles the parties to the same remedies as the breach of any contractual obligation. As a result, the liability for breach of the pre-contractual obligations is based on the same principles and provisions as the liability for breach of the obligations arising under the contract. Most notably, the pre-contractual liability is a strict liability, as is liability under a contract, and not a liability for negligence, as with the general tort liability.¹⁰

2. Duty to negotiate in good faith

The essence of the pre-contractual liability and the nature of the pre-contractual duties was first under scrutiny with regard to the duty to negotiate in good faith. The leading case for this practice is the decision of the Civil Chamber of the Supreme Court from 15 January 2007 (case No. 3-2-1-89-06).¹¹ The case had to do with the preliminary contract regarding the purchase of a plot of land. Under the contract, the seller agreed to sell a plot of land, which was to be created through division of a larger plot, to the purchaser for an agreed purchase price. Under Estonian law, such a contract would have required notarisation for validity, but the parties ignored this requirement knowingly (the seller was a real-estate developer and the purchaser was a lawyer). Later on, as the division of land was effected, the parties got into an argument regarding the conformity of the plot intended for the purchaser. The plot was smaller than what was agreed in the preliminary contract, and the purchaser wanted the price to be reduced accordingly. As a result, the seller refused to complete the sale and enter into a duly notarised agreement. The purchaser claimed for specific performance and alternatively for damages because of the non-performance. He calculated such damages on the basis of a difference between the agreed price and the market price for the plot.

With regard to the specific performance, the courts unanimously concluded that the claim was unfounded, as the agreement was invalid because of the non-compliance with the requirements as to form. A far more interesting argument arose with respect to the claim for damages. The purchaser claimed that the seller had breached the pre-contractual duty to negotiate in good faith when refusing to enter into the final notarised agreement, which was necessary to complete the sale. In the purchaser's opinion, such refusal amounted to a bad-faith interruption of negotiations, which is prohibited in accordance with LOA § 14 (3). The courts consequently had to clarify the content of the obligation to negotiate in good faith. It was first held that negotiations in bad faith preclude the party entering into the negotiations without a willingness to enter into the contract and the negotiations being held for purposes not consistent with the principle of good faith, such as with the aim of obtaining sensitive business information from the other party that such party would not disclose but for the negotiations or in order to prevent the other party entering into an agreement with a concurring third party.¹² In addition, the law prohibits the parties from terminating the negotiations in bad faith (LOA § 14 (3), second sentence). The essence of such bad-faith termination of negotiations was under particular scrutiny in the above-mentioned decision of the Supreme Court.¹³ The court stressed that, in determining whether negotiations not leading to conclusion of a contract were terminated in bad faith, one has to bear in mind that mere negotiations do not create an obligation to conclude a contract. In this connection, LOA § 14 (3), first sentence, provides explicitly that the mere fact that the negotiations are ended and do not lead to the conclusion of a contract does not create 'legal consequences' for the negotiating parties. This means that the parties have no pre-contractual obligation under the law to enter into a contract. Such obligation can only be created by entering into a (valid) 'pre-contract'. On the other hand, the prohibition of terminating the negotiations in bad faith (as set out in LOA § 14 (3), second sentence) evidences that, even in the absence of an obligation to conclude a contract, a termination of negotiations and refusal to conclude a contract can lead to a breach of pre-contractual obligations and to a corresponding liability. The question of whether the

⁹ In the sense of III.-1:101 DCFR.

¹⁰ P. Varul et al. (Note 2), commentary 4.6 to § 14, p. 62.

¹¹ RT III 2007, 3, 23 (in Estonian).

¹² *Ibid.*, Sec. 15.

¹³ *Ibid.*

negotiations have been terminated in bad faith depends mainly on the state of the negotiations at the time of their termination and on whether the other party could reasonably expect the conclusion of the contract.^{*14} It is evident that such expectation is dependent on how far the negotiations have proceeded.^{*15} If, at some point in their negotiations, the parties have acknowledged that they have agreed on the essential conditions of their contract, such acknowledgement would normally be sufficient to create reasonable expectation that the contract would indeed be concluded under the agreed terms. Any subsequent termination of the negotiations and refusal to conclude the contract would hence be contrary to good faith and amount to a breach of pre-contractual obligations under LOA § 14 (3), second sentence. The breach of pre-contractual obligations and bad faith termination is particularly evident where the acknowledgement or agreement to enter into the contract on agreed terms is documented in a pre-contract, memorandum of understanding, or similar document and the negotiations are terminated without valid grounds, despite such acknowledgement. This applies even when such a document is not valid because of the non-fulfilment of requirements concerning form, as was the case in the above-mentioned decision of the Supreme Court.^{*16}

A different issue is the question regarding the consequences of negotiations in bad faith. In considering this, the courts have concluded that, since an obligation to conclude a contract can be created only on the basis of a valid pre-contract, the pre-contractual duty to negotiate in good faith and the attendant prohibition from terminating negotiations in bad faith cannot lead to the compensation of the positive interest. A party who suffered damages because the other party started or terminated negotiations in bad faith cannot therefore file a claim with the goal of being placed in the situation that would have existed if the parties had concluded a contract. In the decision discussed above, the Supreme Court stressed that, although the purchaser could rely on the conclusion of the contract on the basis of the state of the negotiations and agreements evidenced in the invalid pre-contract and the termination of negotiations by the seller was hence performed in bad faith, the purchaser could not claim damages on the basis of the profits lost because of the non-conclusion of the intended contract. The pre-contractual duty to negotiate in good faith merely protects the reliance interest of the parties. Consequently, in the case of a breach, the aggrieved party is to be put in a situation as would have existed if that party had not relied on the negotiations being held in good faith.^{*17} This would mainly lead to the compensation of expenses that the party incurred during the negotiations, such as cost of time, travel costs, or costs related to the drafting of the contract.^{*18} In addition to this, the courts have recognised that in certain cases the protection of reliance interest can lead to compensation of expenses that the aggrieved party has made in reasonable reliance on the conclusion of the contract, such as costs, break fees, or similar expenses under the agreements that the party has entered in reliance on the conclusion.^{*19} It is clear that, prior to the contract's conclusion, such reliance can exist only under special circumstances, mainly where the other party has acknowledged that agreement has been reached in all essential respects, such that the conclusion of the contract is a mere formality. Even in such cases, only reasonable expenses incurred in reliance on such acknowledgement can be recovered as damages.

3. Duty to ensure the validity of a contract

The pre-contractual duties of the parties can involve an obligation to ensure that the contract concluded as a result of such negotiations is valid. Such duty is seldom explicitly stipulated in law. There is also no specific regulation to this effect in Estonian law. The fact that there must be pre-contractual duties regarding the guarantee of validity can be deduced from the various provisions that entitle a party to damages if a contract concluded with the other party is void or becomes invalid (such as through a successful avoidance) for reasons attributable to the other party.

In Estonian law, such regulation can first be found with respect to invalid contracts. A party is entitled to damages in accordance with LOA § 15 (2) if a contract concluded by that party is invalid because of factors attributable to the other party. The same applies if that other party knew or ought to have known of the circumstances leading to invalidity but did not disclose them prior to conclusion of the contract. Similar regulation exists with respect to avoidable contracts. A party who avoids a contract because of a mistake, fraud, or undue influence is entitled to damages in accordance with § 101 of the General Part of the Civil Code Act^{*20} (GPCCA) if such

¹⁴ P. Varul et al. (Note 2), commentary 4.4 to § 14, p. 61.

¹⁵ CCSCd 3-2-1-89-06 (Note 11), Sec. 16.

¹⁶ *Ibid.*, Sec. 15.

¹⁷ *Ibid.*, Sec. 16.

¹⁸ *Ibid.*

¹⁹ *Ibid.*: financing costs or interest payments under financing arrangements entered into in reliance of the conclusion of the contract, costs of valuation of the object of the contract for financing purposes, etc.

²⁰ Tsiviilseadustiku üldosa seadus. – RT I 2002, 35, 216; 2007, 24, 128 (in Estonian). Available in English at <http://www.just.ee/23295> (30.06.2008).

mistake, fraud, or undue influence was caused by the other party or if that other party knew or ought to have known of such circumstances but did not disclose them to the party influenced by such circumstances. Specific rules exist for cases where the invalidity of a contract is due to non-compliance with the form requirements. In LOA § 15 (1) it is provided that, if a party is responsible for preparation of the contract or had to inform the other party of the circumstances related to the conclusion of the contract and the contract is found invalid due to non-compliance with the form requirements, said party is responsible for the damages that the other party sustained because of reliance on the validity of the contract. Responsibility for the preparation of the contract or provision of information regarding the circumstances surrounding the conclusion is usually created when a professional party negotiates with a non-professional who can hence rely on a professional's knowledge to take all steps necessary for due preparation of the contract documentation and for a valid conclusion.^{*21} In practice, the provisions of LOA § 15 (1) have mainly been applied with respect to liability proceeding from invalid (pre-)contracts in the real-estate deals that were entered into in a non-notarised form on the initiative of a professional seller.^{*22} In the above decision of the Supreme Court where the pre-contract related to the purchase of a plot of land was found void because of non-adherence to the form requirements, the purchaser of the plot claimed that as a professional real-estate developer the seller was responsible for preparing the contract documentation.^{*23} One of the major issues in cases related to liability under LOA § 15 (1) has been the fact that since the requirement to notarise a real-estate contract and the consequences of non-adherence to this requirement are generally known, a purchaser who is prepared to enter into a real-estate agreement in a non-notarised form would be acting with gross negligence. As to the issue of how such negligence on the part of the purchaser influences the seller's liability under LOA § 15 (1), the courts have ruled that the reliance by the purchaser on the validity of the contract and the corresponding seller's liability should be excluded only if the purchaser knowingly enters into an invalid agreement.^{*24} If the positive knowledge of the purchaser cannot be proved, simple negligence or even gross negligence is not sufficient to exclude the seller's liability under LOA § 15 (1).^{*25}

With respect to the liability arising due to the breach of duties regarding ensuring of the validity of a contract, the law again protects merely the reliance interest and not the positive interest of the parties; this is generally the case where pre-contractual duties are concerned. In particular, the liability under an invalid contract does not protect the interest toward fulfilment of the contract and cannot lead to a situation where the party entitled to damages because of the invalidity is put in a situation that would have existed if the contract had been valid.^{*26} The law protects reliance on the validity of a concluded contract. If such reliance is not realised, on account of breach of the above-mentioned pre-contractual duties by the other party, the latter is responsible for damages. Such damages again involve the expenses related to negotiations.^{*27} As was discussed above, the damages can also be calculated on the basis of expenses incurred in reliance on the contract. Such expenses become damages if and insofar as they lose their purpose because of the invalidity of the contract. The courts have pointed out that in the case of a contract that has already been concluded (even though it is invalid) the reliance of a party on the validity of the contract is, as a rule, stronger than in the case where negotiations have not yet amounted to conclusion of the contract.^{*28} This means that, in general, any dispositions made by a party to an invalid contract can be deemed to have been performed in reasonable reliance on a contract such that the related expenses are collectable as damages, provided that the party who incurred such expenses did not know of the invalidity.^{*29} As an example, it has been found reasonable that a purchaser of a plot of land who does not know that the pre-contract concluded with the seller is invalid incurs expenses in the amount of approximately €4000 for the planning and design work related to the plot^{*30} whereas the same expenses can seldom be incurred in reasonable reliance on a contract prior to its conclusion irrespective of the state of negotiations.

²¹ P. Varul et al. (Note 2), commentary 4.1 to § 15, p. 66.

²² From the practice of the Supreme Court: the CCSCd 19.06.2007, 3-2-1-70-07 (RT III 2007, 26, 220; in Estonian)), Sec. 12–13 and CCSCd 3-2-1-89-06 (Note 11), Sec. 14.

²³ CCSCd 3-2-1-89-06 (Note 11), Sec. 16.

²⁴ In the case underlying the CCSCd 3-2-1-89-06, the positive knowledge of invalidity was established in case of a purchaser who was a professional lawyer.

²⁵ CCSCd 3-2-1-70-07 (Note 22), Sec. 12.

²⁶ CCSCd 3-2-1-89-06 (Note 11), Sec. 16.

²⁷ Loss of time, travel expenses, expenses for the legal aid, etc., see CCSCd 3-2-1-89-06 (Note 11), Sec. 16.

²⁸ *Ibid.*

²⁹ *Ibid.*

³⁰ S. CCSCd 3-2-1-70-07 (Note 22), Sec. 12.

4. Pre-contractual disclosure requirements and liability for incorrect information

The most important group of pre-contractual duties relates to pre-contractual disclosure requirements and to liability for incorrect information provided to a party during the pre-contractual negotiations.

The question of whether there the parties to a contract should in any way be under an obligation to disclose certain information to the other party in a pre-contractual phase is a matter of great debate among proponents of the various legal systems in Europe. The spectrum of possible solutions starts with the relatively wide disclosure requirements under the German law (disclosure of all material information that the other party can await in good faith) to the approach of England and Wales, with almost no disclosure at all required. This diversity is also reflected in the fragmented regulation of pre-contractual disclosure requirements in articles 3:101–3:106 of Book II of the DCFR, which avoids any references to general disclosure requirements and limits itself to a catalogue of duties to disclose certain specific information, mainly in B-to-C relations.

With regard to pre-contractual information duties, the Estonian law has chosen the German approach, with an explicit regulation of such pre-contractual duties by recognising a general information duty with wide disclosure requirements based on the principle of good faith and fair dealings. As a general rule, LOA § 15 (2), first sentence, provides that each of the negotiating parties is bound to disclose to the other party any information the knowledge of which is apparently material to that other party. This duty is, however, not unlimited. In accordance with LOA § 15 (2), second sentence, the disclosure is required only if and insofar as the other party could have reasonably expected the disclosure in accordance with the principles of good faith and fair dealings. The question of when disclosure of particular circumstances can be expected in accordance with the principles of good faith can be determined in accordance with the principles set out in GPCCA § 95. This provides that, in determining whether disclosure is required, account has to be taken of whether the interest of the other party in the particular information was apparent to the party from whom disclosure is expected, whether the parties have special expertise and knowledge, the costs of obtaining the information, and whether the other party could have obtained the information from another source.

In addition to disclosure in accordance with LOA § 15 (2), the law requires that any information, related to the contract, that is provided to the other party prior to conclusion of the contract is to be true and correct (LOA § 15 (1), second sentence).

Liability for breach of pre-contractual disclosure requirements is somewhat different from liability for breach of other pre-contractual duties, most notably of the duty to negotiate in good faith or of the duty to ensure the validity of the contract. This is mainly due to the fact that, although there can be situations wherein a breach of disclosure requirements or provision of incorrect information by the other party is discovered prior to the conclusion of the contract and leads to the termination of the negotiations^{*31}, the insufficient disclosure or provision of incorrect information would, as a rule, become relevant only if such circumstances are discovered after the parties have concluded a valid contract.

First and foremost, this leads to the question of whether there is room and need at all for the pre-contractual liability in situations where the negotiations have been successful and have ended with the conclusion of a valid contract. If the pre-contractual liability would still be of relevance in such circumstances, its relationship and possible concurrence with the contractual remedies would have to be cleared.

5. Pre-contractual disclosure requirements and liability under the contract

For a number of cases it can indeed be concluded that the breach of pre-contractual duties would lose its relevance if a valid contract is concluded. This is most evident if the breach relates to the disclosure of incorrect information related to the object of the contract. As a general rule, such information would form a part of the parties' agreement as a contractual promise. Any incorrectness of such information would then amount to a breach of a contract and entitle the recipient party to contractual remedies for non-performance. As an example, if a seller of a used car has declared to the potential purchaser, prior to conclusion of a sales agreement, that the car has no accident record, this statement becomes part of the agreement even if this statement is not made in the agreement documented upon conclusion. If the purchaser discovers after conclusion of the agreement that the statement was incorrect, he is entitled to contractual remedies for non-performance.^{*32}

³¹ S. CCSCd 3-2-1-89-06 (Note 11), Sec. 15.

³² Example from P. Varul et al. (Note 2), commentary 3.3.1 to § 217, p. 42.

In this case, the pre-contractual liability for provision of incorrect information is irrelevant, as the purchaser has sufficient remedies for non-performance of the contractual promise. On the other hand, a contract could contain a merger clause that would, in most cases^{*33}, prevent the parties from making recourse to measures for breach of pre-contractual disclosure requirements. In such a case, there is also no recourse to pre-contractual liability, as this is excluded by the contract itself.

There are cases, however, wherein the contractual remedies for non-performance do not provide adequate protection in the event of a breach of pre-contractual obligations. In general terms, this applies in situations wherein the contractual expectations of a party that are partly based on promises given or information provided by the other party in the pre-contractual phase are not fulfilled but the traditional contractual remedies for non-performance fall short because the information or promises have not amounted to a contractual promise. In the Estonian practice, such cases have arisen mainly in connection with sales agreements.

The first of these notable cases was referred to at the beginning of this article and involved a purchase of a house by a seller who was, on the basis of drawings of the house presented to her, convinced that the house had concrete floors.^{*34} As a valid sales agreement existed between the parties, the courts were first bound to examine whether the purchaser was entitled to contractual remedies due to the non-conformity of the purchased house with the agreement. The courts were not convinced that this was the case, as the house was not unfit for the purposes for which a house would usually be used, nor was it of a lower quality than similar, comparable houses. The courts were also of the opinion that the mere fact that the purchaser was able to look at the drawings of the house did not necessarily lead to the conclusion that all information and technical data contained in such drawings amounted to a contractual promise such that any discrepancy from the drawings presented would have amounted to non-conformity of the house with the sales agreement. These arguments make sense in a situation in which the agreement itself contained no references to the drawings. However, as we saw, this did not mean that the purchaser was left entirely without protection. In this particular case, the Supreme Court concluded that, although the house sold by the seller might have conformed to the agreement, the seller had breached a duty to inform the purchaser about the material changes undertaken in the course of construction, compared to the drawings that were introduced to the purchaser.

A similar case was decided by the Supreme Court a few years later.^{*35} This time, a purchaser of a flat claimed he was, at some point during the pre-contractual negotiations, shown the drawings of the house. The drawings indicated that there would be a glass wall directly opposite the front door to the purchaser's flat. In addition, the drawings allegedly provided that there would be a doorway in the wall with access to a public balcony providing great views of an adjacent church. The purchaser claimed to have been prepared to purchase the flat for the agreed price precisely because of the above factors; however, none of this information was contained in the notarised sales agreement, which defined the object of the sale only through references to the flat. As it came out later, the drawings that were shown to the purchaser had already been changed during the time of the conclusion of the sales agreement with the purchaser. The glass wall was indeed constructed, but it was not transparent. The balcony was sold as part of a neighbouring flat and was not publicly accessible. Again the courts had apparent difficulties in acknowledging that the object of the sale was not in conformance with the agreement.^{*36} The case was therefore mainly heard as a dispute over the alleged breach of pre-contractual disclosure requirements.^{*37}

The concurrence of the pre-contractual liability for undue disclosure or provision of incorrect information and contractual liability for non-conformity with a contract is most clearly evidenced in the latest case concerning pre-contractual liability, decided on by the Supreme Court.^{*38} In this case, the purchaser acquired a plot of land for the purposes of constructing a family home. The plot was fairly small and had a size of only 907 m². This was correctly reflected in the sales agreement and corresponded to the information contained in the Land Register. The purchaser had inspected the plot with the seller prior to conclusion of the contract. The plot was partly surrounded by a fence. The purchaser rightfully claimed that it had assumed that the fence marked the border of the plot, which therefore in the inspection did not appear to be so small at all. It was only after the conclusion of the contract that the purchaser discovered that to a large extent the fence was located on neighbouring plots that belonged to the seller. In fact, the area of the land bordered by the fence was 1162 m² — that is, 22% larger than the 907 m² plot that was the object of the sale. Consequently, the purchaser claimed for reduction of the purchase price. The claim was based on the alleged non-conformity of the plot with the agreement. This was rightfully denied by the courts, as it would have precluded the object

³³ There can be exceptions where the adherence to the merger clause would be contrary to good faith, for example if the seller knowingly provided incorrect information to the purchaser and included a merger clause to the contract in order to avoid liability, in such case the seller could be prevented from relying on the merger clause, see P. Varul et al. (Note 2), commentary 3.3.1 to § 217, p. 42.

³⁴ CCSCd 3-2-1-89-06 (Note 11).

³⁵ CCSCd 19.11.2007, 3-2-1-111-07. – RT III 2007, 41, 324 (in Estonian).

³⁶ *Ibid.*, Sec. 13.

³⁷ *Ibid.*, Sec 14. In the end the purchaser was not successful with its claims, however this was mainly due to the insufficient evidence brought by the purchaser to support its claims.

³⁸ CCSCd 12.12.2007, 3-2-1-113-07. – RT III 2007, 46, 373 (in Estonian).

of the sales agreement being a plot with an area of 1162 m².^{*39} Quite clearly, this was not the case. The non-performance by the purchaser was again based on non-fulfilment of the contractual disclosure requirements, as the principle of good faith would have required the seller to disclose to the purchaser that, contrary to the obvious appearance, the fence was not constructed on the border.

These examples show that in specific cases the pre-contractual liability can indeed supplement the liability for the breach of contractual liabilities. If the contract has been validly concluded, the breach of pre-contractual duties becomes relevant where the contractual expectations of a party are based on the breach of pre-contractual disclosure requirements or incorrect information provided to that party prior to conclusion of the contract. The pre-contractual duties are important where the non-disclosure of specific circumstances or promises or expectations resulting from incorrect information provided to the purchaser do not become part of the agreement. In such cases, the party who relied on the information should be entitled to concurrent remedies irrespective of whether the duties with respect of which the breach occurred are contractual or pre-contractual in nature.

6. Remedies for breach of pre-contractual disclosure requirements

The exact nature of the remedies that are available to a party to a valid contract in the event of breach of the pre-contractual obligations related to disclosure or provision of correct information is not self-evident. Indeed, there are a number of concurring remedies available.

First one has to bear in mind that the breach of pre-contractual disclosure requirements or provision of incorrect information would normally amount to a fundamental mistake or fraud, which would enable the affected party to avoid the contract. Under Estonian law, the concept of a legally relevant mistake (which can lead to avoidance of the contract) is closely related to the breach of pre-contractual disclosure requirements. The law enables avoidance of a contract that was entered into under a fundamental mistake, if the mistake was caused by or known to the other party or in cases of a shared mistake (GPCCA § 92 (3)). A mistake deemed to be caused by the other party is defined as a mistake that was caused by (incorrect) information given by the other party or through non-disclosure of information, provided that the other party would have been required to disclose such information in accordance with the principle of good faith (GPCCA § 92 (3) 1)). A mistake 'known to the other party' entitles the party given the mistaken understanding to avoid the contract if the other party knew or ought to have known the mistake but contrary to the principle of good faith did not disclose said mistake (GPCCA § 92 (3) 2). It is evident that in both of these cases the other party who causes a mistake through misrepresentation or knows of the mistake but leaves it undisclosed simultaneously breaches its pre-contractual obligations under LOA § 14 (1) and (2). The same is true in the case of fraud — i.e., in cases where the above misrepresentations are fraudulent in nature (GPCCA § 94). On the other hand, breach of pre-contractual duties regarding the disclosure and provision of correct information always seems to entitle the affected party to avoid the contract if the mistake caused through misrepresentations by the other party was fundamental or amounted to a fraud. As a result, the first remedy for a party affected by the breach of pre-contractual duties regarding the disclosure or provision of correct information is the avoidance of the contract. If the contract is avoided, the avoiding party is also entitled to damages in accordance with GPCCA § 101. Typically in cases of breach of pre-contractual duties, such damages are only awarded for the purposes of putting the avoiding party into the position it would have had if it had not entered into the contract (GPCCA § 101 (1)). Therefore, only the negative interest or reliance on the validity of the contract is protected and the costs of negotiating and entering into contract or dispositions made in reliance on the contract are recoverable.

If the contract is not avoided or cannot be avoided, the situation is somewhat more complex. As discussed above, the first question then would be whether a misrepresentation that has occurred through provision of incorrect information on breach of pre-contractual disclosure requirements amounts to a contractual promise. In such cases, the party affected by the misrepresentation would be entitled to contractual remedies for non-performance. If this is not the case, the affected party should be entitled to remedies because of the breach of the pre-contractual duties.^{*40}

In Estonian law, the primary remedy for breach of pre-contractual duties is the claim for damages.^{*41} The nature of such a claim and the damages to which the other party is entitled in the event of breach of the pre-contractual duties was discussed above with respect to cases where the breach led to termination of negotiations or invalidity of a concluded contract. However, it remains to be shown that the interests protected by

³⁹ *Ibid.*, Sec. 10.

⁴⁰ In the DCFR this is simply procured by enabling the mistaken party (or the party affected by the fraud) to claim damages irrespective of the avoidance of the contract (see DCFR II.-7:304).

⁴¹ P. Varul et al. (Note 2), commentary 4.6.1 to § 14, p. 62.

the pre-contractual duties and the respective damages can be different if the parties reach agreement and a contract is validly concluded despite the pre-contractual breach. This is already evident from the general purpose for which the damages are rewarded — to help the aggrieved person into a position that would have existed but for the breach that led to the liability for damages. In cases where the conclusion of a contract was influenced by a breach of the pre-contractual disclosure requirements but the contract is valid, the compensation of damages resulting from such breach can lead to two, fundamentally different situations, depending on the circumstances of the case.

The party who entered into the contract under the influence of a misrepresentation by the other party could claim that he would not have entered into the contract if the other party had disclosed correct information or had not omitted to disclose certain circumstances. This could be a valid claim in the above-mentioned case where the seller omitted to disclose to the purchaser that the fence that was thought to mark the border was indeed located on the neighbouring plot. Here the pre-contractual duties seem to protect the negative interest and the compensation of damages would require the party influenced by the misrepresentation to be placed in a situation as would have existed if said party had not concluded the contract. An apparent concurrence of remedies occurs here between the claim for damages and avoidance of the contract, based on the mistake or fraud.^{*42} In order to avoid contradictions, it may be advisable not to grant damages that would lead to restitution and *de facto* termination of the contract where the contract in question cannot be avoided because of the mistake or fraud under the relevant provisions.

In a number of cases where the pre-contractual disclosure requirements are breached, the affected party is not interested in restitution or avoidance. It is often the case that the party whose decision to enter into the contract was influenced by a misrepresentation by the other party would have concluded the contract even if the relevant information had been properly disclosed. On the other hand, the party who has discovered the misrepresentation might be interested in keeping to the contract, provided that said party is able to reduce the price or otherwise provided with adequate compensation. In such cases, the parties often claim that they would have entered into the contract under the different conditions and mainly for the different price, less the negative value of the circumstances not properly disclosed. If damages are sought here, they seem to lead to compensation of the positive interest, as the damaged party is put in a situation that would have existed if the contract and the related pre-contractual obligations would have been properly fulfilled. It is therefore apparent that there can be pre-contractual duties that protect essentially the same interests as the contract itself. At least this is true with respect to the pre-contractual duties that require disclosure of certain material circumstances related to the object of the contract or that sanction provision of incorrect information related to the intended contract. In such cases, the contractual expectations of the affected party (and the related positive interest) are based on the misrepresentation. The compensation of damages for pre-contractual misrepresentation would lead to a situation that would have existed if such contractual expectations would have been fulfilled; this can be described as compensation of the positive interest. This is most evident in the case described under article 4:117 in the full-text version of the Principles of European Contract Law: A developer buys a plot of land in reliance on a statement by the seller that the land is not subject to any third-party rights. In fact, there is a right of way running across the site and it would cost £10,000 to divert the path. The purchaser cannot avoid the contract, as its mistake is not serious enough but is awarded damages in the amount of £10,000 under article 4:117 because of the seller's misrepresentation. In the Estonian cases discussed above where the purchaser's decision to enter into the contract was influenced by incorrect information provided by the seller, the courts also concluded that the purchaser is in principle entitled to damages that can be calculated as the difference between the value that the object of the sale would have had if the information provided to the purchaser had been correct and the actual value of the object. In the case of the sale of the plot with a misleading fence, the Supreme Court issued reference that the purchaser can claim damages due to the breach of pre-contractual obligations as can be calculated under the same principles as reduction of the purchase price — that is, on the basis of the reduced market value compared to the value the plot would have had if the fence had actually marked its border.^{*43}

⁴² *Ibid.*, commentary 4.7.3 to § 14, p. 64.

⁴³ CCSCd 3-2-1-113-07 (Note 38), Sec. 12.

7. The borderline between contractual and pre-contractual liability

In practice, this has led to the question of whether it is at all appropriate to speak of a pre-contractual liability when the breach of pre-contractual duties is discovered after the conclusion of the contract and does not lead to its invalidity. In legal theory it has been suggested that under such circumstances the pre-contractual duties are to be treated as duties under the contract such that their breach would lead to non-performance of the contract and to the contractual liability and remedies.^{*44} This idea has now been picked up by the Supreme Court, which has ruled that if the breach of pre-contractual obligations is discovered after the conclusion of a valid contract the relationship between the parties is to be viewed as a uniform contractual relationship the contents of which are, in addition to the obligations arising from the contract itself also the obligations that existed between the parties prior to conclusion of the contract.^{*45} For the above examples this would mean that, in addition to an obligation to ensure that the object of sale conforms with the agreement, the seller would be under the contractual obligation to assure that any information provided by it with respect to the object of the sale prior to conclusion of the contract is correct and no material information has been left undisclosed to the purchaser in a manner counter to good faith.

The idea of treating pre-contractual obligations as obligations arising under the contract is mainly aimed at helping the affected party to satisfaction with, in addition to the claim for damages, contractual remedies such as reduction of purchase price or termination of the contract in cases of material breach. As such remedies are only available under the contract and as a result of non-performance of contractual obligations, they could not be used in cases of a breach of a mere pre-contractual obligation.^{*46} As the above cases show, there is indeed need for such specific remedies as one would otherwise need to adapt the claim for damages to achieve the same results as price reduction or even termination. Even more important is the need to ensure that the solution of the case is not dependent on whether a particular non-performance qualifies as pre-contractual or contractual breach. For contractual breach there is often specific regulation in place that limits or adapts the remedies or the liability regime under a particular contract. It would be advisable often to apply this specific regulation also in the case of pre-contractual liability. This is mainly due to the fact that on many occasions the two categories of contractual and pre-contractual liability are almost impossible to distinguish. One should consider only the question of whether the incorrect information provided in the pre-contractual phase has amounted to a contractual promise or not.

The Estonian practice shows that there are a number of cases at the borderline between contractual and pre-contractual liability. Such cases should not be decided on the basis of whether a pre-contractual misrepresentation has amounted to a contractual promise and to corresponding non-performance of the contract, as this is indeed often difficult to prove. The practice also shows that the provisions related to non-performance of contracts often need assistance from the realm of pre-contractual liability, mainly in cases where the conclusion of the contract has been influenced by pre-contractual misrepresentations. It seems that a more general and less specific scheme of regulation of pre-contractual duties, such as the one adopted in Estonia, is able to offer more flexible solutions for these cases than does regulation that is limited to a catalogue of very specific pre-contractual information duties, such as in Chapter 3 of Book II of the DCFR.

⁴⁴ I. Kull, M. Käerdi, V. Kõve (Note 8), p. 81.

⁴⁵ CCSCd 3-2-1-111-07 (Note 35), Sec. 14.

⁴⁶ P. Varul et al. (Note 2), commentary 4.6.1 to § 14, p. 62.



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The European Consumer Sales Directive — the Impact on Estonian Law

1. Introduction

The European Consumer Sales Directive (directive 99/44/EC^{*1} — hereinafter Directive) can be considered an important cornerstone in the consumer legislation adopted by the European Community. This directive is destined to be a milestone on the way to unified European private law. It is aimed at improving the functioning of the internal market and protecting the consumer. In the legal literature there is even argument that the Consumer Sales Directive is not primarily consumer law but not primarily commercial law either. Rather, it is genuine general private law.^{*2}

Many of the provisions of the Directive have their origin in the 1980 UN Convention on Contracts for the International Sale of Goods^{*3} (hereinafter CISG). The main difference between the Directive and the CISG is that the Directive only deals with consumer sales, whereas this kind of sale has been explicitly excluded from the scope of the CISG.^{*4}

The legal basis for the Directive is found in article 95 of the Treaty establishing the European Community, the former article 100A of the Treaty of Maastricht version.

As Estonia has been a member of the European Union since 2004, the national legislation in force has to comply with the Community's minimum requirements.

The idea of establishing minimum quality standards and equal rules for consumer sales and guarantees for the common European market was introduced early on, in 1975, with the Community's first programme for a consumer protection and information policy.^{*5} The preamble to the Directive suggests that consumers who are keen to benefit from the large market by purchasing goods in the Member States play a fundamental role in the completion of the internal market and that in the absence of minimum harmonisation of the rules governing the sale of consumer goods the competition between sellers may be distorted (see recitals 1 and 4).

¹ OJ L 171, 07.07.1999.

² See S. Grundmann. Consumer Law, Commercial Law, Private Law: How can the Sales Directive and the Sales Convention be So Similar? – European Business Law Review 2003/14, p. 238.

³ See, on the Web site of the United Nations Commission on International Trade Law, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html.

⁴ S. A. Kruisinga. What do Consumer and Commercial Sales Law Have in Common? A comparison of the EC directive on consumer sales law and the UN Convention on contracts for the international sale of goods. – European Review of Private Law 2001/2&3, p. 179.

⁵ OJ 1975 C 92/1.

The Estonian consumer sales rules are integrated with the sales regulation in the Law of Obligations Act⁶ (hereinafter LOA). The Estonian legislator in opting for an integrated solution chose a solution that modern codes have adopted before, among them the Dutch code of 1992 and the revised German Civil Code.

The legislator has chosen an option of transposing the Directive into the provisions on sales and contract-of-work law simultaneously. In this choice, the distinction between a sales contract and a contract for work becomes obsolete for the consumer, starting from the proposition that the aim of the legislator was to give consumers a correspondingly broad protection base. The revised Estonian Consumer Protection Act⁷ (hereinafter CPA) now contains only a few provisions of this nature and refers to the LOA.⁸

2. Definitions and scope of the regulation

The main provisions on consumer sales are found in Chapter 11 of the LOA (comprising sales contract material). The provisions concerning consumer sales apply to contracts concluded by a professional seller (or a trader) with a private consumer.

LOA defines ‘consumer sale’ as the sale of goods on the basis of a contract of sale wherein a consumer is sold a movable by a seller who enters into the contract in the course of his or her economic or professional activities.

Although most of the consumer sales regulation is centralised in the LOA, it offers only core definitions and opens merely the notion of the consumer. Under the CPA, the consumer is defined as any natural person who performs a transaction not related to an independent economic or professional activity. As such, the definition shall cover all transactions aimed at satisfying consumers’ personal and household needs.⁹

Under Estonian law, consumer protection legislation does not extend in any part to small businesses or not-for-profit legal institutions.

The existing regulation distinguishes between a seller and a trader, defined in different legal acts. A trader is defined in the CPA as a person who offers and sells, or markets in any other manner, goods or who provides services to consumers within the scope of his business or professional activities. A seller is defined in the Trading Act¹⁰ as any natural person who serves clients on behalf of a trader, or a person who sells goods or provides services outside the economic or professional activities thereof by way of street or market trading.

The CPA does not define ‘consumer goods’ but supplies a relevant definition for ‘goods’. Pursuant to the CPA, ‘goods’ are movable items a trader sells to a consumer.

It is worth stating that the provisions of the LOA concerning the sale of goods apply to the sale of rights and other objects, including the sale of energy, water, and heat through a network, unless otherwise provided for in the LOA and if this is not contrary to the nature of the object (LOA § 208 (3)).

Estonian sales regulation is applicable both to new and to second-hand goods, and there are no categories of restrictions set forth in the Directive’s article 2 (b) concerning sale of electricity, water, or gas in limited volume and goods sold by way of execution. Also, second-hand goods sold at public auction, where consumers have the opportunity of attending the sale in person, are included in the scope of the CPA.¹¹

Goods that still need to be produced are also covered by a higher level of protection unless the customer has supplied a substantial amount of the material needed for final production of the goods. Under the LOA, a consumer contract for services (work) is a contract for services entered into by a contractor acting for the purposes of the contractor’s economic or professional activities and a customer who is a consumer where the object of the contract is the provision of a service with regard to a movable of the consumer or the manufacture or production of a movable for the consumer.

⁶ Võlaõigusseadus, adopted on 26 September 2001. – RT I 2002, 53, 336 (in Estonian). English translation available at <http://www.legaltext.ee/et/andmebaas/tekst.asp?loc=text&dok=X30085K2&keel=en&pg=1&ptyyp=RT&tyyp=X&query=v%F5la%F5igusseadus> (25.09.2008).

⁷ Tarbijakaitse seadus, adopted on 11 February 2004. – RT I 2004, 13, 86 (in Estonian). English translation available at <http://www.legaltext.ee/et/andmebaas/tekst.asp?loc=text&dok=X40032K6&keel=en&pg=1&ptyyp=RT&tyyp=X&query=tarbijakaitse> (25.09.2008).

⁸ In Estonian law there does not exist a special Consumer Sales Act as in Sweden and all sales regulation is concentrated to one legal act — LOA.

⁹ Also the definition of consumer, contained in the Consumer Protection Act, which version was in force until 15.04.2004, referred to “personal needs”.

¹⁰ Kaubandustegevuse seadus, adopted on 11 February 2004. – RT I 2004, 12, 78 (in Estonian). English translation available at <http://www.legaltext.ee/et/andmebaas/tekst.asp?loc=text&dok=X80015&keel=en&pg=1&ptyyp=RT&tyyp=X&query=Kaubandustegevuse+seadus> (25.09.2008).

¹¹ See article 2 clause 3 of the Directive.

The concept of producer is defined in two separate legal acts. Under the LOA, a producer is defined as a manufacturer of a material or finished product, a person who claims to be the manufacturer of a product, and also an importer to Estonia or into other member states of the European Union (LOA § 217 (7) and § 1062 (1)). ‘Producer’ is defined in a parallel manner in the Product Safety Act.^{*12} The definition is similar to that given in the LOA but includes, in addition to the above-mentioned persons, a person who reconditions the product; the manufacturer’s representative, when the manufacturer is not established in the European Union; and the importer of the product, if there is no representative in the European Union. Also, other professionals in the supply chain may be considered to be producers insofar as their activities may affect the safety characteristics of a product.

3. Legal requirements for consumer goods

The only provisions on legal requirements for consumer goods are found in the LOA’s regulation of sales and contracts for services (work).

It is important to note that, despite the general principle of freedom of contract, the regulation of consumer sales in the LOA has a mandatory nature, as the law prescribes that agreements that are related to the legal remedies to be used in the case of a breach of contract and which derogate from the provisions of the law to the prejudice of the consumer are void (LOA § 237 (1) and § 657 (1) for consumer contract for services). In other words, the rights of the consumer as a buyer are of a binding nature, and they may be neither waived nor restricted in advance.

3.1. Conformity of goods

The requirement of conformity with the contract is one of the central provisions of the Directive and inspired by article 35 of the CISG.

The LOA requires that goods and also documents related to goods and delivered to a purchaser conform to the contract, in particular, in respect of quality, quantity, type, description, and packaging.

As are the Directive’s minimum standards, the requirements are cumulative and non-exhaustive: § 217 of the LOA includes a list of types of non-conformities, which apply to all kind of sales. In addition to the list found in article 2 of the Directive, the LOA treats goods as being non-conformant with the contract if the movable is not packaged in the manner usual for such goods or adequate to preserve and protect the goods. Also goods shall be treated as non-conformant if third parties have claims or other rights that they may exercise with respect to the goods or the use thereof is hindered by provisions of legislation of which the seller was aware or ought to have been aware. The same requirements apply when the object of the sale is the right to possess goods.

In the case of consumer sales, consumers’ reasonable expectations as well as public statements made by the seller, producer, or previous seller or by another retailer of the goods in question should be taken into account in examination of defects (LOA § 217 (2) paragraph 6)).^{*13}

This seems to resemble article 2 (2) d of the Directive, which requires taking into account any statements concerning the characteristics of the goods, which includes all public statements made by the producer, importer, and final seller. Expressed public statements bind the seller unless he proves that he was not bound by the statements. Usually advertisements ordered by the producers or importers may be assumed to be known to the final seller to the same extent that they are known to the consumer.^{*14}

Incorrect installation is deemed to be equivalent to lack of conformity arising from the goods (LOA § 217 (5)).

Mandatory requirements for consumer information, labelling of goods, instruction manuals, and indication of prices of consumer goods are specified in the CPA. Strict requirements for labelling of goods do not apply to

¹² Toote ohutuse seadus, adopted on 24 March 2004. – RT I 2004, 25, 167 (in Estonian). English translation available at <http://www.legaltext.ee/text/en/X80038.htm> (25.09.2008).

¹³ For example see Consumer Complaints Committee decision 7-1/4816/267-05 from 31 October 2005, available at <http://tka.riik.ee/?id=3104> (7.03.2008) (in Estonian).

In this case mobile phone stopped to work in a relatively low humidity environment.

In the time of the conclusion of contract the seller gave to the consumer any information about cautions related to humid environment. The Committee found that the seller could not prove that the mobile phone sold to consumer reaches normal expectations of the consumer.

¹⁴ See also LOA § 217 (3), which restricts the liability of the seller. The liability of a seller in the case of statements made by the seller, producer or previous seller of the good or another retailer specified in § 217 (2) 6) of the LOA does not apply if the seller was not aware or did not need to have been aware of the statement or if the seller proves that the statement had been withdrawn or changed by the time of entry into the contract or that the statement did not affect the purchase of the thing.

second-hand goods unless warnings and precautions related to the use or destruction of the goods are necessary for ensuring safety and to protect consumers' health and property.

Similar regulation protects the consumer in the case of contracts for work. Under a consumer contract for services, the work must be of the quality that is usual for such work and what the customer may reasonably have expected on the basis of the nature of the work and considering the declarations made publicly by the contractor with respect to the particular qualities of the work — in particular, in advertising the work or on labels — unless the contractor proves that the declarations had been modified by the time of entry into the contract or that the declarations did not affect entry into the contract (LOA § 641 (2) paragraph 5).

3.2. Time limits for exercise of the rights

In the case of lack of conformity of goods, Estonian legislation gives the consumer a legal guarantee for a term of two years, which equals the minimum term required by the Directive. Pursuant to LOA § 218 (2), the seller is liable for any lack of conformity of an item that becomes apparent within two years of the date of delivery of the goods to the purchaser. This legal guarantee is established in the law only for consumers, and whether there is any legal guarantee for other purchasers remains unclear.^{*15}

When a consumer makes his purchasing decision, he usually relies on the information given to him by the seller and/or the producer or previous seller or that provided by another retailer. Which of them owes responsibility to the consumer in this situation?

Primary liability for non-conforming goods rests with the party selling them to the consumer (LOA § 218 (1)). Therefore, the consumer has no right to choose whether to sue the manufacturer or the seller, or both, unless otherwise agreed by contract. An exception to this general rule is stipulated in LOA § 1044 (3), which gives the consumer the right of choice in the case of personal damages (i.e., where death, bodily injury, or harm to a person's health is caused as a result of the violation of a contractual obligation). Other members of the supply chain are not responsible to the consumer, irrespective of their statements and influence on the purchase process.^{*16}

However, the above-mentioned two-year legal guarantee period is not available for all goods, as the durability of the goods depends upon the nature of the goods. To fall under the guarantee, the goods must be intended for long-term use, and the consumer's reasonable expectations should be taken into account. Although the existing law does not provide a list of durable items, the legal practice of the Consumer Complaints Committee has adopted a viewpoint from which only items that can be used normally for more than two years are covered by the legal guarantee. Items of this nature may include personal computers, mobile telephones, electrical appliances, furniture, etc.^{*17}

For the case of consumer sale, it is presumed by the law that any lack of conformity that becomes apparent within six months of the date of delivery of goods to the consumer existed before the delivery of the goods, unless such presumption is in contradiction with the nature of the goods or the deficiency (LOA § 218 (2) second sentence). For instance, the non-conformity may be caused by damage or abuse of the goods.

The following case from the *Tarbijakaebuste komisjon*, the Estonian Consumer Complaints Committee^{*18}, demonstrates how the abuse of goods can be detected:

A consumer bought a mobile phone in July 2006. In December 2006, the phone switched off and stopped working. The consumer therefore demanded that it be repaired free of charge. The seller rejected the claim. The seller refused the repair and, referring to expert opinion, claimed that the phone had been damaged by excessive humidity.

The Consumer Complaints Committee dismissed the claim, arguing that the seller has an obligation to prove, within the first six months from the date of delivery of an item to the consumer, that the item conforms with

¹⁵ The Civil Code of the Estonian Soviet Socialist Republic of 12 June 1964 which was in force until 2002 gave to all buyers (including consumers and business buyers) time-limit of 6 months compulsory guarantee for movable goods and another six months for filing of a pretension — altogether a one-year period.

¹⁶ This proposition seems not to be in conflict with article 4 of the Directive which entitles the final seller to pursue remedies against the person(s) liable in the contractual chain. A similar provision is prescribed in § 228 of LOA, which states that in the event of consumer sales, if the seller is liable for any non-conformity it is presumed that the seller may claim compensation for damage caused thereto from the corresponding person in accordance with the relationship between them and to the extent of the liability of the seller to the consumer. There are no provisions in Estonian law concerning manufacturer's and seller's joint liability ahead the consumer.

¹⁷ For examples see Consumer Complaints Committee decisions 7-1/1169-67 from 16.04.2007 (mobile phone). Available at <http://tka.riik.ee/?id=3138> (7.03.2008) (in Estonian); 7-1/11882-70 from 23.04.2007 (laptop computer). Available at <http://tka.riik.ee/?id=3138> (7.03.2008) (in Estonian); 7-1/1912-86 from 28.05.2007 (furniture). Available at <http://tka.riik.ee/?id=3138> (7.03.2008) (in Estonian); 7-1/5364-176 from 13.11.2007 (vacuum cleaner). Available at <http://tka.riik.ee/?id=3528> (7.03.2008) (in Estonian).

¹⁸ Consumer Complaints Committee was founded in June 2004 for settlement of consumer complaints under the CPA outside court system (see §§ 22–37 of CPA).

the contract. The seller has fulfilled his obligation by ordering expert opinion. The committee was of the view that the expert opinion is reliable, and therefore it rejected the buyer's claim.^{*19}

In accordance with § 218 (2) LOA, it is presumed that the seller has sold goods not conforming with established requirements. So the seller has to prove clearly that the lack of conformity is not induced by production deficiencies. This provision seems to imply that the consumer does not have to check anything in the first six months after delivery. If he claims non-conformity of the good, it is presumed that any defect existed at the time of delivery.^{*20}

After the above-mentioned six-month time limit has passed, the presumption of conformity is a general rule and the consumer has to prove that the defect derives from the producer.

Time limits are prolonged by the time for which the goods are being repaired. The limitation period for claims against the eliminated deficiency begins anew as of the repair of the goods. If the goods or any part thereof is replaced, the limitation period begins upon delivery of the substitute item by the seller (LOA § 231 (4)).

Under the Directive, the purchaser has an obligation to notify the seller of the lack of conformity in reasonable time after he becomes or should become aware of the lack of conformity. For consumer sale, this reasonable time is limited to two months from the moment the consumer becomes aware of the lack of conformity (LOA § 220 (1) second sentence). The following case from the Estonian Consumer Complaints Committee demonstrates how the two-month time limit has been interpreted:

A consumer bought a white-coloured leather handbag in March 2006. She used the handbag for about two months and then packed it away with winter clothes at the end of May. After more than four months (in October), she unpacked the handbag and then discovered a defect — the bag was dirty. Thereafter she notified the seller, who rejected the claim.

The Consumer Complaints Committee also dismissed the claim, arguing that the consumer should have discovered the non-conformity while packing the handbag for storage. Therefore, the consumer was obliged to notify the seller considerably earlier than when she in fact did so.^{*21}

This time limit is not, however, absolute in nature, as the consumer may rely on temporary obstacles. However, if the purchaser has a reasonable excuse for the failure to give notice in time, he may still rely on the lack of conformity, but remedies are available only in a limited extent and include price reduction and compensation for damages (LOA § 220). It should be noted that the compensation for damages in this situation does not cover any loss of profits (LOA § 220 (3)).

3.3. Remedies available

Estonian law provides for a broader set of remedies than the Directive in the case where an infringement of obligation is adjudged to have occurred.^{*22} Under LOA § 101 (1), in the case of non-performance by an obligor the obligee may

- 1) require performance of the obligation;
- 2) withhold performance of an obligation that is due from the obligee;
- 3) demand compensation for damage;
- 4) withdraw from the contract;
- 5) reduce the price; or
- 6) in the case of a delay in the performance of a monetary obligation, demand payment of a penalty for late payment.

It is distinctive of the Estonian civil-law system that the full set of remedies are gathered together in the general part of the LOA. The special part of the LOA contains only exceptions from general rules for different types of contracts.

At first sight, it seems that the consumer as a creditor has an option to freely choose appropriate remedies.

¹⁹ See Consumer Complaints Committee decision 7-1/1169-67 from 16 April 2007. Available at <http://tka.riik.ee/?id=3138> (7.03.2008) (in Estonian).

²⁰ Similar approach has been adopted in the Netherlands by E. Hondius, H. Schelhaas. In conformity with the Consumer Sales Directive? Some remarks on transposition into Dutch Law. – *European Review of Private Law* 2001/2&3, p. 332.

²¹ See Consumer Complaints Committee decision 7-1/4890-244 from 10 November 2006, available at <http://tka.riik.ee/?id=2951> (7.03.2008) (in Estonian).

²² A model law for the system of legal remedies of the existing law has been 1980 Vienna Convention on International Sales. For more information see also the explanatory note to the draft of LOA, <http://web.riigikogu.ee/ems/plsq/motions.active> (7.03.2008) (in Estonian).

The general part of LOA § 101 (2) allows the obligee to resort to any legal remedy separately or resort simultaneously to all legal remedies that arise from the law or the contract and can be invoked simultaneously.^{*23}

Although the general part of the LOA gives the consumer the right to choose any available remedy, the sales regulation limits that choice considerably. When one considers sales regulation as a whole, there seems to be a kind of hierarchy in the system of remedies available for the creditor.

Originating from LOA §§ 222 and 224, the consumer's first choice by law is the right to require performance of the obligation. This remedy covers both repair and replacement. As in other civil-law jurisdictions, the Estonian consumer may demand the repair of the goods or delivery of substitute goods from the seller if this is possible and does not cause unreasonable costs or unreasonable inconvenience to the seller (LOA § 222 (1)). In assessing the choice of remedy, the assessor must take into account, *inter alia*, the value of the goods, the significance of the lack of conformity, and the opportunity for the purchaser to acquire elsewhere goods that conform to the contract without inconvenience. The seller may, instead of repairing the goods, deliver a substitute item that conforms to the contract.

When pondering whether to choose repair or replacement, the consumer has to take into account the aim of the law. The Directive states in the Preamble (recital 11) and in article 3, subsection 3 that a remedy shall be deemed to be disproportionate if it imposes costs for the seller that, in comparison to alternative remedy, are unreasonable. In the absence of relevant provisions in Estonian law, the aim of the Directive should be taken into account in assessment of the question in practice. In legal practice, the Consumer Complaints Committee has found that, according to article 3, subsection 3 of the Directive, the seller has a right to choose the remedy that is less expensive for him.^{*24}

According to LOA § 222 (4), the seller is the person who incurs the costs related to the repair of the goods or delivery of substitute goods — in particular, costs relating to transport, postage, work, travel, and materials. Therefore, the costs for returning large or heavy goods for repairs must be borne by the seller.

Estonian civil law does not give the consumer an 'indirect right' of repair or replacement by means of awarding damages, which places it in contrast to what is common to English and Scottish law.^{*25} The existing remedial system gives the Estonian consumer the right to require performance of the contract as well as to demand compensation for damage.^{*26}

If a consumer legitimately requires the repair of an item and the seller fails to repair it within a reasonable time, the consumer may repair the goods himself or have the goods repaired. In the latter situation, the consumer has a right to claim compensation for any reasonable costs incurred thereby from the seller.

Another remedy the consumer may choose is reduction in the purchase price. The use of this remedy is restricted by LOA § 224, which states that, if the seller repairs the goods or delivers substitute goods conforming to the contract, the consumer should not reduce the purchase price. The same rule should be applied if the consumer unreasonably refuses to accept the proposal of the seller concerning the repair of the goods or delivery of a substitute.

The most fundamental remedy available to the consumer is the right of withdrawal. The general part of the LOA lays down as a fundamental principle that a party to a contract may withdraw from the contract only in the case of fundamental breach of contract (LOA § 116 (1)). It seems to be in accordance with the aim of the Directive not to entitle the consumer to rescind the contract if the lack of conformity is minor.^{*27}

The sales regulation of LOA § 223 (1) specifies that, *inter alia*, a fundamental breach of a sales contract occurs if the repair or substitution of an item is not possible or fails, or if the seller refuses to repair an item or supply a substitute in reasonable time after the seller is notified of the lack of conformity. In the case of consumer sales, any unreasonable inconvenience caused to the consumer by the repair or substitution of goods is deemed also to be a fundamental breach of contract (LOA § 223 (2)). The Consumer Complaints Committee has found that, under this clause, unreasonable inconvenience is caused to the consumer if there have been three or more unsuccessful attempts to repair the product in question.^{*28}

²³ Estonian legislation supports the position of the European Consumer Law Group who have insisted that consumers must be entitled to choose freely between all remedies provided by the Directive. See European Consumer Law Group Opinion on the Proposal for a Directive on the Sale of Consumer Goods and Associated Guarantees. — Journal of Consumer Policy 1998 (21), p. 94.

²⁴ See Consumer Complaints Committee decision 7-1/4323/235 from 22 September 2005. Available at <http://tka.riik.ee/?id=3104> (7.03.2008) (in Estonian).

²⁵ See more S. Watterson. Consumer Sales Directive 1999/44/EC — The impact on English law. — European Review of Private Law 2001/2&3, pp. 209–212.

²⁶ Under LOA § 101 (2) invoking a legal remedy arising from non-performance shall not deprive the obligee of the right to demand compensation for damage caused by non-performance.

²⁷ See article 3 subsection 6 of the Directive.

²⁸ See Consumer Complaints Committee decision 7-1/2852/48-04 from 26 October 2004. Available at <http://tka.riik.ee/?id=1699> (7.03.2008) (in Estonian).

The seller shall not rely on an agreement that precludes or restricts the rights of the consumer in connection with lack of conformity of goods if the seller is aware or ought to be aware that the goods do not conform to the contract and fails to notify the consumer of this (LOA § 221 (2)).

In addition to the list of remedies prescribed in article 3, paragraph 2 of the Directive, the LOA gives the consumer the primary right to receive compensation for damage. In the case of non-performance of an obligation by the seller, the consumer may, alongside or in lieu of performance, claim compensation for damage caused by the non-performance, except in cases where the seller is not liable or the damage is not subject to compensation for any other reason provided by law.

The Civil Chamber of the Supreme Court of Estonia has in a decision from 2005 noted that in the case of infringement of the sales contract the buyer has no right to claim simultaneously the right to damages and reduction of the purchase price.^{*29} However, this does not mean that the consumer has no right to claim compensation for additional damages.

The consumer may, *inter alia*, claim compensation from the seller for such damage as is caused through the use of an item for purposes other than those originally intended if the damage derived from the seller providing insufficient information to the consumer (LOA § 225). In addition, the LOA, in § 225, provides that the consumer is entitled to compensation for the damage caused to the item itself in consequence of the lack of conformity.

The Directive has been criticised for the absence of traditional remedies such as consequential damages.^{*30} However, in Estonian law the liability of the seller is limited in relation to a 'consequential loss' for such damage caused intentionally or due to gross negligence as the party foresaw or should have foreseen as a possible consequence of non-performance at the time of entering into the contract^{*31} (LOA § 127 (3)). In other cases, the theory of the purpose of the provision should be applied.

4. Commercial guarantee

4.1. Scope and nature of regulation

The LOA contains special rules for voluntary guarantees offered by a producer or seller (hereinafter commercial guarantee^{*32}).

The legal regime for commercial guarantees relies basically on the rules of the Directive. The existing law makes a clear distinction between legal and commercial guarantees. This distinction is based on drawing a line between dispositive guarantee rules and binding guarantee rules. The LOA contains two relevant provisions dealing with dispositive commercial guarantees.^{*33}

General conditions concerning commercial guarantees are applicable to both consumer and business sale contracts. A commercial guarantee is, within the meaning of the LOA, a promise made by a seller, previous seller, or producer (warrantor) to replace or repair sold goods, without charge or for a fee, under the conditions prescribed in the warranty or to ensure in other ways the compliance of the goods with the conditions prescribed in the warranty. A commercial guarantee, in order to be enforceable, must afford the consumer a better legal position than do legal rules governing the sale of consumer goods.^{*34} For example, some computer-sellers have offered the consumer an option of on-site maintenance service. Despite the fact that a commercial guarantee is a voluntary and unilateral promise, it shall be highly binding on the offerer under the conditions laid down in the guarantee statement and the associated advertising. This principle is expressed clearly in article 6, subsection 1 of the Directive and supported by general principles of contract law found in the LOA.

Traders and producers are required to provide consumers with detailed information concerning, *inter alia*, the guarantee and possibilities for submitting complaints regarding the goods (LOA § 231 (1)).

²⁹ Decision of the Supreme Court of Estonia 3-2-1-131-05. – RT III 2005, 43, 425 (in Estonian).

³⁰ E. Hondius. Consumer Guarantees: Towards a European Sale of Goods Act. Available at <http://w3.uniroma1.it/ide/centro/publications/18hondius.pdf> (7.03.2008).

³¹ The notion of consequential loss is not defined in Estonian law in writing.

³² The notion "commercial guarantee" is used because it is a commercial decision for the seller or producer as to whether to offer it at all, whereas the "legal guarantee" must by law be offered. See also E. Deards. The Proposed Guarantees Directive: Is It Fit for the Purpose? – Journal of Consumer Policy 1998 (21), p. 107.

³³ See LOA § 230 and § 231.

³⁴ See also D. Staudenmayer. The Directive on the Sale of Consumer Goods and Associated Guarantees — A Milestone in the European Consumer and Private Law. – European Review of Private Law 2000/4, p. 551.

According to LOA § 230 (3), it is presumed that the seller guarantees the durability of the goods within the period stated.

Where the seller or producer has provided a commercial guarantee, consumers may, within the guarantee period, submit complaints to the seller about defects as specified in the guarantee and that prevent the intended use of the goods. The guarantee period begins such that it runs from the delivery of the goods to the purchaser unless a later time for beginning of the guarantee period is prescribed in the contract or letter of guarantee. If the seller is required to dispatch the goods to the purchaser, the guarantee period does not begin before the goods are delivered to the purchaser (LOA § 230 (2) second sentence).

In LOA § 230 (2), it is stated that the elapsing of the guarantee period is suspended for the time for which the purchaser cannot use the goods on account of a lack of conformity for which the warrantor is applicable.

4.2. Execution of guarantee rights

It is presumed by the law that a guarantee provided by a warrantor covers all defects of the goods concerned that become apparent during the guarantee period (LOA § 230 (3)). Therefore, when in practice the seller informs the consumer in brief terms that, for shoes bought by the consumer, he grants a commercial guarantee of 30 days without any additional information, it must be inferred that the seller has given a full guarantee for the shoes and promises to remove, without restrictions, all defects emerging in the shoes during the guarantee period. If the seller wants to rely on restrictions, he must prove the actual content of the guarantee agreement.

When a seller wants to give a guarantee, he must also lay down the procedural mechanism for exercising the rights. This procedure shall not be unreasonably cumbersome for the purchaser (LOA § 230 (4)). It is clearly worth noting that the commercial guarantee does not preclude or restrict the right of the consumer to exercise other legal remedies arising under the law or on the basis of the contract (LOA § 230 (5)). This means that if the goods are also covered by legal guarantee, the consumer has an opportunity to exercise the rights arising from both a legal guarantee and a commercial guarantee.

The LOA includes a special section (§ 231) concerning additional requirements for consumer guarantees. This section establishes a considerably higher standard of protection of the consumer as compared with other purchasers. Inherited actually from article 6 of the Directive, this provision stipulates the so-called ‘requirement of transparency’. To fulfil the binding requirement of transparency, LOA § 231 (1) urges the seller to give the consumer — in an understandable manner — information concerning the subject matter of the warranty and the procedure for exercising the rights arising from the warranty. The Directive specifies this duty by ordering the seller to give the requested information clearly and in plain, intelligible language (Art. 6, paragraph 2, recital 2 of the Directive). Article 6 of the Directive gives to each Member State the right within its own territory to provide that the guarantee be drafted in one or more official languages of the Community. The Estonian CPA expressly dictates that information provided to consumers shall be truthful, understandable, and in the Estonian language (see § 4 (4)). In addition to this, the Language Act^{*35} declares that use of the Estonian language is required if it is in the public interest. The act considers consumer protection to be in the public interest (as specified in § 2¹ (2) of the Language Act). A consumer shall be given the opportunity to freely examine the conditions of guarantee before entering into a sale contract. This requirement is often infringed on in legal practice by a seller supplying guarantee information after conclusion of the contract.

The LOA establishes the minimum content of conditions for commercial consumer guarantee (in its § 231 (1)).

According to § 230, the seller is allowed to give requested guarantee information to the consumer in a freely chosen form, even orally. Only in the case of a special request from the consumer need the guarantee be presented to the consumer in writing or via another durable medium that the consumer is able to use.

However, the CPA provides clearly that when goods are sold under a guarantee a document must be handed over carrying at least the date of sale, the price of the goods, and data about the trader (see § 4 (6)). Surprisingly, the seller has no obligation under existing Estonian law to specify the name of each distinct item. Therefore it may be difficult for the consumer to prove that the price is associated with a specific item.^{*36}

For consumer sales, it is presumed under LOA § 231 (4) that the guarantee grants the purchaser the right to demand the repair of the goods or delivery of substitute goods without charge during the warranty period; for goods replaced during the warranty period, a new warranty with the same duration as the original warranty will be granted; and if the piece of goods is repaired during the warranty period, the warranty is automatically extended by the length of the time of repair. This presumption is valid until and unless proved otherwise.

³⁵ Keeleseadus, adopted on 21 February 1995 – RT I 1995, 23, 334; 2003, 82, 551 (in Estonian).

³⁶ See also Consumer Protection Act § 4 (6).

4.3. After-sales services

The Directive does not contain any provision concerning after-sales services. The exclusion of after-sales services was justified by reference to the principle of subsidiarity. In Estonian law, only one rule concerning after-sales services can be found in the LOA pertaining to consumer sales.

According to LOA § 232, if the purchaser may reasonably expect that services related to the use, maintenance, or repair of the goods will be provided but the seller does not provide such services, the seller shall provide sufficient information to the purchaser at the time of delivery and, at the request of the consumer, after the delivery of the goods regarding the possibilities for using such services. However, the legislator does not bind the seller to warrant to the buyers the existence of appropriate after-sales services and the supply of spares for a minimal time period. Possibly providing indirect support for the consumer, LOA § 23 (1) states that obligations of the parties may arise also from the nature and purpose of the contract and the principles of good faith and reasonableness.

5. Conclusions

Principles from the Directive are transposed simultaneously to sales as well as to the contract-of-work regulation of the LOA. The approach chosen by the legislator gives the consumer a considerably broad protection base. The consumer's reasonable expectations have a decisive role in determining whether the goods or work shall be deemed to conform to the contract or not.

Estonian sales regulation is applicable both to new and to second-hand goods, and there are no restrictions specified in the Directive's article 2 (b) concerning sale of electricity, water, or gas in limited volume and goods sold by way of execution. Also, second-hand goods sold at public auction, where consumers have the opportunity of attending the sale in person, are included in the scope of the CPA.

It is distinctive of the Estonian civil-law system that the full set of remedies are gathered together in the general part of the LOA. The special part of the LOA contains only exemptions from general rules for various types of contracts.

At first sight, it seems that the consumer as a creditor has an option to freely choose appropriate remedies. The general part of the LOA (§ 101 (2)) allows the obligee to resort to any legal remedy separately or resort simultaneously to all legal remedies that arise from the law or the contract and can be invoked simultaneously.³⁷

Although the general part of the LOA gives the consumer the right to choose any available remedy, the sales regulation limits that choice considerably. When one considers sales regulation as a whole, there seems to be a kind of hierarchy in the system of remedies available to the creditor.

Pursuant to LOA §§ 222 and 224, a consumer has as first recourse the right to require the performance of the obligation. This remedy covers both repair and replacement. The consumer may demand the repair of the goods or delivery of substitute goods from the seller if this is possible and does not cause the seller unreasonable costs or unreasonable inconvenience. The sales regulation of the LOA restricts the use of the reduction of price as a remedy by stating that if the seller repairs the goods or delivers a substitute item that conforms with the contract, the consumer should not be entitled to a reduced purchase price.

Usually, a party to a sales contract may withdraw from the contract only in the event of fundamental breach of contract. It seems to be in accordance with the aim of the Directive not to entitle the consumer to rescind the contract if the lack of conformity is minor.

Under Estonian legislation, the liability of the seller is limited in relation to 'consequential loss' for such damage as the party foresaw or should have foreseen as a possible consequence of non-performance at the time of entering into the contract.

In conclusion, it can be said that the Estonian consumer sales law is in conformity with the Directive. There are some minor divergences that do not need to be remedied.

³⁷ Estonian legislation supports the position of the European Consumer Law Group who have insisted that consumers must be entitled to choose freely between all remedies provided by the Directive. See European Consumer Law Group Opinion on the Proposal for a Directive on the Sale of Consumer Goods and Associated Guarantees. – *Journal of Consumer Policy* 1998 (21), p. 94.

Abbreviations

RT	Riigi Teataja (State Gazette)
RTL	Riigi Teataja Lisa (Appendix to the State Gazette)
CCSCd	decision of the Civil Chamber of the Supreme Court of Estonia
UNIDROIT	International Institute for the Unification of the Private Law
OJ	Official Journal of the European Union (formerly Official Journal of the European Communities)
ECR	European Court Reports
BGB	Bürgerliches Gesetzbuch (German Civil Code)